FIRST BANCORP /PR/
Form 10-Q
August 09, 2016

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, DC 20549**

---

# FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2016

[ ] 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<br>(State or other jurisdiction of<br><br>incorporation or organization) | 66-0561882<br>(I.R.S. employer<br><br>identification number) |
| --- | --- |
| 1519 Ponce de León Avenue, Stop 23<br><br>Santurce, Puerto Rico<br><br>(Address of principal executive offices) | 00908<br><br>(Zip Code) |

(787) 729-8200
(Registrant's telephone number, including area code)
Not applicable

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

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

Yesþ No ¨

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

Yesþ No ¨

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

Large accelerated filer ¨ Accelerated filer

þ

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ¨ No þ

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

Common stock: 217,177,665 shares outstanding as of July 29, 2016.

---

**FIRST BANCORP.**

**INDEX PAGE**


| **PART I FINANCIAL INFORMATION** | **PAGE** |
|---|---|
| Item 1. Financial Statements: | |
| Consolidated Statements of Financial Condition (Unaudited) as of June 30, 2016 and December 31, 2015 | 5 |
| Consolidated Statements of Income (Loss) (Unaudited) – Quarters ended June 30, 2016 and 2015 and six-month periods ended June 30, 2016 and 2015 | 6 |
| Consolidated Statements of Comprehensive Income (Loss) (Unaudited) – Quarters ended June 30, 2016 and 2015 and six-month periods ended June 30, 2016 and 2015 | 7 |
| Consolidated Statements of Cash Flows (Unaudited) – Six-month periods ended June 30, 2016 and 2015 | 8 |
| Consolidated Statements of Changes in Stockholders' Equity (Unaudited) – Six-month periods ended June 30, 2016 and 2015 | 9 |
| Notes to Consolidated Financial Statements (Unaudited) | 10 |
| Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations | 77 |
| Item 3. Quantitative and Qualitative Disclosures About Market Risk | 136 |
| Item 4. Controls and Procedures | 136 |
| | |
| **PART II. OTHER INFORMATION** | |
| Item 1. Legal Proceedings | 137 |
| Item 1A. Risk Factors | 137 |
| Item 2. Unregistered Sales of Equity Securities and Use of Proceeds | 139 |
| Item 3. Defaults Upon Senior Securities | 140 |
| Item 4. Mine Safety Disclosures | 140 |
| Item 5. Other Information | 140 |
| Item 6. Exhibits | 140 |
| | |
| **SIGNATURES** | |

**Forward Looking Statements**

This Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), which are subject to the safe harbors created by such sections. When used in this Form 10-Q 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 words or phrases "would," "will allow," "intends," "will likely result," "expect to," "should," "anticipate," "look forward," "believes," and other terms of similar meaning or import in connection with any discussion of future operating, financial or other performance are meant to identify "forward-looking statements."

FirstBanCorp. 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 these forward-looking statements are not guarantees of future performance and involve certain risks, uncertainties, estimates and assumptions by us that are difficult to predict. Various factors, some of which are beyond our control, could cause actual results to differ materially from those expressed in, or implied by, such forward-looking statements. Factors that might cause such a difference include, but are not limited to, the risks described or referenced below in Item 1A. "Risk Factors," and the following:

- the ability of the Puerto Rico government or any of its public corporations or other instrumentalities to repay its respective debt obligations, including the effect of recent payment defaults on the Puerto Rico government general obligations, bonds of the Government Development Bank for Puerto Rico (the"GDB") and certain bonds of government public corporations, and recent and any future downgrades of the long-term and short-term debt ratings of the Puerto Rico government, which could exacerbate Puerto Rico's adverse economic conditions and, in turn, further adversely impact the Corporation;

- uncertainty as to the ultimate outcomes of actions resulting from the enactment by the U.S. government of the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA) to address Puerto Rico's financial problems;

- uncertainty about whether the Corporation will be able to continue 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") that, among other things, requires the Corporation to serve as a source of strength to FirstBank Puerto Rico ("FirstBank" or the "Bank") and that, except with the consent generally of the New York FED and the Board of Governors of the Federal Reserve System (the "Federal Reserve Board"), prohibits the Corporation from paying dividends to stockholders or receiving dividends from FirstBank, making payments on trust preferred securities or subordinated debt and incurring, increasing or guaranteeing debt or repurchasing any capital securities and uncertainty whether such consent will be provided for future interest payments on the subordinated debt despite the consent that enabled the Corporation to pay all the accrued but deferred interest payments plus the interest

for the second quarter of 2016 on the Corporation’s subordinated debentures associated with its trust preferred securities;

- a decrease in demand for the Corporation’s products and services and lower revenues and earnings because of the continued recession in Puerto Rico;

- 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 to fund operations and provide liquidity;

- 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 need to receive approval from the New York FED and the Federal Reserve Board to declare or pay any dividends and to take dividends or any other form of payment representing a reduction in capital from FirstBank or FirstBank’s failure to generate sufficient cash flow to make a dividend payment to the Corporation;

- the weakness of the real estate markets and of the consumer and commercial sectors and their impact on the credit quality of the Corporation’s loans and other assets, which have contributed and may continue to contribute to, among other things, high levels of non-performing assets, charge-offs and provisions for loan and lease losses and may subject the Corporation to further risk from loan defaults and foreclosures;

- the ability of FirstBank to realize the benefits of its deferred tax assets subject to the remaining valuation allowance;

- adverse changes in general economic conditions in Puerto Rico, the 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 reduced interest margins and affected funding sources, and has affected



---

demand for all of the Corporation’s products and services and reduced the Corporation’s revenues and earnings, and the value of the Corporation’s assets, and may continue to have these effects;

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

- the risk that additional portions of the unrealized losses in the Corporation’s investment portfolio are determined to be other-than-temporary, including additional impairments on the Puerto Rico government’s obligations;

- uncertainty about regulatory and legislative changes for financial services companies in Puerto Rico, the U.S., the USVI and the 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 U.S. federal government and the Puerto Rico and other governments, including those determined by the Federal Reserve Board, the New York FED, the Federal Deposit Insurance Corporation (“FDIC”), government-sponsored housing agencies, and regulators in Puerto Rico, the USVI and the 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 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 impairments on the Corporation’s financial instruments, goodwill or other intangible assets relating to acquisitions;

- the risk 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 on the Corporation's businesses, business practices and results of operations of a potential higher interest rate environment; and

- general competitive factors and industry consolidation.

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

Investors should refer to the Corporation's Annual Report on Form 10-K for the year ended December 31, 2015, as well as "Part II, Item 1A, Risk Factors" in this quarterly report on Form 10-Q, for a discussion of such factors and certain risks and uncertainties to which the Corporation is subject.

**FIRST BANCORP.**

**CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION**

**(Unaudited)**

| | June 30, 2016 | | | December 31, 2015 | |
|---|---|---|---|---|---|
| (In thousands, except for share information) | | | | | |
| **ASSETS** | | | | | |
| Cash and due from banks | $ | 617,827 | | $ | 532,985 |
| Money market investments: | | | | | |
| Time deposits with other financial institutions | | 2,800 | | | 3,000 |
| Other short-term investments | | 207,287 | | | 216,473 |
| Total money market investments | | 210,087 | | | 219,473 |
| Investment securities available for sale, at fair value: | | | | | |
| Securities pledged that can be repledged | | 780,895 | | | 793,562 |
| Other investment securities | | 1,222,154 | | | 1,092,833 |
| Total investment securities available for sale | | 2,003,049 | | | 1,886,395 |
| Investment securities held to maturity, at amortized cost: | | | | | |
| Securities pledged that can be repledged | | - | | | - |
| Other investment securities | | 161,342 | | | 161,483 |
| Total investment securities held to maturity | | 161,342 | | | 161,483 |
| Other equity securities | | 32,379 | | | 32,169 |
| Loans, net of allowance for loan and lease losses of $234,454 | | | | | |
| (2015 - $240,710) | | 8,636,293 | | | 8,871,672 |
| Loans held for sale, at lower of cost or market | | 37,958 | | | 35,869 |
| Total loans, net | | 8,674,251 | | | 8,907,541 |
| Premises and equipment, net | | 155,608 | | | 161,016 |
| Other real estate owned | | 139,159 | | | 146,801 |
| Accrued interest receivable on loans and investments | | 45,984 | | | 48,697 |
| Other assets | | 469,016 | | | 476,459 |
| Total assets | $ | 12,508,702 | | $ | 12,573,019 |
| **LIABILITIES** | | | | | |
| Non-interest-bearing deposits | $ | 1,409,072 | | $ | 1,336,559 |
| Interest-bearing deposits | | 7,815,947 | | | 8,001,565 |
| Total deposits | | 9,225,019 | | | 9,338,124 |
| Securities sold under agreements to repurchase | | 700,000 | | | 700,000 |
| | | 455,000 | | | 455,000 |

| | | | | | |
|---|---|---|---|---|---|
| Advances from the Federal Home Loan Bank (FHLB) | | | | | |
| Other borrowings | | 216,187 | | | 226,492 |
| Accounts payable and other liabilities | | 126,043 | | | 159,269 |
| Total liabilities | | 10,722,249 | | | 10,878,885 |
| **STOCKHOLDERS' EQUITY** | | | | | |
| Preferred stock, authorized, 50,000,000 shares: | | | | | |
| Non-cumulative Perpetual Monthly Income Preferred Stock: issued 22,004,000 | | | | | |
| shares, outstanding 1,444,146 shares, aggregate liquidation value of $36,104 | | 36,104 | | | 36,104 |
| Common stock, $0.10 par value, authorized, 2,000,000,000 shares; | | | | | |
| issued, 218,278,207 shares (2015 - 216,051,128 shares issued) | | 21,828 | | | 21,605 |
| Less: Treasury stock (at par value) | | (115) | | | (96) |
| Common stock outstanding, 217,129,074 shares outstanding (2015 - 215,088,698 | | | | | |
| shares outstanding) | | 21,713 | | | 21,509 |
| Additional paid-in capital | | 928,900 | | | 926,348 |
| Retained earnings, includes legal surplus reserve of $42,798 | | 783,219 | | | 737,922 |
| Accumulated other comprehensive income (loss), net of tax of $7,752 | | 16,517 | | | (27,749) |
| Total stockholders' equity | | 1,786,453 | | | 1,694,134 |
| Total liabilities and stockholders' equity | $ | 12,508,702 | | $ | 12,573,019 |
| | | | | | |
| The accompanying notes are an integral part of these statements. | | | | | |

**FIRST BANCORP.**

**CONSOLIDATED STATEMENTS OF INCOME (LOSS)**

**(Unaudited)**

| | Quarter Ended June 30, 2016 | Quarter Ended June 30, 2015 | Six-Month Period Ended June 30, 2016 | Six-Month Period Ended June 30, 2015 |
|---|---|---|---|---|
| (In thousands, except per share information) | | | | |
| **Interest and dividend income:** | | | | |
| Loans | $ 132,111 | $ 137,997 | $ 267,250 | $ 275,497 |
| Investment securities | 13,552 | 13,125 | 28,171 | 27,573 |
| Money market investments | 1,271 | 510 | 2,344 | 1,047 |
| Total interest income | 146,934 | 151,632 | 297,765 | 304,117 |
| **Interest expense:** | | | | |
| Deposits | 17,224 | 16,980 | 34,481 | 34,674 |
| Securities sold under agreements to repurchase | 6,029 | 5,388 | 11,505 | 11,781 |
| Advances from FHLB | 1,471 | 944 | 2,942 | 1,878 |
| Other borrowings | 1,982 | 1,843 | 3,961 | 3,660 |
| Total interest expense | 26,706 | 25,155 | 52,889 | 51,993 |
| Net interest income | 120,228 | 126,477 | 244,876 | 252,124 |
| **Provision for loan and lease losses** | 20,986 | 74,266 | 42,039 | 107,236 |
| Net interest income after provision for loan and lease losses | 99,242 | 52,211 | 202,837 | 144,888 |
| **Non-interest income:** | | | | |
| Service charges and fees on deposit accounts | 5,618 | 5,219 | 11,418 | 9,774 |
| Mortgage banking activities | 4,893 | 4,763 | 9,646 | 8,381 |
| Net gain on sale of investments | - | - | 8 | - |
| Other-than-temporary impairment (OTTI) losses on available-for-sale debt securities: | | | | |
| Total other-than-temporary impairment losses | - | (29,521) | (1,845) | (29,521) |
| Portion of other-than-temporary impairment | | | | |
| recognized in other comprehensive income (OCI) | - | 16,424 | (4,842) | 16,268 |
| Net impairment losses on available-for-sale debt securities | - | (13,097) | (6,687) | (13,253) |

| | | | | |
|---|---|---|---|---|
| Gain on early extinguishment of debt | - | - | 4,217 | - |
| Insurance commission income | 1,542 | 1,522 | 4,811 | 4,544 |
| Bargain purchase gain | - | - | - | 13,443 |
| Other non-interest income | 7,725 | 8,263 | 14,834 | 16,510 |
| Total non-interest income | 19,778 | 6,670 | 38,247 | 39,399 |
| **Non-interest expenses:** | | | | |
| Employees' compensation and benefits | 37,401 | 37,945 | 75,836 | 73,599 |
| Occupancy and equipment | 13,043 | 15,059 | 27,226 | 29,408 |
| Business promotion | 4,048 | 3,934 | 8,051 | 6,802 |
| Professional fees | 11,327 | 19,005 | 22,103 | 34,223 |
| Taxes, other than income taxes | 3,756 | 3,131 | 7,548 | 6,132 |
| Insurance and supervisory fees | 7,066 | 6,796 | 14,409 | 13,656 |
| Net loss on other real estate owned (OREO) and OREO operations | 3,325 | 4,874 | 6,531 | 7,502 |
| Credit and debit card processing expenses | 3,274 | 3,945 | 6,556 | 7,902 |
| Communications | 1,725 | 2,045 | 3,533 | 3,653 |
| Other non-interest expenses | 4,579 | 6,065 | 10,748 | 11,650 |
| Total non-interest expenses | 89,544 | 102,799 | 182,541 | 194,527 |
| **Income (loss) before income taxes** | 29,476 | (43,918) | 58,543 | (10,240) |
| **Income tax (expense) benefit** | (7,523) | 9,844 | (13,246) | 1,812 |
| **Net income (loss)** | $ 21,953 | $ (34,074) | $ 45,297 | $ (8,428) |
| **Net income (loss) attributable to common stockholders** | $ 21,953 | $ (34,074) | $ 45,297 | $ (8,428) |
| **Net income (loss) per common share:** | | | | |
| Basic | $ 0.10 | $ (0.16) | $ 0.21 | $ (0.04) |
| Diluted | $ 0.10 | $ (0.16) | $ 0.21 | $ (0.04) |
| **Dividends declared per common share** | $ - | $ - | $ - | $ - |

The accompanying notes are an integral part of these statements.

**FIRST BANCORP.**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**

**(Unaudited)**

| | Quarter Ended | | Six-Month Period Ended | |
|---|---|---|---|---|
| | June 30, 2016 | June 30, 2015 | June 30, 2016 | June 30, 2015 |
| (In thousands) | | | | |
| Net income (loss) | $ 21,953 | $ (34,074) | $ 45,297 | $ (8,428) |
| Available-for-sale debt securities on which an other-than-temporary | | | | |
| impairment has been recognized: | | | | |
| Unrealized gain on debt securities on which an | | | | |
| other-than-temporary impairment has been recognized | 2,453 | 683 | 1,455 | 1,372 |
| Reclassification adjustment for other-than-temporary impairment | | | | |
| on debt securities included in net income | - | 13,097 | 6,687 | 13,253 |
| All other unrealized gains and losses on available-for-sale securities: | | | | |
| Reclassification adjustments for net gain included in net income | - | - | (8) | - |
| All other unrealized holding gains (losses) on | | | | |
| available-for-sale securities arising during the period | 11,422 | (23,948) | 36,132 | (17,653) |
| Other comprehensive income (loss) for the period, net of tax | 13,875 | (10,168) | 44,266 | (3,028) |
| Total comprehensive income (loss) | $ 35,828 | $ (44,242) | $ 89,563 | $ (11,456) |

The accompanying notes are an integral part of these statements.

**FIRST BANCORP.**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(Unaudited)**

| | Six-Month Period Ended | | | | |
|---|---|---|---|---|---|
| | June 30, 2016 | | | June 30, 2015 | |
| (In thousands) | | | | | |
| **Cash flows from operating activities:** | | | | | |
| Net income (loss) | $ | 45,297 | | $ | (8,428) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | | | | |
| Depreciation and amortization | | 9,015 | | | 10,561 |
| Amortization of intangible assets | | 2,442 | | | 2,491 |
| Provision for loan and lease losses | | 42,039 | | | 107,236 |
| Deferred income tax expense | | 11,972 | | | 2,683 |
| Stock-based compensation | | 3,346 | | | 3,043 |
| Gain on sales of investments | | (8) | | | - |
| Bargain purchase gain | | - | | | (13,443) |
| Gain on early extinguishment of debt | | (4,217) | | | - |
| Other-than-temporary impairments on debt securities | | 6,687 | | | 13,253 |
| Unrealized loss (gain) on derivative instruments | | 243 | | | (182) |
| Net gain on disposition of premises and equipment and other assets | | (686) | | | (178) |
| Net gain on sales of loans | | (5,089) | | | (3,157) |
| Net amortization/accretion of premiums, discounts and deferred loan fees and costs | | (4,624) | | | (2,217) |
| Originations and purchases of loans held for sale | | (220,056) | | | (213,586) |
| Sales and repayments of loans held for sale | | 224,765 | | | 210,394 |
| Amortization of broker placement fees | | 1,645 | | | 2,504 |
| Net amortization/accretion of premium and discounts on investment securities | | 1,898 | | | 3,803 |
| Decrease in accrued interest receivable | | 2,713 | | | 313 |
| (Decrease) increase in accrued interest payable | | (26,580) | | | 1,737 |
| Decrease (increase) in other assets | | 2,816 | | | (627) |
| (Decrease) increase in other liabilities | | (11,414) | | | 16,523 |
| Net cash provided by operating activities | | 82,204 | | | 132,723 |
| | | | | | |
| **Cash flows from investing activities:** | | | | | |
| Principal collected on loans | | 1,494,316 | | | 1,563,520 |
| Loans originated and purchased | | (1,321,511) | | | (1,437,877) |
| Proceeds from sales of loans held for investment | | - | | | 107,702 |

| | | | | |
|---|---|---|---|---|
| Proceeds from sales of repossessed assets | | 27,674 | | 33,720 |
| Proceeds from sales of available-for-sale securities | | 14,990 | | - |
| Purchases of available-for-sale securities | | (279,500) | | (158,932) |
| Purchase of securities held to maturity | | - | | (4,530) |
| Proceeds from principal repayments and maturities of available-for-sale securities | | 183,570 | | 141,226 |
| Proceeds from principal repayments and maturities of held-to-maturity securities | | 141 | | 142 |
| Additions to premises and equipment | | (5,280) | | (6,161) |
| Purchases of other equity securities | | (210) | | (400) |
| Proceeds from sale of premises and equipment and other assets | | 2,250 | | 2,511 |
| Net cash received from acquisition | | - | | 217,659 |
| Net cash outflows from purchase/sale of insurance contracts | | (960) | | - |
| Net cash provided by investing activities | | 115,480 | | 458,580 |
| | | | | |
| **Cash flows from financing activities:** | | | | |
| Net decrease in deposits | | (114,613) | | (504,270) |
| Change in securities sold under agreements to repurchase | | - | | (200,000) |
| Repurchase of outstanding common stock | | (590) | | (738) |
| Repayment of junior subordinated debentures | | (7,025) | | - |
| Net cash used in financing activities | | (122,228) | | (705,008) |
| | | | | |
| Net increase (decrease) in cash and cash equivalents | | 75,456 | | (113,705) |
| Cash and cash equivalents at beginning of period | | 752,458 | | 796,108 |
| Cash and cash equivalents at end of period | $ | 827,914 | $ | 682,403 |
| | | | | |
| Cash and cash equivalents include: | | | | |
| Cash and due from banks | $ | 617,827 | $ | 462,934 |
| Money market instruments | | 210,087 | | 219,469 |
| | $ | 827,914 | $ | 682,403 |
| The accompanying notes are an integral part of these statements. | | | | |
| | | | | |

**FIRST BANCORP.**

**CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**

**(Unaudited)**

| | Six-Month Period Ended | | | |
|---|---|---|---|---|
| | June 30, 2016 | | | June 30, 2015 |
| (In thousands) | | | | |
| **Preferred Stock** | $ | 36,104 | $ | 36,104 |
| | | | | |
| **Common Stock outstanding:** | | | | |
| Balance at beginning of period | | 21,509 | | 21,298 |
| Common stock issued as compensation | | 44 | | 17 |
| Common stock withheld for taxes | | (19) | | (12) |
| Common stock issued in exchange for trust preferred securities | | - | | 85 |
| Restricted stock grants | | 179 | | 83 |
| Restricted stock forfeited | | - | | (2) |
| Balance at end of period | | 21,713 | | 21,469 |
| | | | | |
| **Additional Paid-In-Capital:** | | | | |
| Balance at beginning of period | | 926,348 | | 916,067 |
| Stock-based compensation | | 3,346 | | 3,043 |
| Common stock withheld for taxes | | (571) | | (726) |
| Common stock issued in exchange for trust preferred securities | | - | | 5,543 |
| Restricted stock grants | | (179) | | (83) |
| Common stock issued as compensation | | (44) | | (17) |
| Restricted stock forfeited | | - | | 2 |
| Balance at end of period | | 928,900 | | 923,829 |
| | | | | |
| **Retained Earnings:** | | | | |
| Balance at beginning of period | | 737,922 | | 716,625 |
| Net income (loss) | | 45,297 | | (8,428) |
| Balance at end of period | | 783,219 | | 708,197 |
| | | | | |
| **Accumulated Other Comprehensive Income (Loss), net of tax:** | | | | |
| Balance at beginning of period | | (27,749) | | (18,351) |
| Other comprehensive income (loss), net of tax | | 44,266 | | (3,028) |
| Balance at end of period | | 16,517 | | (21,379) |
| | | | | |
| Total stockholders' equity | $ | 1,786,453 | $ | 1,668,220 |

| | | | | | |
|---|---|---|---|---|---|
| The accompanying notes are an integral part of these statements. | | | | | |

9

**FIRST BANCORP.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

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

The Consolidated Financial Statements (unaudited) of First BanCorp. (the "Corporation") have been prepared in conformity with the accounting policies stated in the Corporation's Audited Consolidated Financial Statements included in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2015. Certain information and note disclosures normally included in the financial statements prepared in accordance with generally accepted accounting principles in the United States of America ("GAAP") have been condensed or omitted from these statements pursuant to the rules and regulations of the SEC and, accordingly, these financial statements should be read in conjunction with the Audited Consolidated Financial Statements of the Corporation for the year ended December 31, 2015, which are included in the Corporation's 2015 Annual Report on Form 10-K. All adjustments (consisting only of normal recurring adjustments) that are, in the opinion of management, necessary for a fair presentation of the statement of financial position, results of operations and cash flows for the interim periods have been reflected. All intercompany accounts and transactions have been eliminated in consolidation.

During the second quarter of 2016, the Corporation reviewed its historical accounting treatment as loans for its $161.3 million of financing arrangements with Puerto Rico municipalities issued in bond form, but underwritten as loans with features that are typically found in commercial loan transactions. This review came as a result of the recent determination of the Federal Reserve Board that the transactions must be treated for regulatory reporting purposes as investment securities. The Puerto Rico Municipal Finance Act (the "Act") requires the designation of financing arrangements obtained by municipalities with maturities greater than 8 years as "special obligation bonds" subject to specific provisions under the Act. The Corporation has concluded that the impact of accounting for the transactions as investment securities rather than loans does not have a material effect on previously reported results of operations, financial condition, or cash flows and, accordingly, these financing arrangements are now accounted for and reported as held-to-maturity investment securities and not as loans as of June 30, 2016 and for prior periods.

The results of operations for the quarter and six-month period ended June 30, 2016 are not necessarily indicative of the results to be expected for the entire year.

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

The Financial Accounting Standards Board (“FASB”) has issued the following accounting pronouncements and guidance relevant to the Corporation’s operations:

In June 2014, the FASB updated the Accounting Standards Codification (the “Codification” or the “ASC”) to provide guidance for determining compensation cost when an employee’s compensation award is eligible to vest regardless of whether the employee is rendering service on the date the performance target is achieved. This Update is effective for annual and interim periods beginning after December 15, 2015. The adoption of this guidance did not have an impact on the Corporation’s financial statements.

In November 2014, the FASB updated the Codification to clarify how current GAAP should be interpreted in evaluating the economic characteristics and risk of a host contract in a hybrid financial instrument that is issued in the form of a share. In addition, the Update was issued to clarify that, in evaluating the nature of a host contract, an entity should assess the substance of the relevant terms and features (that is, the relative strength of the debt-like or equity-like terms and features given the facts and circumstances) when considering how to weight those terms and features. The effects of initially adopting this Update should be applied on a modified retrospective basis to existing hybrid financial instruments issued in the form of a share as of the beginning of the fiscal year for which the amendments are effective. Retrospective application is permitted to all relevant prior periods. This Update is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. The adoption of this guidance did not have an impact on the Corporation’s financial statements.

In January 2015, the FASB updated the Codification to eliminate from GAAP the concept of extraordinary items as part of its initiative to reduce complexity in accounting standards (the Simplification Initiative).  Under current GAAP, an event or transaction is presumed to be an ordinary and usual activity of the reporting entity unless evidence clearly supports its classification as an extraordinary item. In order to be classified as an extraordinary item, the event or transaction must be: (i) unusual in nature and (ii) infrequent in occurrence.  Before the Update was issued, an entity was required to segregate these items from the results of ordinary operations and show the items separately in the income statement, net of tax, after income from continuing operations. This Update is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. The adoption of this guidance did not have an impact on the Corporation’s financial statements.

In February 2015, the FASB updated the Codification to eliminate the deferral of the requirements of Accounting Standards Update (“ASU”) No. 2009-17 for certain interests in investment funds and provide a scope for exception for certain investments in money market funds. While the Update is aimed at asset managers, it will affect all reporting entities involved with limited partnerships or similar entities. In some cases, consolidation conclusions will change. In other cases, reporting entities will need to provide additional

disclosure about entities that currently are not considered Variable Interest Entities (“VIEs”) but will be considered VIEs under the new guidance when they have a variable interest in those VIEs. Regardless of whether conclusions change or additional disclosure requirements are triggered, reporting entities will need to re-evaluate limited partnerships and similar entities for consolidation and revise their documentation. For public business entities, the Update is effective for annual and interim periods beginning after December 15, 2015. A reporting entity must apply the amendments retrospectively. The adoption of this guidance did not have an impact on the Corporation’s financial statements.

In April 2015, the FASB updated the Codification to clarify that customers should determine whether a cloud computing arrangement includes the license of software by applying the same guidance cloud service providers use to make this determination. Examples of cloud computing arrangements include software as a service, platform as a service, infrastructure as a service and other hosting arrangements. If a hosting arrangement includes a software license for internal use software, the software license should be accounted for by the customer under ASC 350-40. A license of software other than internal use software would be accounted for by the customer under other GAAP (e.g., a research and development cost and software to be sold, leased or otherwise marketed). A software license included in a hosting arrangement would be accounted for separately from any service contract in the arrangement. Hosting arrangements that do not include software licenses should be accounted for as service contracts. The Update also eliminates the existing requirement for customers to account for software licenses they acquire by analogizing to the guidance on leases. Instead, customers will account for software licenses that are in the scope of ASC 350-40 in the same manner as licenses of other intangible assets. Entities have the option of applying the guidance (1) prospectively to all arrangements entered into or materially modified after the effective date or (2) retrospectively. Entities that elect prospective application are required to disclose the reason for the change in accounting principle, the transition method, and a description of the financial statement line items affected by the change. Entities that elect retrospective application must disclose the information required by ASC 250. For public business entities, the guidance is effective for annual periods, including interim periods within those annual periods, beginning after December 15, 2015. The adoption of this guidance did not have an impact on the Corporation’s financial statements.

In May 2015, the FASB updated the Codification to provide guidance on disclosures for investments in certain entities that calculate net asset value (NAV) per share (or its equivalent). This Update removes the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the net asset value per share practical expedient and modifies certain disclosure requirements. This guidance is effective for interim and annual reporting periods in fiscal years beginning after December 31, 2015, and requires retrospective adoption. The adoption of this pronouncement did not have an impact on the Corporation’s financial statements.

In September 2015, the FASB updated the Codification to simplify the accounting for adjustments made to provisional amounts recognized in a business combination by eliminating the requirement to retrospectively account for those adjustments. This Update allows the acquirer to recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. The acquirer must record, in the same period’s financial statements, the effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the provisional amounts, calculated as if the accounting had been completed at the acquisition date. Also, this Update requires entities to present separately on the face of the income statement or disclose in the notes the portion of the amount recorded in current-period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had

been recognized as of the acquisition date. Prior to this Update, GAAP required that, during the measurement period, the acquirer retrospectively adjust the provisional amounts recognized at the acquisition date with a corresponding adjustment to goodwill. The acquirer also had to revise comparative information for prior periods presented in financial statements as needed, including revising depreciation, amortization, or other income effects as a result of changes made to provisional amounts. For public business entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2015, including interim periods within those fiscal years. The amendments in this Update should be applied prospectively to adjustments to provisional amounts that occur after the effective date of this Update with earlier application permitted for financial statements that have not been issued. The adoption of this guidance did not have an impact on the Corporation's financial statements.

In March 2016, the FASB updated the Codification to simplify certain aspects of the accounting for share-based payment transactions. The main provisions in this Update include: (i) recognition of all tax benefits and tax deficiencies (including tax benefits of dividends on share-base payment awards) as income tax expense or benefit in the income statement, (ii) classification of the excess tax benefit along with other income tax cash flows as an operating activity, (iii) an entity-wide accounting policy election to either estimate the number of awards that are expected to vest (current GAAP) or account for forfeitures when they occur, (iv) a threshold to qualify for equity classification which permits withholding up to the maximum statutory tax rates in the applicable jurisdictions, and (v) classification of cash paid by an employer as a financing activity when the payment results from the withholding of shares for tax withholding purposes. In addition to those simplifications, the amendments eliminate the guidance in ASC 718 that was indefinitely deferred shortly after the issuance of FASB Statement No. 123 (revised 2004), Share-Based Payment. This should not result in a change in practice because the guidance that is being superseded was never effective. For public business entities, the amendments in this Update are effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. The Corporation is currently evaluating the impact of the adoption of this guidance on its consolidated financial statements.

In March 2016, the FASB updated the Codification to require an equity method investor to add the cost of acquiring the additional interest in the investee to the current basis of the investor's previously held interest and adopt the equity method of accounting as of the date the investment becomes qualified for equity method accounting. Therefore, upon qualifying for the equity method of accounting, no retroactive adjustment of the investment is required. Also, this Update requires that an entity that has an available-for sale equity security that becomes qualified for the equity method of accounting recognize through earnings the unrealized holding gain or loss in accumulated other comprehensive income at the date the investment becomes qualified for use of the equity method. The amendments in this Update are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. The amendments should be applied prospectively upon their effective date to increases in the level of ownership interest or degree of influence that result in the adoption of the equity method. Earlier application is permitted. The Corporation is currently evaluating the impact of the adoption of this guidance, if any, on its consolidated financial statements.

In June 2016, the FASB updated the Codification and issued ASU 2016-13, Financial Instruments – Credit Losses (Topic 326), which introduces new guidance for the accounting for credit losses on instruments within its scope. The new guidance introduces an approach based on expected losses to estimate credit losses on certain types of financial instruments. It also modifies the impairment model for available-for-sale debt securities and provides for a simplified accounting model for purchased financial assets with credit deterioration since their origination.

The new model, referred to as the current expected credit losses (CECL) model, will apply to: (1) financial assets subject to credit losses and measured at amortized cost and (2) certain off-balance sheet credit exposures. This includes loans, held-to-maturity debt securities, loan commitments, financial guarantees, and net investments in leases, as well as reinsurance and trade receivables. Upon initial recognition of the exposure, the CECL model requires an entity to estimate the credit losses expected over the life of an exposure (or pool of exposures). The estimate of expected credit losses (ECL) should consider historical information, current information, and reasonable and supportable forecasts, including estimates of prepayments. Financial instruments with similar risk characteristics should be grouped together when estimating ECL. The ASU does not prescribe a specific method to make the estimate so its application will require significant judgment.

Generally, upon initial recognition of a financial asset the estimate of the ECL will be recorded through an allowance for loan and lease losses with an offset to current earnings. Subsequently, the ECL will need to be assessed each period, and both negative and positive changes to the estimate will be recognized through an adjustment to the allowance for loan and lease losses and earnings.

The ASU amends the current available-for-sale security other-than-temporary impairment (OTTI) model for debt securities. The new available-for-sale debt security model will require an estimate of ECL only when the fair value is below the amortized cost of the asset. The length of time the fair value of an available-for-sale debt security has been below the amortized cost will no longer impact the determination of whether a credit loss exists. As such, the new available-for-sale debt security model is not an OTTI model. In addition, credit losses on available-for-sale debt securities will now be limited to the difference between the security's amortized cost basis and its fair value. The available-for-sale debt security model will also require the use of an allowance to record estimated credit losses (and subsequent recoveries).

The purchased financial assets with credit deterioration (PCD) model applies to purchased financial assets (measured at amortized cost or available-for-sale) that have experienced more than insignificant credit deterioration since origination. This represents a change from the scope of what are considered purchased credit-impaired assets under

today's model. In contrast to the accounting for originated or purchased assets that do not qualify as PCD, the initial estimate of expected credit losses for a PCD would be recognized through an allowance for loan and lease losses with an offset to the cost basis of the related financial asset at acquisition (i.e., there is no impact to net income at initial recognition). Subsequently, the accounting will follow the applicable CECL or available-for-sale debt security impairment model with all adjustments of the allowance for loan and lease losses recognized through earnings. Beneficial interests classified as held-to-maturity or available-for-sale will need to apply the PCD model if the beneficial interest meets the definition of PCD or if there is a significant difference between contractual and expected cash flows at initial recognition.

In general, the new guidance will require modified retrospective application to all outstanding instruments, with a cumulative effect adjustment recorded to opening retained earnings as of the beginning of the first period in which the guidance becomes effective. However, prospective application is required for PCD assets previously accounted for under ASC 310-30 and for debt securities for which an other-than-temporary impairment was recognized prior to the date of adoption.

ASU 2016-13 also expands the disclosure requirements regarding an entity's assumptions, models, and methods for estimating the allowance for loan and lease losses. In addition, public business entities will need to disclose the amortized cost balance for each class of financial asset by credit quality indicator, disaggregated by the year of origination (i.e., by vintage year).

The ASU will be effective for public business entities that are SEC filers in fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early application of the guidance will be permitted for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Corporation is currently evaluating the impact of the adoption of this guidance on its consolidated financial statements.



---

**NOTE 2 – EARNINGS PER COMMON SHARE**

The calculations of earnings (loss) per common share for the quarters and six-month periods ended June 30, 2016 and 2015 are as follows:

| | Quarter Ended June 30, | | | | Six-Month Period Ended June 30, | | | |
|---|---|---|---|---|---|---|---|---|
| | **2016** | | **2015** | | **2016** | | **2015** | |
| (In thousands, except per share information) | | | | | | | | |
| Net income (loss) | $ | 21,953 | $ | (34,074) | $ | 45,297 | $ | (8,428) |
| Net income (loss) attributable to common stockholders | $ | 21,953 | $ | (34,074) | $ | 45,297 | $ | (8,428) |
| **Weighted-Average Shares:** | | | | | | | | |
| Average common shares outstanding | | 212,768 | | 211,247 | | 212,558 | | 210,968 |
| Average potential dilutive common shares | | 3,155 | | - | | 2,040 | | - |
| Average common shares outstanding- assuming dilution | | 215,923 | | 211,247 | | 214,598 | | 210,968 |
| **Earnings (loss) per common share:** | | | | | | | | |
| Basic | $ | 0.10 | $ | (0.16) | $ | 0.21 | $ | (0.04) |
| Diluted | $ | 0.10 | $ | (0.16) | $ | 0.21 | $ | (0.04) |

Earnings per common share is computed by dividing net income attributable to common stockholders by the weighted average number of common shares issued and outstanding. Net income attributable to common stockholders represents net income adjusted for any preferred stock dividends, including any dividends declared and any cumulative dividends related to the current dividend period that have not been declared as of the end of the period.

Potential common shares consist of common stock issuable under the assumed exercise of stock options, unvested shares of restricted stock, and outstanding warrants using the treasury stock method. This method assumes that the potential common shares are issued and the proceeds from the exercise, in addition to the amount of compensation cost attributable to future services, are used to purchase common stock at the exercise date. The difference between the number of potential shares issued and the shares purchased is added as incremental shares to the actual number of shares outstanding to compute diluted earnings per share. Stock options, unvested shares of restricted stock, and outstanding warrants that result in lower potential shares issued than shares purchased under the treasury stock method are not included in the computation of dilutive earnings per share since their inclusion would have an antidilutive

effect on earnings per share. Stock options not included in the computation of outstanding shares because they were antidilutive amounted to 39,855 and 69,848 as of June 30, 2016 and 2015, respectively. Warrants outstanding to purchase 1,285,899 shares of common stock and 2,939,794 unvested shares of restricted stock were excluded from the computation of diluted earnings per share for the quarter and six-month period ended June 30, 2015 because the Corporation reported a net loss attributable to common stockholders for the periods and their inclusion would have an antidilutive effect.



---

**NOTE 3 – STOCK-BASED COMPENSATION**

As of January 21, 2007, the Corporation's 1997 stock option plan expired and no additional awards could be granted under that plan. All outstanding awards granted under this plan have continued in full force and effect since then, subject to their original terms. No awards of shares could be granted under the 1997 stock option plan as of its expiration.

The activity of stock options granted under the 1997 stock option plan for the six-month period ended June 30, 2016 is set forth below:

| | Number of Options | | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Term (Years) | | Aggregate Intrinsic Value (In thousands) |
|---|---|---|---|---|---|---|
| Beginning of period outstanding and exercisable | 69,848 | $ | 160.30 | | | |
| Options expired | (29,993) | | 190.07 | | | |
| End of period outstanding and exercisable | 39,855 | $ | 137.89 | 0.5 | $ | - |

On May 24, 2016, the Corporation's stockholders approved the amendment and restatement of the First BanCorp 2008 Omnibus Incentive Plan, as amended (the "Omnibus Plan"), to, among other things, increase the number of shares of Common Stock reserved for issuance under the Omnibus Plan, to extend the term of the Omnibus Plan to May 24, 2026 and to re-approve the material terms of the performance goals under the Omnibus Plan for purposes of Section 162(m) of the U.S. Internal Revenue Code of 1986, as amended. The Omnibus Plan provides for equity-based compensation incentives (the "awards") through the grant of stock options, stock appreciation rights, restricted stock, restricted stock units, performance shares, cash-based awards and other stock-based awards. The Omnibus Plan authorizes the issuance of up to 7,335,928 shares of common stock, subject to adjustments for stock splits, reorganizations, and other similar events. The Corporation's Board of Directors, upon receiving the relevant recommendation of the Compensation Committee, has the power and authority to determine those eligible to receive awards and to establish the terms and conditions of any awards, subject to various limits and vesting restrictions that apply to individual and aggregate awards.

Under the Omnibus Plan, during the first half of 2016, the Corporation issued 1,786,137 shares of restricted stock to employees subject to a vesting period of two years. Included in those 1,786,137 shares of restricted stock are

1,546,137 shares granted to certain senior officers consistent with the requirements of the Troubled Asset Relief Program ("TARP") Interim Final Rule, which permit TARP recipients to grant "long-term restricted stock" without violating the prohibition on paying or accruing a bonus payment provided that: (i) the value of the grant may not exceed one-third of the amount of the employee's annual compensation, (ii) no portion of the grant may vest before two years after the grant date, and (iii) the grant must be subject to a further restriction on transfer or payment as described below. Specifically, the stock that has otherwise vested may not become transferable at any time earlier than as permitted under the schedule set forth by TARP, which is based on the repayment in 25% increments of the aggregate financial assistance received from the U.S. Treasury. Hence, notwithstanding the vesting period mentioned above, the senior officers covered by TARP are restricted from transferring the shares. The U.S. Treasury confirmed that, effective March 2014, it has recovered more than 25% of its investment in First BanCorp. Therefore, the restriction on transfer relating to 25% of the shares granted under TARP requirements were released.

The fair value of the shares of restricted stock granted in the first half of 2016 was based on the market price of the Corporation's outstanding common stock on the date of the grant. For the 1,546,137 shares of restricted stock granted under the TARP requirements, the market price was discounted due to TARP transferability restrictions. For purposes of determining the awards' fair value, the Corporation estimated an appreciation of 14% in the value of the common stock using the Capital Asset Pricing Model as a basis of what would be a market participant's expected return on the Corporation's stock and assumed that the U.S. Treasury would hold the common stock of the Corporation that it currently owns for a period not to exceed two years, resulting in a fair value of $1.43 for each share of restricted stock granted under the TARP requirements. Also, the Corporation used empirical data to estimate employee terminations; separate groups of employees that have similar historical exercise behavior were considered separately for valuation purposes.

The following table summarizes the restricted stock activity in the first half of 2016 under the Omnibus Plan for both executive officers covered by the TARP requirements and other employees as well as for the independent directors:

| | Six-Month Period Ended June 30, 2016 | | |
|---|---|---|---|
| | **Number of shares of restricted stock** | | **Weighted-Average Grant Date Fair Value** |
| Non-vested shares at beginning of year | 2,968,461 | $ | 3.34 |
| Granted | 1,786,137 | | 1.62 |
| Forfeited | (1,000) | | 6.03 |
| Vested | (468,391) | | 3.78 |
| Non-vested shares at June 30, 2016 | 4,285,207 | $ | 2.57 |

For the quarter and six-month period ended June 30, 2016, the Corporation recognized $1.0 million and $1.9 million, respectively, of stock-based compensation expense related to restricted stock awards, compared to $1.0 million and $2.0 million for the same periods in 2015. As of June 30, 2016, there was $4.9 million of total unrecognized compensation cost related to nonvested shares of restricted stock. The weighted average period over which the Corporation expects to recognize such cost is 1.7 years.

During the first half of 2015, 30,068 shares of restricted stock were awarded to one of the Corporation's independent directors subject to vesting periods that range from 1 to 5 years. In addition, during the first half of 2015, the Corporation issued 793,964 shares of restricted stock to employees and independent directors subject to vesting periods that range from 3 months to 3 years. Included in those 793,964 shares of restricted stock are 615,464 shares granted to certain senior officers consistent with the requirements of TARP. The employees covered by TARP are restricted from transferring the shares, subject to certain conditions as explained above.

The fair value of the shares of restricted stock granted in the first six months of 2015 was based on the market price of the Corporation's outstanding common stock on the date of the grant. For the 615,464 shares of restricted stock granted under the TARP requirements, the market price was discounted due to the post-vesting restrictions. For purposes of computing the discount, the Corporation estimated an appreciation of 14% in the value of the common stock using the Capital Asset Pricing Model as a basis of what would be a market participant's expected return on the Corporation's stock and assumed that the U.S. Treasury would hold the common stock of the Corporation that it owned as of the date of the grants for a period not to exceed one year, resulting in a fair value of $3.18 for restricted shares granted under the TARP requirements.

Stock-based compensation accounting guidance requires the Corporation to reverse compensation expense for any awards that were forfeited due to employee or director turnover. Approximately $5 thousand and $36 thousand of compensation expense was reversed during the first half of 2016 and 2015, respectively, related to forfeited awards.

Also, under the Omnibus Plan, effective April 1, 2013, the Corporation's Board of Directors determined to increase the salary amounts paid to certain executive officers primarily by paying the increased salary amounts in the form of shares of the Corporation's common stock, instead of cash. During the first half of 2016, the Corporation issued 441,942 shares of common stock (first half of 2015 – 168,265 shares) with a weighted average market value of $3.20 (first half of 2015 – $6.20) as salary stock compensation. This resulted in a compensation expense of $1.4 million recorded in the first half of 2016 (first half of 2015 – $1.0 million).

For the first half of 2016, the Corporation withheld 134,949 shares (first half of 2015 – 56,486 shares) from the common stock paid to certain senior officers as additional compensation and 51,754 shares of restricted stock that vested during the first half of 2016 (first half of 2015 – 61,372) to cover employees' payroll and income tax withholding liabilities; these shares are held as treasury shares. The Corporation paid any fractional share of salary stock that the officer was entitled to in cash. In the consolidated financial statements, the Corporation treats shares withheld for tax purposes as common stock repurchases.

**NOTE 4 – INVESTMENT SECURITIES**

***Investment Securities Available for Sale***

The amortized cost, non-credit loss component of other-than-temporary impairment ("OTTI") recorded in other comprehensive income ("OCI"), gross unrealized gains and losses recorded in OCI, approximate fair value, and weighted average yield of investment securities available for sale by contractual maturities as of June 30, 2016 and December 31, 2015 were as follows:

| | June 30, 2016 | | | | | |
|---|---|---|---|---|---|---|
| | | Noncredit Loss Component of OTTI Recorded in OCI | Gross Unrealized | | | |
| | Amortized cost | | gains | losses | Fair value | Weighted average yield% |
| | (Dollars in thousands) | | | | | |
| U.S. Treasury securities: | | | | | | |
| Due within one year | $ 7,519 | $ - | $ 4 | $ - | $ 7,523 | 0.57 |
| | | | | | | |
| Obligations of U.S. | | | | | | |
| government-sponsored | | | | | | |
| agencies: | | | | | | |
| Due within one year | 14,628 | - | 16 | - | 14,644 | 0.68 |
| After 1 to 5 years | 461,198 | - | 4,172 | - | 465,370 | 1.29 |
| After 5 to 10 years | 30,037 | - | 1,018 | - | 31,055 | 2.16 |
| After 10 years | 45,465 | - | 60 | 35 | 45,490 | 0.87 |
| | | | | | | |
| Puerto Rico government | | | | | | |
| obligations: | | | | | | |
| | 21,423 | 9,785 | - | - | 11,638 | 4.38 |

| | | | | | | |
|---|---|---|---|---|---|---|
| After 1 to 5 years | | | | | | |
| After 5 to 10 years | 845 | - | 1 | - | 846 | 5.20 |
| After 10 years | 21,178 | 3,706 | 169 | 1,578 | 16,063 | 5.38 |
| | | | | | | |
| United States and Puerto Rico | | | | | | |
| government obligations | 602,293 | 13,491 | 5,440 | 1,613 | 592,629 | 1.54 |
| | | | | | | |
| Mortgage-backed securities: | | | | | | |
| FHLMC certificates: | | | | | | |
| After 5 to 10 years | 298 | - | 31 | - | 329 | 4.95 |
| After 10 years | 266,916 | - | 5,730 | - | 272,646 | 2.16 |
| | 267,214 | - | 5,761 | - | 272,975 | 2.17 |
| | | | | | | |
| GNMA certificates: | | | | | | |
| Due within one year | 2 | - | - | - | 2 | 1.72 |
| After 1 to 5 years | 91 | - | 3 | - | 94 | 4.34 |
| After 5 to 10 years | 105,841 | - | 2,951 | - | 108,792 | 3.06 |
| After 10 years | 150,109 | - | 14,007 | 1 | 164,115 | 4.38 |
| | 256,043 | - | 16,961 | 1 | 273,003 | 3.83 |
| FNMA certificates: | | | | | | |
| After 1 to 5 years | 24,726 | - | 45 | 85 | 24,686 | 1.55 |
| After 5 to 10 years | 21,300 | - | 1,089 | - | 22,389 | 2.73 |
| After 10 years | 715,204 | - | 18,185 | - | 733,389 | 2.34 |
| | 761,230 | - | 19,319 | 85 | 780,464 | 2.33 |
| Collateralized mortgage | | | | | | |
| obligations issued or guaranteed by | | | | | | |
| the FHLMC and GNMA: | | | | | | |
| After 5 to 10 years | 19,854 | - | 14 | 24 | 19,844 | 1.12 |

| | | | | | | |
|---|---|---|---|---|---|---|
| After 10 years | 39,843 | - | 2 | 45 | 39,800 | 1.14 |
| | 59,697 | - | 16 | 69 | 59,644 | 1.13 |
| Other mortgage pass-through | | | | | | |
| trust certificates: | | | | | | |
| After 5 to 10 years | 84 | - | - | - | 84 | 7.20 |
| After 10 years | 31,708 | 7,976 | - | - | 23,732 | 2.34 |
| | 31,792 | 7,976 | - | - | 23,816 | 2.34 |
| Total mortgage-backed | | | | | | |
| securities | 1,375,976 | 7,976 | 42,057 | 155 | 1,409,902 | 2.52 |
| | | | | | | |
| Other | | | | | | |
| After 1 to 5 years | 100 | - | - | - | 100 | 1.50 |
| | | | | | | |
| Equity Securities (1) | 410 | - | 8 | - | 418 | 2.13 |
| | | | | | | |
| Total investment securities | | | | | | |
| available for sale | $ 1,978,779 | $ 21,467 | $ 47,505 | $ 1,768 | $ 2,003,049 | 2.22 |

(1) Equity securities consisted of investment in a Community Reinvestment Act Qualified Investment Fund.

| | December 31, 2015 | | | | | |
|---|---|---|---|---|---|---|
| | | Noncredit Loss Component of OTTI Recorded in OCI | Gross Unrealized | | | |
| | Amortized cost | | gains | losses | Fair value | Weighted average yield% |
| U.S. Treasury securities: | | | | | | |
| After 1 to 5 years | $ 7,530 | $ - | $ - | $ 33 | $ 7,497 | 0.57 |
| Obligations of U.S. | | | | | | |
| government-sponsored | | | | | | |
| agencies: | | | | | | |
| Due within one year | 14,624 | - | 4 | 10 | 14,618 | 0.68 |
| After 1 to 5 years | 384,323 | - | 174 | 4,305 | 380,192 | 1.32 |
| After 5 to 10 years | 58,150 | - | 343 | 242 | 58,251 | 2.34 |
| Puerto Rico Government | | | | | | |
| obligations: | | | | | | |
| After 1 to 5 years | 25,663 | 14,662 | - | - | 11,001 | 4.38 |
| After 5 to 10 years | 855 | - | - | - | 855 | 5.20 |
| After 10 years | 23,162 | 5,255 | 134 | 1,680 | 16,361 | 5.40 |
| United States and Puerto Rico | | | | | | |
| Government obligations | 514,307 | 19,917 | 655 | 6,270 | 488,775 | 1.75 |
| Mortgage-backed securities: | | | | | | |
| FHLMC certificates: | | | | | | |

| | | | | | | |
|---|---|---|---|---|---|---|
| After 5 to 10 years | 336 | - | 31 | - | 367 | 4.95 |
| After 10 years | 287,711 | - | 1,073 | 1,706 | 287,078 | 2.14 |
| | 288,047 | - | 1,104 | 1,706 | 287,445 | 2.15 |
| GNMA certificates: | | | | | | |
| Due within one year | 2 | - | - | - | 2 | 1.70 |
| After 1 to 5 years | 109 | - | 5 | - | 114 | 4.26 |
| After 5 to 10 years | 120,298 | - | 3,182 | - | 123,480 | 3.07 |
| After 10 years | 165,175 | - | 12,822 | 20 | 177,977 | 4.38 |
| | 285,584 | - | 16,009 | 20 | 301,573 | 3.83 |
| FNMA certificates: | | | | | | |
| After 1 to 5 years | 2,552 | - | 74 | - | 2,626 | 3.32 |
| After 5 to 10 years | 21,557 | - | 433 | 233 | 21,757 | 2.73 |
| After 10 years | 759,247 | - | 5,628 | 6,063 | 758,812 | 2.34 |
| | 783,356 | - | 6,135 | 6,296 | 783,195 | 2.35 |
| | | | | | | |
| Other mortgage pass-through | | | | | | |
| trust certificates: | | | | | | |
| After 5 to 10 years | 92 | - | 1 | - | 93 | 7.26 |
| After 10 years | 34,905 | 9,691 | - | - | 25,214 | 2.26 |
| | 34,997 | 9,691 | 1 | - | 25,307 | 2.26 |
| Total mortgage-backed | | | | | | |
| securities | 1,391,984 | 9,691 | 23,249 | 8,022 | 1,397,520 | 2.61 |
| | | | | | | |
| Other | | | | | | |
| After 1 to 5 years | 100 | - | - | - | 100 | 1.50 |
| | | | | | | |
| Total investment securities | | | | | | |
| available for sale | $ 1,906,391 | $ 29,608 | $ 23,904 | $ 14,292 | $ 1,886,395 | 2.38 |
| | | | | | | |

Maturities of mortgage-backed securities are based on contractual terms assuming no prepayments. Expected maturities of investments might differ from contractual maturities because they may be subject to prepayments and/or call options. The weighted average yield on investment securities available for sale is based on amortized cost and, therefore, does not give effect to changes in fair value. The net unrealized gain or loss on securities available for sale and the non-credit loss component of OTTI are presented as part of OCI.

The following tables show the Corporation's available-for-sale investments' fair value and gross unrealized losses, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, as of June 30, 2016 and December 31, 2015. The tables also include debt securities for which an OTTI was recognized and only the amount related to a credit loss was recognized in earnings. For unrealized losses for which OTTI was recognized, the related credit loss was charged against the amortized cost basis of the debt security.

| | As of June 30, 2016 | | | | | |
|---|---|---|---|---|---|---|
| | Less than 12 months | | 12 months or more | | Total | |
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| | (In thousands) | | | | | |
| **Debt securities:** | | | | | | |
| Puerto Rico Government obligations | $ - | $ - | $ 23,349 | $ 15,069 | $ 23,349 | $ 15,069 |
| U.S. Treasury and U.S. government agencies obligations | 13,947 | 35 | - | - | 13,947 | 35 |
| **Mortgage-backed securities:** | | | | | | |
| FNMA | 22,776 | 85 | - | - | 22,776 | 85 |
| FHLMC | - | - | - | - | - | - |
| GNMA | - | - | 1,054 | 1 | 1,054 | 1 |
| Collateralized mortgage obligations issued or guaranteed by FHLMC and GNMA | 40,769 | 69 | - | - | 40,769 | 69 |
| Other mortgage pass-through trust certificates | - | - | 23,732 | 7,976 | 23,732 | 7,976 |
| | $ 77,492 | $ 189 | $ 48,135 | $ 23,046 | $ 125,627 | $ 23,235 |

| | As of December 31, 2015 | | | | | |
|---|---|---|---|---|---|---|
| | Less than 12 months | | 12 months or more | | Total | |
| | | Unrealized | | Unrealized | | Unrealized |

| | Fair Value | Losses | Fair Value | Losses | Fair Value | Losses |
|---|---|---|---|---|---|---|
| | (In thousands) | | | | | |
| **Debt securities:** | | | | | | |
| Puerto Rico Government obligations | $ - | $ - | $ 23,008 | $ 21,597 | $ 23,008 | $ 21,597 |
| U.S. Treasury and U.S. government | | | | | | |
| agencies obligations | 198,243 | 929 | 210,504 | 3,661 | 408,747 | 4,590 |
| **Mortgage-backed securities:** | | | | | | |
| FNMA | 437,305 | 4,516 | 88,013 | 1,780 | 525,318 | 6,296 |
| FHLMC | 141,890 | 1,338 | 19,306 | 368 | 161,196 | 1,706 |
| GNMA | 1,047 | 20 | - | - | 1,047 | 20 |
| Collateralized mortgage obligations | | | | | | |
| issued or guaranteed by FHLMC and GNMA | - | - | - | - | - | - |
| Other mortgage pass-through trust | | | | | | |
| certificates | - | - | 25,214 | 9,691 | 25,214 | 9,691 |
| | $ 778,485 | $ 6,803 | $ 366,045 | $ 37,097 | $ 1,144,530 | $ 43,900 |

***Assessment for OTTI on Available-For-Sale Securities***

Debt securities issued by U.S. government agencies, U.S. government-sponsored entities and the U.S. Treasury accounted for approximately 97% of the total available-for-sale portfolio as of June 30, 2016 and no credit losses are expected, given the explicit and implicit guarantees provided by the U.S. federal government. The Corporation's OTTI assessment was concentrated mainly on available-for-sale Puerto Rico Government debt securities, with an amortized cost of $43.4 million, and on private label mortgage-backed securities ("MBS") with an amortized cost of $31.7 million, and for which credit losses are evaluated on a quarterly basis. The Corporation considered the following factors in determining whether a credit loss exists and the period over which the debt security is expected to recover:

- The length of time and the extent to which the fair value has been less than the amortized cost basis;

- Any adverse change to the credit conditions and liquidity of the issuer, taking into consideration the latest information available about the financial condition of the issuer, credit ratings, the failure of the issuer to make scheduled principal or interest payments, recent legislation and government actions affecting the issuer's industry and actions taken by the issuer to deal with the present economic climate;

- Changes in the near term prospects of the underlying collateral of a security, if any, such as changes in default rates, loss severity given default, and significant changes in prepayment assumptions; and

- The level of cash flows generated from the underlying collateral, if any, supporting the principal and interest payments of the debt securities.

The Corporation recorded OTTI losses on available-for-sale debt securities as follows:

| | Quarter ended June 30, | | Six-Month Period Ended June 30, | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| (In thousands) | | | | |
| Total other-than-temporary impairment losses | $ - | $ (29,521) | $ (1,845) | $ (29,521) |
| Portion of other-than-temporary impairment recognized in OCI | - | 16,424 | (4,842) | 16,268 |
| Net impairment losses recognized in earnings (1) | $ - | $ (13,097) | $ (6,687) | $ (13,253) |

(1) For the first half of 2016 and 2015, approximately $6.3 million and $12.9 million, respectively, of the credit impairment recognized in earnings consisted of credit losses on Puerto Rico Government debt securities and $0.4 million and $0.6 million, respectively, was associated with credit losses on

| | |
|---|---|
| | private label MBS. |
| | |

The following tables summarize the roll-forward of credit losses on debt securities held by the Corporation for which a portion of an OTTI is recognized in OCI:

| | Cumulative OTTI credit losses recognized in earnings on securities still held | | | |
|---|---|---|---|---|
| | March 31, 2016 Balance | Credit impairments recognized in earnings on securities not previously impaired | Credit impairments recognized in earnings on securities that have been previously impaired | June 30, 2016 Balance |
| (In thousands) | | | | |
| Available-for-sale securities | | | | |
| Puerto Rico Government obligations | $ 22,189 | $ - | $ - | $ 22,189 |
| Private label MBS | 6,792 | - | - | 6,792 |
| Total OTTI credit losses for available-for-sale debt securities | $ 28,981 | $ - | $ - | $ 28,981 |

| | Cumulative OTTI credit losses recognized in earnings on securities still held | | | |
|---|---|---|---|---|
| | December 31, 2015 Balance | Credit impairments recognized in earnings on securities not previously impaired | Credit impairments recognized in earnings on securities that have been previously impaired | June 30, 2016 Balance |
| (In thousands) | | | | |
| Available-for-sale securities | | | | |
| Puerto Rico Government obligations | $ 15,889 | $ - | $ 6,300 | $ 22,189 |
| Private label MBS | 6,405 | - | 387 | 6,792 |
| Total OTTI credit losses for available-for-sale debt securities | $ 22,294 | $ - | $ 6,687 | $ 28,981 |

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

| | Cumulative OTTI credit losses recognized in earnings on securities still held | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | March 31, 2015 Balance | | Credit impairments recognized in earnings on securities not previously impaired | | Credit impairments recognized in earnings on securities that have been previously impaired | | June 30, 2015 Balance | |
| (In thousands) | | | | | | | | |
| Available-for-sale securities | | | | | | | | |
| Puerto Rico Government obligations | $ | - | $ | 12,856 | $ | - | $ | 12,856 |
| Private label MBS | | 5,933 | | - | | 241 | | 6,174 |
| Total OTTI credit losses for available-for-sale debt securities | $ | 5,933 | $ | 12,856 | $ | 241 | $ | 19,030 |

| | Cumulative OTTI credit losses recognized in earnings on securities still held | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | December 31, 2014 Balance | | Credit impairments recognized in earnings on securities not previously impaired | | Credit impairments recognized in earnings on securities that have been previously impaired | | June 30, 2015 Balance | |
| (In thousands) | | | | | | | | |
| Available-for-sale securities | | | | | | | | |
| Puerto Rico Government obligations | $ | - | $ | 12,856 | $ | - | $ | 12,856 |
| Private label MBS | | 5,777 | | - | | 397 | | 6,174 |
| Total OTTI credit losses for available-for-sale debt securities | $ | 5,777 | $ | 12,856 | $ | 397 | $ | 19,030 |

In the first quarter of 2016, the Corporation recorded a $6.3 million OTTI charge on three Puerto Rico Government debt securities held by the Corporation as part of its available-for-sale securities portfolio, specifically bonds of the GDB maturing on February 1, 2019 and the Puerto Rico Public Buildings Authority maturing on July 1, 2028. This was the third OTTI charge on these securities recorded since June 30, 2015, as OTTI charges of $12.9 million and $3.0 million were booked in the second and fourth quarters of 2015, respectively, and reduced the amortized cost basis of these three Puerto Rico Government debt securities to $34.7 million as of June 30, 2016 ($21.4 million of GDB bonds and $13.3 million of Puerto Rico Public Buildings Authority bonds).

During the first half of 2016, in consideration of the latest available information about the Puerto Rico Government's financial condition, including the enactment of a debt moratorium law and the declaration of a state of emergency at the GDB, the issuance of the GDB and the Commonwealth's audited financial statements, as well as issuance of exchange proposals with the Commonwealth's creditors related to its outstanding bond obligations, the Corporation applied a discounted cash flow analysis to its Puerto Rico Government debt securities in order to calculate the cash flows expected to be collected and to determine if any portion of the decline in market value of these securities was considered a credit-related other-than-temporary impairment. The analysis derives an estimate of value based on the present value of risk-adjusted cash flows of the underlying securities and included the following components:

- The contractual future cash flows of the bonds are projected based on the key terms as set forth in the official statements for each security. Such key terms include, among others, the interest rate, amortization schedule, if any, and maturity date.

- The risk-adjusted cash flows are calculated based on a probability of default analysis and recovery rate assumptions, including the weighting of different scenarios of ultimate recovery, considering the credit rating of each security. Constant monthly default rates are assumed throughout the life of the bonds, which considers the respective security's credit rating as of the date of the analysis.

- The adjusted future cash flows are then discounted at the original effective yield of each investment based on the purchase price and expected risk-adjusted future cash flows as of the purchase date of each investment.

The discounted risk-adjusted cash flow analysis for the three Puerto Rico Government bonds mentioned above assumed a default probability of 100%, thus reflecting that it is more likely than not that these three bonds will default during their remaining terms. Based on this analysis, the Corporation determined that it is unlikely to receive all of the remaining contractual interest and principal amounts when due on these bonds and recorded, in the first quarter of 2016, other-than-temporary credit-related impairment charges amounting to $6.3 million, assuming recovery rates ranging from 35% to 80% (weighted average of 61%). GDB defaulted on a $28 million payment of interest due to its creditors on August 1, 2016, including interest due on bonds held by the Corporation. As of June 30, 2016, the Corporation had $0.7 million of accrued interest receivable related to such bonds. The default marked the first time

the GDB failed to pay interest on bonds held by the Corporation.

The Corporation does not have the intention to sell these securities and has sufficient capital and liquidity to hold these securities until a recovery of the fair value occurs; as such, only the credit loss component was reflected in earnings. Given the significant and prolonged uncertainty of a debt restructuring process, the Corporation cannot be certain that future impairment charges will not be required against these securities.

In addition, during the first half of 2016, the Corporation recorded a $0.4 million credit-related impairment loss associated with private label MBS, which are collateralized by fixed-rate mortgages on single-family residential properties in the United States. The interest rates on these private-label MBS is variable, tied to 3-month LIBOR and limited to the weighted-average coupon of the underlying collateral. The underlying mortgages are fixed-rate, single-family loans with original high FICO scores (over 700) and moderate original loan-to-value ratios (under 80%), as well as moderate delinquency levels.

Based on the expected cash flows, and since the Corporation does not have the intention to sell the securities and has sufficient capital and liquidity to hold these securities until a recovery of the fair value occurs, only the credit loss component was reflected in earnings. Significant assumptions in the valuation of the private label MBS were as follows:

| | **June 30, 2016** | | | | **December 31, 2015** | | |
|---|---|---|---|---|---|---|---|
| | **Weighted Average** | | **Range** | | **Weighted Average** | | **Range** |
| Discount rate | 14.5% | | 14.5% | | 14.5% | | 14.5% |
| Prepayment rate | 31% | | 21.83% - 100% | | 28% | | 15.92% - 100.00% |
| Projected Cumulative Loss Rate | 7% | | 0.52% - 80% | | 7% | | 0.18% - 80.00% |

***Investments Held to Maturity***

The amortized cost, gross unrealized gains and losses, approximate fair value, weighted-average yield and contractual maturities of investment securities held to maturity as of June 30, 2016 and December 2015 were as follows:

| | June 30, 2016 | | | | |
|---|---|---|---|---|---|
| | Amortized cost | Gross Unrealized gains | Gross Unrealized losses | Fair value | Weighted average yield% |
| Puerto Rico Municipal Bonds: | | | | | |
| After 1 to 5 years | $ 1,371 | $ - | $ 20 | $ 1,351 | 5.38 |
| After 5 to 10 years | 11,382 | - | 728 | 10,654 | 4.23 |
| After 10 years | 148,589 | - | 22,629 | 125,960 | 4.64 |
| Total investment securities | | | | | |
| held to maturity | $ 161,342 | $ - | $ 23,377 | $ 137,965 | 4.62 |

| | December 31, 2015 | | | | |
|---|---|---|---|---|---|
| | Amortized cost | Gross Unrealized gains | Gross Unrealized losses | Fair value | Weighted average yield% |
| Puerto Rico Municipal Bonds: | | | | | |
| After 1 to 5 years | $ 1,371 | $ - | $ 37 | $ 1,334 | 5.38 |
| After 5 to 10 years | 11,523 | - | 1,041 | 10,482 | 4.25 |
| After 10 years | 148,589 | - | 28,861 | 119,728 | 4.64 |

| Total investment securities | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | held to maturity | $ | 161,483 | | $ | - | | $ | 29,939 | | $ | 131,544 | | 4.62 |
| | | | | | | | | | | | | | |

The following tables show the Corporation's held-to-maturity investments' fair value and gross unrealized losses, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, as of June 30, 2016 and December 31, 2015:

| | As of June 30, 2016 | | | | | |
|---|---|---|---|---|---|---|
| | Less than 12 months | | 12 months or more | | Total | |
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| | (In thousands) | | | | | |
| **Debt securities:** | | | | | | |
| Puerto Rico Municipal Bonds | $ - | $ - | $ 137,965 | $ 23,377 | $ 137,965 | $ 23,377 |

| | As of December 31, 2015 | | | | | |
|---|---|---|---|---|---|---|
| | Less than 12 months | | 12 months or more | | Total | |
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| | (In thousands) | | | | | |
| **Debt securities:** | | | | | | |
| Puerto Rico Municipal Bonds | $ 4,163 | $ 140 | $ 127,381 | $ 29,799 | $ 131,544 | $ 29,939 |

Approximately 87% of the held-to-maturity municipal bonds were issued by five of the largest municipalities in Puerto Rico (San Juan, Carolina, Bayamon, Mayaguez and Guaynabo). These obligations typically are not issued in bearer form, nor are they registered with the SEC and are not rated by external credit agencies. In most cases, these bonds have priority over to the payment of operating costs and expenses of the municipality, which are required by law to levy special property taxes in such amounts as are required for the payment of all of their respective general obligation bonds and loans.

The Corporation determines the fair market value of Puerto Rico Municipal Bonds based on a discounted cash flow analysis using risk-adjusted discount rates. A security with similar characteristics traded in the open market is used as a proxy for each municipal bond. Then the cash flow is discounted at the average spread over the discount curve exhibited by the proxy security at the end of each quarter.

When evaluating if the decrease in fair value could be classified as other-than-temporary, management considered aspects such as the fact that all municipalities are current on their payments and the fact that the bonds are subject to periodic credit reviews and are supported by assigned property tax revenues.

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

Based on the quarterly analysis performed and the circumstances discussed above, management concluded that the unrealized loss is attributable to the time value of money and liquidity assumptions and no individual municipal bond was other-than-temporarily impaired as of June 30, 2016.

**NOTE 5 – OTHER EQUITY SECURITIES**

Institutions that are members of the FHLB system are required to maintain a minimum investment in FHLB stock. Such minimum investment is calculated as a percentage of aggregate outstanding mortgages, and an additional investment is required that is calculated as a percentage of total FHLB advances, letters of credit, and the collateralized portion of interest-rate swaps outstanding. The stock is capital stock issued at $100 par value. Both stock and cash dividends may be received on FHLB stock.

As of June 30, 2016 and December 31, 2015, the Corporation had investments in FHLB stock with a book value of $31.1 million and $31.3 million, respectively. The net realizable value is a reasonable proxy for the fair value of these instruments. Dividend income from FHLB stock for the quarters ended June 30, 2016 and 2015 was $0.4 million and $0.3 million, respectively, and for the six-month periods ended June 30, 2016 and 2015 was $0.7 million and $0.6 million, respectively.

The shares of FHLB stock owned by the Corporation were issued by the FHLB of New York. The FHLB of New York is part of the Federal Home Loan Bank System, a national wholesale banking network of 12 regional, stockholder-owned congressionally chartered banks. The Federal Home Loan Banks are all privately capitalized and operated by their member stockholders. The system is supervised by the Federal Housing Finance Agency, which ensures that the Federal Home Loan Banks operate in a financially safe and sound manner, remain adequately capitalized and able to raise funds in the capital markets, and carry out their housing finance mission.

The Corporation has other equity securities that do not have a readily available fair value. The carrying value of such securities as of June 30, 2016 and December 31, 2015 was $1.2 million and $0.9 million, respectively.

**NOTE 6 – LOANS HELD FOR INVESTMENT**

The following table provides information about the loan portfolio held for investment:

| | | As of<br>June 30, | | As of<br>December 31, |
|---|---|---|---|---|
| | | **2016** | | **2015** |
| (In thousands) | | | | |

| | | | | |
|---|---|---|---|---|
| Residential mortgage loans, mainly secured by first mortgages | $ | 3,323,844 | $ | 3,344,719 |
| Commercial loans: | | | | |
| Construction loans | | 137,406 | | 156,195 |
| Commercial mortgage loans | | 1,523,676 | | 1,537,806 |
| Commercial and Industrial loans (1) | | 2,133,623 | | 2,246,513 |
| Total commercial loans | | 3,794,705 | | 3,940,514 |
| Finance leases | | 230,025 | | 229,165 |
| Consumer loans | | 1,522,173 | | 1,597,984 |
| Loans held for investment | | 8,870,747 | | 9,112,382 |
| Allowance for loan and lease losses | | (234,454) | | (240,710) |
| Loans held for investment, net | $ | 8,636,293 | $ | 8,871,672 |

(1) As of June 30, 2016 and December 31, 2015, includes $1.0 billion of commercial loans that are secured by real estate but are not dependent upon the real estate for repayment.

Loans held for investment on which accrual of interest income had been discontinued as of the indicated dates were as follows:

| (In thousands) | | June 30, 2016 | | December 31, 2015 |
|---|---|---|---|---|
| Non-performing loans: | | | | |
| Residential mortgage | $ | 164,399 | $ | 169,001 |
| Commercial mortgage | | 200,376 | | 51,333 |
| Commercial and Industrial | | 154,405 | | 137,051 |
| Construction: | | | | |
| Land | | 11,889 | | 12,174 |
| Construction-commercial | | 38,607 | | 39,466 |
| Construction-residential | | 2,053 | | 2,996 |
| Consumer: | | | | |
| Auto loans | | 14,260 | | 17,435 |
| Finance leases | | 2,111 | | 2,459 |
| Other consumer loans | | 10,094 | | 10,858 |
| Total non-performing loans held for investment (1)(2)(3) | $ | 598,194 | $ | 442,773 |

(1) As of June 30, 2016 and December 31, 2015, excludes $8.1 million of non-performing loans held for sale.

(2) Amount excludes purchased-credit impaired ("PCI") loans with a carrying value of approximately $169.7 million and $173.9 million as of June 30, 2016 and December 31, 2015, respectively, primarily mortgage loans acquired from Doral Bank in the first quarter of 2015 and from Doral Financial in the second quarter of 2014, as further discussed below. These loans are not considered non-performing due to the application of the accretion method, under which these loans will accrete interest income over the remaining life of the loans using an estimated cash flow analysis.

(3) Non-performing loans exclude $421.0 million and $414.9 million of Troubled Debt Restructuring ("TDR")loans that are in compliance with modified terms and in accrual status as of June 30, 2016 and December 31, 2015, respectively.

***Loans in Process of Foreclosure***

As of June 30, 2016, the recorded investment of residential mortgage loans collateralized by residential real estate property that are in the process of foreclosure amounted to $144.1 million. The Corporation commences the foreclosure process on residential real estate loans when a borrower becomes 120 days delinquent in accordance with the guidelines of the Consumer Financial Protection Bureau (CFPB). Foreclosure procedures and timelines vary depending on whether the property is located in a judicial or non-judicial state. Judicial states (Puerto Rico) require the foreclosure to be processed through the state's court while foreclosures in non-judicial states are processed without court intervention. Foreclosure timelines vary according to state law and Investor Guidelines. Occasionally, foreclosures may be delayed due to mandatory mediations, bankruptcy proceedings, court delays and title issues, among other reasons.

25

---

The Corporation's aging of the loans held for investment portfolio is as follows:

| **As of June 30, 2016** (In thousands) | **30-59 Days Past Due** | **60-89 Days Past Due** | **90 days or more Past Due (1)** | **Total Past Due** | **Purchased Credit-Impaired Loans** | **Current** | **Total loans held for investment** | **90 days past due and still accruing (2)** |
|---|---|---|---|---|---|---|---|---|
| Residential mortgage: | | | | | | | | |
| FHA/VA and other government-guaranteed loans (2) (3) (4) | $ - | $ 6,143 | $ 83,638 | $ 89,781 | $ - | $ 46,045 | $ 135,826 | $ 83,638 |
| Other residential mortgage loans (4) | - | 87,083 | 181,962 | 269,045 | 166,556 | 2,752,417 | 3,188,018 | 17,563 |
| Commercial: | | | | | | | | |
| Commercial and Industrial loans | 2,169 | 522 | 158,425 | 161,116 | - | 1,972,507 | 2,133,623 | 4,020 |
| Commercial mortgage loans (4) | - | 1,354 | 207,885 | 209,239 | 3,134 | 1,311,303 | 1,523,676 | 7,509 |
| Construction: | | | | | | | | |
| Land (4) | - | 351 | 12,188 | 12,539 | - | 21,764 | 34,303 | 299 |
| Construction-commercial (4) | - | - | 38,607 | 38,607 | - | 48,591 | 87,198 | - |
| Construction-residential | - | - | 2,053 | 2,053 | - | 13,852 | 15,905 | - |

| (4) | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Consumer: | | | | | | | | |
| Auto loans | 62,121 | 13,969 | 14,260 | 90,350 | - | 784,136 | 874,486 | - |
| Finance leases | 8,379 | 2,607 | 2,111 | 13,097 | - | 216,928 | 230,025 | - |
| Other consumer loans | 9,146 | 6,275 | 14,340 | 29,761 | - | 617,926 | 647,687 | 4,246 |
| Total loans held for investment | $ 81,815 | $ 118,304 | $ 715,469 | $ 915,588 | $ 169,690 | $ 7,785,469 | $ 8,870,747 | $ 117,275 |

(1) Includes non-performing loans and accruing loans which are contractually delinquent 90 days or more (i.e., FHA/VA guaranteed loans and credit cards). Credit card loans continue to accrue finance charges and fees until charged-off at 180 days.

(2) 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 $31.7 million of residential mortgage loans insured by the FHA or guaranteed by the VA, which are over 15 months delinquent, and are no longer accruing interest as of June 30, 2016.

(3) As of June 30, 2016, includes $44.8 million of defaulted loans collateralizing Government National Mortgage Association ("GNMA") securities for which the Corporation has an unconditional option (but not an obligation) to repurchase the defaulted loans.

(4) According to the Corporation's delinquency policy and consistent with the instructions for the preparation of the Consolidated Financial Statements for Bank Holding Companies (FR Y-9C) required by the Federal Reserve Board, residential mortgage, commercial mortgage, and construction loans are considered past due when the borrower is in arrears two or more monthly payments. FHA/VA government guaranteed loans, other residential mortgage loans, commercial mortgage loans, and land loans past due 30-59 days as of June 30, 2016 amounted to $10.0 million, $149.7 million, $21.8 million, and $1.0 million, respectively.

| **As of December 31, 2015** | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| (In thousands) | **30-59 Days Past Due** | **60-89 Days Past Due** | **90 days or more Past Due (1)** | **Total Past Due** | **Purchased Credit-Impaired Loans** | **Current** | **Total loans held for investment** | **90 days past due and still accruing (2)** |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Residential mortgage: | | | | | | | |
| FHA/VA and other government-guaranteed loans (2) (3) (4) | $ - | $ 6,048 | $ 90,168 | $ 96,216 | $ - | $ 46,925 | $ 143,141 | $ 90,168 |
| Other residential mortgage loans (4) | - | 90,406 | 185,018 | 275,424 | 170,766 | 2,755,388 | 3,201,578 | 16,017 |
| Commercial: | | | | | | | | |
| Commercial and Industrial loans | 5,577 | 6,412 | 150,893 | 162,882 | - | 2,083,631 | 2,246,513 | 13,842 |
| Commercial mortgage loans (4) | - | 24,729 | 63,805 | 88,534 | 3,147 | 1,446,125 | 1,537,806 | 12,472 |
| Construction: | | | | | | | | |
| Land (4) | - | 161 | 12,350 | 12,511 | - | 39,363 | 51,874 | 176 |
| Construction-commercial | - | 11,722 | 39,466 | 51,188 | - | 32,142 | 83,330 | - |
| Construction-residential (4) | - | - | 6,042 | 6,042 | - | 14,949 | 20,991 | 3,046 |
| Consumer: | | | | | | | | |
| Auto loans | 70,836 | 16,787 | 17,435 | 105,058 | - | 829,922 | 934,980 | - |
| Finance leases | 7,664 | 3,100 | 2,459 | 13,223 | - | 215,942 | 229,165 | - |
| Other consumer loans | 9,462 | 5,524 | 15,124 | 30,110 | - | 632,894 | 663,004 | 4,266 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Total loans held for investment | $ 93,539 | $ 164,889 | $ 582,760 | $ 841,188 | $ 173,913 | $ 8,097,281 | $ 9,112,382 | $ 139,987 |

(1) Includes non-performing loans and accruing loans which are contractually delinquent 90 days or more (i.e. FHA/VA guaranteed loans and credit cards). Credit card loans continue to accrue finance charges and fees until charged-off at 180 days.

(2) 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 $37.3 million of residential mortgage loans insured by the FHA or guaranteed by the VA, which are over 15 months delinquent, and are no longer accruing interest as of December 31, 2015.

(3) As of December 31, 2015, includes $37.3 million of defaulted loans collateralizing GNMA securities for which the Corporation has an unconditional option (but not an obligation) to repurchase the defaulted loans.

(4) According to the Corporation's delinquency policy and consistent with the instructions for the preparation of the Consolidated Financial Statements for Bank Holding Companies (FR Y-9C) required by the Federal Reserve Board, residential mortgage, commercial mortgage, and construction loans are considered past due when the borrower is in arrears two or more monthly payments. FHA/VA government guaranteed loans, other residential mortgage loans, commercial mortgage loans, land loans and construction-residential loans past due 30-59 days as of December 31, 2015 amounted to $11.0 million, $162.9 million, $38.6 million, $5.7 million and $0.8 million, respectively.

The Corporation's credit quality indicators by loan type as of June 30, 2016 and December 31, 2015 are summarized below:

| | Commercial Credit Exposure-Credit Risk Profile Based on Creditworthiness Category: | | | | |
|---|---|---|---|---|---|
| **June 30, 2016** | **Substandard** | **Doubtful** | **Loss** | **Total Adversely Classified (1)** | **Total Portfolio** |
| (In thousands) | | | | | |
| Commercial mortgage | $ 200,815 | $ 51,487 | $ - | $ 252,302 | $ 1,523,676 |
| Construction: | | | | | |
| Land | 13,592 | - | - | 13,592 | 34,303 |
| Construction-commercial | 38,607 | - | - | 38,607 | 87,198 |
| Construction-residential | 2,053 | - | - | 2,053 | 15,905 |
| Commercial and Industrial | 187,686 | 72,036 | 478 | 260,200 | 2,133,623 |

| | Commercial Credit Exposure-Credit Risk Profile Based on Creditworthiness Category: | | | | |
|---|---|---|---|---|---|
| **December 31, 2015** | **Substandard** | **Doubtful** | **Loss** | **Total Adversely Classified (1)** | **Total Portfolio** |
| (In thousands) | | | | | |
| Commercial mortgage | $ 252,941 | $ 140 | $ - | $ 253,081 | $ 1,537,806 |
| Construction: | | | | | |
| Land | 14,035 | 1 | - | 14,036 | 51,874 |
| Construction-commercial | 39,466 | - | - | 39,466 | 83,330 |
| Construction-residential | 2,996 | - | - | 2,996 | 20,991 |
| Commercial and Industrial | 140,827 | 71,341 | 354 | 212,522 | 2,407,996 |

(1) Excludes $8.1 million as of June 30, 2016 and December 31, 2015, of construction-land non-performing loans held for sale.

The Corporation considers a loan as adversely classified if its risk rating is Substandard, Doubtful or Loss. These categories are defined as follows:

Substandard- A Substandard asset is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Doubtful- Doubtful classifications have all the weaknesses inherent in those classified Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions and values, highly questionable and improbable. A Doubtful classification may be appropriate in cases where significant risk exposures are perceived, but loss cannot be determined because of specific reasonable pending factors which may strengthen the credit in the near term.

Loss- Assets classified Loss are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather that it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be affected in the future. There is little or no prospect for near term improvement and no realistic strengthening action of significance pending.

| | Consumer Credit Exposure-Credit Risk Profile based on Payment activity | | | |
|---|---|---|---|---|---|
| | Residential Real Estate | | Consumer | | |
| June 30, 2016 | FHA/VA/ Guaranteed (1) | Other residential loans | Auto | Finance Leases | Other Consumer |
| (In thousands) | | | | | |
| Performing | $ 135,826 | $ 2,857,063 | $ 860,226 | $ 227,914 | $ 637,593 |
| Purchased Credit-Impaired (2) | - | 166,556 | - | - | - |
| Non-performing | - | 164,399 | 14,260 | 2,111 | 10,094 |
| Total | $ 135,826 | $ 3,188,018 | $ 874,486 | $ 230,025 | $ 647,687 |

(1) It is the Corporation's policy to report delinquent residential mortgage loans insured by the FHA or guaranteed by the VA as past due loans 90 days and still accruing as opposed to non-performing loans since the principal repayment is insured. These balances include $31.7 million of residential mortgage loans insured by the FHA or guaranteed by the VA, which are over 15 months delinquent, and are no longer accruing interest as of June 30, 2016.

(2) PCI loans are excluded from non-performing statistics due to the application of the accretion method, under which these loans will accrete interest income over the remaining life of the loans using estimated cash flow analysis.

| | Consumer Credit Exposure-Credit Risk Profile based on Payment activity | | | | |
|---|---|---|---|---|---|
| | Residential Real Estate | | Consumer | | |
| December 31, 2015 | FHA/VA/ Guaranteed (1) | Other residential loans | Auto | Finance Leases | Other Consumer |
| (In thousands) | | | | | |
| Performing | $ 143,141 | $ 2,861,811 | $ 917,545 | $ 226,706 | $ 652,146 |
| Purchased Credit-Impaired (2) | - | 170,766 | - | - | - |
| Non-performing | - | 169,001 | 17,435 | 2,459 | 10,858 |
| Total | $ 143,141 | $ 3,201,578 | $ 934,980 | $ 229,165 | $ 663,004 |

(1) It is the Corporation's policy to report delinquent residential mortgage loans insured by the FHA or guaranteed by the VA as past due loans 90 days and still accruing as opposed to non-performing loans since the principal repayment is insured. These balances include $37.3 million of residential mortgage loans insured by the FHA or guaranteed by the VA, which are over 15 months delinquent, and are no longer accruing interest as of December 31, 2015.

(2) PCI loans are excluded from non-performing statistics due to the application of the accretion method, under which these loans will accrete interest income over the remaining life of the loans using estimated cash flow analysis.

28

The following tables present information about impaired loans, excluding PCI loans, which are reported separately, as discussed below:

| **Impaired Loans** | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| (In thousands) | | | | | | | | |
| | | | | | **Quarter ended** | | **Six-month Period Ended** | |
| | | | | | **June 30, 2016** | | | |
| | **Recorded Investment** | **Unpaid Principal Balance** | **Related Specific Allowance** | **Year-To-Date Average Recorded Investment** | **Interest Income Recognized on Accrual Basis** | **Interest Income Recognized on Cash Basis** | **Interest Income Recognized on Accrual Basis** | **Interest Income Recognized on Cash Basis** |
| **As of June 30, 2016** | | | | | | | | |
| **With no related allowance recorded:** | | | | | | | | |
| FHA/VA-Guaranteed loans | $ - | $ - | $ - | $ - | $ - | $ - | $ - | $ - |
| Other residential mortgage loans | 58,474 | 69,873 | - | 60,041 | 153 | 102 | 241 | 194 |
| Commercial: | | | | | | | | |
| Commercial mortgage loans | 44,639 | 54,226 | - | 45,243 | 278 | 123 | 509 | 258 |
| Commercial and Industrial Loans | 13,812 | 17,131 | - | 14,008 | 37 | - | 37 | - |
| Construction: | | | | | | | | |
| Land | - | - | - | - | - | - | - | - |
| Construction-commercial | 38,607 | 40,000 | - | 39,037 | - | - | - | - |
| Construction-residential | 956 | 1,531 | - | 956 | - | - | - | - |
| Consumer: | | | | | | | | |
| Auto loans | 2 | 2 | - | 3 | - | - | - | - |
| Finance leases | 14 | 14 | - | 15 | - | - | - | - |
| Other consumer loans | 3,303 | 4,430 | - | 3,500 | 5 | 34 | 17 | 72 |
| | $ 159,807 | $ 187,207 | $ - | $ 162,803 | $ 473 | $ 259 | $ 804 | $ 524 |
| **With an allowance recorded:** | | | | | | | | |
| FHA/VA-Guaranteed loans | $ - | $ - | $ - | $ - | $ - | $ - | $ - | $ - |
| | 393,806 | 444,389 | 11,972 | 399,060 | 4,706 | 249 | 9,311 | 570 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Other residential mortgage loans | | | | | | | | |
| Commercial: | | | | | | | | |
| Commercial mortgage loans | 166,709 | 174,843 | 40,071 | 167,614 | 96 | 31 | 202 | 270 |
| Commercial and Industrial Loans | 183,556 | 210,474 | 27,750 | 187,504 | 629 | 59 | 1,157 | 88 |
| Construction: | | | | | | | | |
| Land | 9,261 | 13,451 | 991 | 9,314 | 8 | 16 | 20 | 27 |
| Construction-commercial | - | - | - | - | - | - | - | - |
| Construction-residential | 392 | 551 | 123 | 392 | - | - | - | - |
| Consumer: | | | | | | | | |
| Auto loans | 24,369 | 24,369 | 3,669 | 25,518 | 470 | - | 936 | - |
| Finance leases | 2,298 | 2,298 | 57 | 2,467 | 55 | - | 105 | - |
| Other consumer loans | 13,576 | 13,944 | 1,739 | 14,106 | 362 | 7 | 713 | 17 |
| | $ 793,967 | $ 884,319 | $ 86,372 | $ 805,975 | $ 6,326 | $ 362 | $ 12,444 | $ 972 |
| **Total:** | | | | | | | | |
| FHA/VA-Guaranteed loans | $ - | $ - | $ - | $ - | $ - | $ - | $ - | $ - |
| Other residential mortgage loans | 452,280 | 514,262 | 11,972 | 459,101 | 4,859 | 351 | 9,552 | 764 |
| Commercial: | | | | | | | | |
| Commercial mortgage loans | 211,348 | 229,069 | 40,071 | 212,857 | 374 | 154 | 711 | 528 |
| Commercial and Industrial Loans | 197,368 | 227,605 | 27,750 | 201,512 | 666 | 59 | 1,194 | 88 |
| Construction: | | | | | | | | |
| Land | 9,261 | 13,451 | 991 | 9,314 | 8 | 16 | 20 | 27 |
| Construction-commercial | 38,607 | 40,000 | - | 39,037 | - | - | - | - |
| Construction-residential | 1,348 | 2,082 | 123 | 1,348 | - | - | - | - |
| Consumer: | | | | | | | | |
| Auto loans | 24,371 | 24,371 | 3,669 | 25,521 | 470 | - | 936 | - |
| Finance leases | 2,312 | 2,312 | 57 | 2,482 | 55 | - | 105 | - |
| Other consumer loans | 16,879 | 18,374 | 1,739 | 17,606 | 367 | 41 | 730 | 89 |
| | $ 953,774 | $ 1,071,526 | $ 86,372 | $ 968,778 | $ 6,799 | $ 621 | $ 13,248 | $ 1,496 |



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

| (In thousands) | Recorded Investment | Unpaid Principal Balance | Related Specific Allowance | Average Recorded Investment |
|---|---|---|---|---|
| **As of December 31, 2015** | | | | |
| **With no related allowance recorded:** | | | | |
| FHA/VA-Guaranteed loans | $ - | $ - | $ - | $ - |
| Other residential mortgage loans | 65,495 | 74,146 | - | 67,282 |
| Commercial: | | | | |
| Commercial mortgage loans | 54,048 | 66,448 | - | 54,967 |
| Commercial and Industrial Loans | 27,492 | 29,957 | - | 28,326 |
| Construction: | | | | |
| Land | - | - | - | - |
| Construction-commercial | 39,466 | 40,000 | - | 39,736 |
| Construction-residential | 3,046 | 3,046 | - | 3,098 |
| Consumer: | | | | |
| Auto loans | - | - | - | - |
| Finance leases | - | - | - | - |
| Other consumer loans | 2,618 | 4,300 | - | 2,766 |
| | $ 192,165 | $ 217,897 | $ - | $ 196,175 |
| **With an allowance recorded:** | | | | |
| FHA/VA-Guaranteed loans | $ - | $ - | $ - | $ - |
| Other residential mortgage loans | 395,173 | 440,947 | 21,787 | 398,790 |
| Commercial: | | | | |
| Commercial mortgage loans | 27,479 | 40,634 | 3,073 | 30,518 |
| Commercial and Industrial Loans | 143,214 | 164,050 | 18,096 | 148,547 |
| Construction: | | | | |
| Land | 9,578 | 13,758 | 1,060 | 9,727 |
| Construction-commercial | - | - | - | - |
| Construction-residential | 1,426 | 2,180 | 142 | 1,476 |
| Consumer: | | | | |
| Auto loans | 21,581 | 21,581 | 6,653 | 23,531 |
| Finance leases | 2,077 | 2,077 | 86 | 2,484 |
| Other consumer loans | 13,816 | 14,043 | 1,684 | 14,782 |
| | $ 614,344 | $ 699,270 | $ 52,581 | $ 629,855 |
| **Total:** | | | | |
| FHA/VA-Guaranteed loans | $ - | $ - | $ - | $ - |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Other residential mortgage loans | | 460,668 | | 515,093 | | 21,787 | | 466,072 |
| Commercial: | | | | | | | | |
| Commercial mortgage loans | | 81,527 | | 107,082 | | 3,073 | | 85,485 |
| Commercial and Industrial Loans | | 170,706 | | 194,007 | | 18,096 | | 176,873 |
| Construction: | | | | | | | | |
| Land | | 9,578 | | 13,758 | | 1,060 | | 9,727 |
| Construction-commercial | | 39,466 | | 40,000 | | - | | 39,736 |
| Construction-residential | | 4,472 | | 5,226 | | 142 | | 4,574 |
| Consumer: | | | | | | | | |
| Auto loans | | 21,581 | | 21,581 | | 6,653 | | 23,531 |
| Finance leases | | 2,077 | | 2,077 | | 86 | | 2,484 |
| Other consumer loans | | 16,434 | | 18,343 | | 1,684 | | 17,548 |
| | $ | 806,509 | $ | 917,167 | $ | 52,581 | $ | 826,030 |

Interest income of approximately $8.9 million ($6.1 million accrual basis and $2.8 million cash basis) and $18.1 million ($12.1 million accrual basis and $6.0 million cash basis) was recognized on impaired loans for the second quarter and six-month period ended June 30, 2015, respectively.



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

The following tables show the activity for impaired loans and the related specific reserve for the quarters and six-month periods ended June 30, 2016 and 2015:

| | Quarter Ended June 30, | | | | Six-Month Period Ended June 30, | | | |
|---|---|---|---|---|---|---|---|---|
| (In thousands) | | 2016 | | 2015 | | 2016 | | 2015 |
| **Impaired Loans:** | | | | | | | | |
| Balance at beginning of period | $ | 917,591 | $ | 954,981 | $ | 806,509 | $ | 945,407 |
| Loans determined impaired during the period | | 76,947 | | 34,889 | | 234,931 | | 97,822 |
| Charge-offs (1) | | (11,249) | | (70,813) | | (19,601) | | (82,528) |
| Loans sold, net of charge-offs | | - | | (66,699) | | - | | (67,836) |
| Increases to impaired loans-additional disbursements | | 414 | | 1,597 | | 1,761 | | 2,116 |
| Foreclosures | | (9,189) | | (10,234) | | (16,610) | | (20,186) |
| Loans no longer considered impaired | | (4,547) | | (3,287) | | (24,886) | | (13,185) |
| Paid in full or partial payments | | (16,193) | | (15,618) | | (28,330) | | (36,794) |
| Balance at end of period | $ | 953,774 | $ | 824,816 | $ | 953,774 | $ | 824,816 |

(1) Includes $63.9 million of charge-offs related to a bulk sale of assets completed in the second quarter of 2015, mostly comprised of non-performing and adversely classified commercial loans, as further discussed below.

| | Quarter Ended June 30, | | | | Six-Month Period Ended June 30, | | | |
|---|---|---|---|---|---|---|---|---|
| (In thousands) | | 2016 | | 2015 | | 2016 | | 2015 |
| **Specific Reserve:** | | | | | | | | |
| Balance at beginning of period | $ | 81,495 | $ | 62,140 | $ | 52,581 | | 55,205 |
| Provision for loan losses | | 16,126 | | 53,707 | | 53,392 | | 72,357 |
| Net charge-offs | | (11,249) | | (65,929) | | (19,601) | | (77,644) |
| | $ | 86,372 | $ | 49,918 | $ | 86,372 | $ | 49,918 |

| Balance at end of period | | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | | | | | | | | |

**PCI Loans**

The Corporation acquired PCI loans accounted for under ASC 310-30 as part of the transaction closed on February 27, 2015 in which FirstBank acquired 10 Puerto Rico branches of Doral Bank, and acquired certain assets, including PCI loans, and assumed deposits, through an alliance with Banco Popular of Puerto Rico, which was the successful lead bidder with the FDIC on the failed Doral Bank, as well as other co-bidders. The Corporation also acquired PCI loans in previously completed asset acquisitions that are accounted for under ASC 310-30. These previous transactions include the acquisition from Doral Financial in the second quarter of 2014 of all its rights, title and interest in first and second residential mortgages loans in full satisfaction of secured borrowings owed by such entity to FirstBank, and the acquisition in 2012 of a FirstBank-branded credit card loans portfolio from FIA Card Services ("FIA").

Under ASC 310-30, the acquired PCI loans were aggregated into pools based on similar characteristics (i.e. delinquency status, loan terms). Each loan pool is accounted for as a single asset with a single composite interest rate and an aggregate expectation of cash flows. Since the loans are accounted for by the Corporation under ASC 310-30, they are not considered non-performing and will continue to have an accretable yield as long as there is a reasonable expectation about the timing and amount of cash flows expected to be collected. The Corporation recognizes additional losses on this portfolio when it is probable that the Corporation will be unable to collect all cash flows expected as of the acquisition date plus additional cash flows expected to be collected arising from changes in estimates after the acquisition date.

The carrying amount of PCI loans follows:

| | June 30, 2016 | | December 31, 2015 | |
|---|---|---|---|---|
| (In thousands) | | | | |
| Residential mortgage loans | $ | 166,556 | $ | 170,766 |
| Commercial mortgage loans | | 3,134 | | 3,147 |
| Total PCI loans | $ | 169,690 | $ | 173,913 |
| Allowance for loan losses | | (6,857) | | (3,962) |
| Total PCI loans, net of allowance for loan losses | $ | 162,833 | $ | 169,951 |

The following tables present PCI loans by past due status as of June 30, 2016 and December 31, 2015:

| As of June 30, 2016<br>(In thousands) | 30-59 Days | | 60-89 Days | | 90 days or more | | Total Past Due | | Current | | Total PCI loans | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | $ | - | $ | 12,354 | $ | 25,546 | $ | 37,900 | $ | 128,656 | $ | 166,556 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Residential mortgage loans (1) | | | | | | |
| Commercial mortgage loans (1) | - | - | 990 | 990 | 2,144 | 3,134 |
| | $ - | $ 12,354 | $ 26,536 | $ 38,890 | $ 130,800 | $ 169,690 |

(1) According to the Corporation's delinquency policy and consistent with the instructions for the preparation of the Consolidated Financial Statements for Bank Holding Companies (FR Y-9C) required by the Federal Reserve Board, residential mortgage and commercial mortgage loans are considered past due when the borrower is in arrears two or more monthly payments. PCI residential mortgage loans and commercial mortgage loans past due 30-59 days as of June 30, 2016 amounted to $22.2 million and $0.6 million, respectively.

| **As of December 31, 2015**<br>(In thousands) | **30-59 Days** | **60-89 Days** | **90 days or more** | **Total Past Due** | **Current** | **Total PCI loans** |
|---|---|---|---|---|---|---|
| Residential mortgage loans (1) | $ - | $ 16,094 | $ 22,218 | $ 38,312 | $ 132,454 | $ 170,766 |
| Commercial mortgage loans (1) | - | - | 992 | 992 | 2,155 | 3,147 |
| | $ - | $ 16,094 | $ 23,210 | $ 39,304 | $ 134,609 | $ 173,913 |

(1) According to the Corporation's delinquency policy and consistent with the instructions for the preparation of the Consolidated Financial Statements for Bank Holding Companies (FR Y-9C) required by the Federal Reserve Board, residential mortgage and commercial mortgage loans are considered past due when the borrower is in arrears two or more monthly payments. PCI residential mortgage loans past due 30-59 days as of December 31, 2015 amounted to $23.6 million.

*Initial Fair Value and Accretable Yield of PCI Loans*

At acquisition, the Corporation estimated the cash flows the Corporation expected to collect on PCI loans. Under the accounting guidance for PCI loans, the difference between the contractually required payments and the cash flows expected to be collected at acquisition is referred to as the non-accretable difference. This difference is neither accreted into income nor recorded on the Corporation’s consolidated statement of financial condition. The excess of cash flows expected to be collected over the estimated fair value is referred to as the accretable yield and is recognized in interest income over the remaining life of the loans, using the effective-yield method.

*Changes in accretable yield of acquired loans*

Subsequent to an acquisition of loans, the Corporation is required to periodically evaluate its estimate of cash flows expected to be collected. These evaluations, performed quarterly, require the continued use of key assumptions and estimates, similar to the initial estimate of fair value. Subsequent changes in the estimated cash flows expected to be collected may result in changes in the accretable yield and non-accretable difference or reclassifications from nonaccretable yield to accretable yield. Increases in the cash flows expected to be collected will generally result in an increase in interest income over the remaining life of the loan or pool of loans. Decreases in expected cash flows due to further credit deterioration will generally result in an impairment charge recognized in the Corporation’s provision for loan and lease losses, resulting in an increase to the allowance for loan losses. During the first half of 2016, the Corporation increased by $2.9 million to $6.9 million the reserve related to PCI loans acquired from Doral Financial in 2014. The reserve is driven by the revisions to the expected cash flows of the portfolio for the remaining term of the loan pool based on expected performance and market conditions.

Changes in the accretable yield of PCI loans for the quarters and six-month periods ended June 30, 2016 and 2015 were as follows:

| | **Quarter ended** | | **Six-month period ended** | |
|---|---|---|---|---|
| | **June 30, 2016** | **June 30, 2015** | **June 30, 2016** | **June 30, 2015** |
| (In thousands) | | | | |
| Balance at beginning of period | $ 114,098 | $ 118,502 | $ 118,385 | $ 82,460 |
| Additions (accretable yield at acquisition | | | | |
| of loans from Doral) | - | - | - | 38,319 |
| Accretion recognized in earnings | (2,927) | (3,007) | (5,816) | (5,284) |
| Reclassification from non-accretable | 11,008 | 8,793 | 9,610 | 8,793 |

| Balance at end of period | $ | 122,179 | | $ | 124,288 | | $ | 122,179 | | $ | 124,288 |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | | | | |

Changes in the carrying amount of loans accounted for pursuant to ASC 310-30 follows:

| | Quarter Ended | | Six-Month Period Ended | |
|---|---|---|---|---|
| | June 30, 2016 | June 30, 2015 | June 30, 2016 | June 30, 2015 |
| (In thousands) | | | | |
| Balance at beginning of period | $ 172,332 | $ 181,114 | $ 173,913 | $ 102,604 |
| Additions (1) | - | - | - | 79,889 |
| Accretion | 2,927 | 3,007 | 5,816 | 5,284 |
| Collections | (4,581) | (5,627) | (8,952) | (9,283) |
| Foreclosures | (988) | - | (1,087) | - |
| Ending balance | $ 169,690 | $ 178,494 | $ 169,690 | $ 178,494 |
| Allowance for loan losses | (6,857) | (3,164) | (6,857) | (3,164) |
| Ending balance, net of allowance for loan losses | $ 162,833 | $ 175,330 | $ 162,833 | $ 175,330 |

(1) For the six-month period ended June 30, 2015, additions represents the estimated fair value of PCI loans acquired from Doral Bank at the date of acquisition.

Changes in the allowance for loan losses related to PCI loans follows:

| | Quarter ended | | Six-month period ended | |
|---|---|---|---|---|
| | June 30, 2016 | June 30, 2015 | June 30, 2016 | June 30, 2015 |
| | (In thousands) | | | |
| Balance at beginning of period | $ 4,568 | $ - | $ 3,962 | $ - |
| Provision for loan losses | 2,289 | 3,164 | 2,895 | 3,164 |
| Balance at end of period | $ 6,857 | $ 3,164 | $ 6,857 | $ 3,164 |

The outstanding principal balance of PCI loans, including amounts charged off by the Corporation, amounted to $212.7 million as of June 30, 2016 (December 2015 - $218.1 million).

**Purchases and Sales of Loans**

During the first half of 2016, the Corporation purchased $42.1 million of residential mortgage loans consistent with a strategic program established by the Corporation in 2005 to purchase ongoing residential mortgage loan production from mortgage bankers in Puerto Rico. Generally, the loans purchased from mortgage bankers were conforming residential mortgage loans. Purchases of conforming residential mortgage loans provide the Corporation the flexibility

to retain or sell the loans, including through securitization transactions, depending upon the Corporation's interest rate risk management strategies. When the Corporation sells such loans, it generally keeps the servicing of the loans.

In the ordinary course of business, the Corporation sells residential mortgage loans (originated or purchased) to GNMA and government-sponsored entities ("GSEs") such as Fannie Mae ("FNMA") and Freddie Mac ("FHLMC"), which generally securitize the transferred loans into mortgage-backed securities for sale into the secondary market. The Corporation sold approximately $72.8 million of performing residential mortgage loans to FNMA and FHLMC during the first half of 2016. Also, during the first half of 2016, the Corporation sold $146.3 million of FHA/VA mortgage loans to GNMA, which packages them into mortgage-backed securities. The Corporation's continuing involvement in these loan sales consists primarily of servicing the loans. In addition, the Corporation agreed to repurchase loans when it breaches any of the representations and warranties included in the sale agreement. These representations and warranties are consistent with the GSEs' selling and servicing guidelines (i.e., ensuring that the mortgage was properly underwritten according to established guidelines).

For loans sold to GNMA, the Corporation holds an option to repurchase individual delinquent loans issued on or after January 1, 2003 when the borrower fails to make any payment for three consecutive months. This option gives the Corporation the ability, but not the obligation, to repurchase the delinquent loans at par without prior authorization from GNMA.

Under ASC Topic 860, *Transfer and Servicing*, once the Corporation has the unilateral ability to repurchase the delinquent loan, it is considered to have regained effective control over the loan and is required to recognize the loan and a corresponding repurchase liability on the balance sheet regardless of the Corporation's intent to repurchase the loan.

During the first half of 2016 and 2015, the Corporation repurchased pursuant to its repurchase option with GNMA $14.6 million and $6.3 million, respectively, of loans previously sold to GNMA. The principal balance of these loans is fully guaranteed and the risk of

loss related to the repurchased loans is generally limited to the difference between the delinquent interest payment advanced to GNMA computed at the loan's interest rate and the interest payments reimbursed by FHA, which are computed at a pre-determined debenture rate. Repurchases of GNMA loans allow the Corporation, among other things, to maintain acceptable delinquency rates on outstanding GNMA pools and remain as a seller and servicer in good standing with GNMA. The Corporation generally remediates any breach of representations and warranties related to the underwriting of such loans according to established GNMA guidelines without incurring losses. The Corporation does not maintain a liability for estimated losses as a result of breaches in representations and warranties.

Loan sales to FNMA and FHLMC are without recourse in relation to the future performance of the loans. The Corporation repurchased at par loans previously sold to FNMA and FHLMC in the amount of $0.7 million and $0.5 million during the first half of 2016 and 2015, respectively. The Corporation's risk of loss with respect to these loans is also minimal as these repurchased loans are generally performing loans with documentation deficiencies. No losses related to breaches of representations and warranties were incurred in the first half of 2016. Historically, losses experienced on these loans have been immaterial. As a consequence, as of June 30, 2016, the Corporation does not maintain a liability for estimated losses on loans expected to be repurchased as a result of breaches in loan and servicer representations and warranties.

**Bulk Sale of Assets**

During the second quarter of 2015, the Corporation completed the sale of commercial and construction loans with a book value of $147.5 million ($90.7 million of commercial mortgage loans, $45.8 million of commercial and industrial loans, and $11.0 million of construction loans), comprised mostly of non-performing and adversely classified loans, as well as other real estate owned ("OREO") with a book value of $2.9 million, in a cash transaction. The sales price of this bulk sale was $87.3 million. Approximately $15.3 million of reserves had been allocated to the loans. This transaction resulted in total charge-offs of $61.4 million and an incremental pre-tax loss of $48.7 million, including $0.9 million in professional service fees directly attributable to the bulk sale.

**Loan Portfolio Concentration**

The Corporation's primary lending area is Puerto Rico. The Corporation's banking subsidiary, First Bank, also lends in the USVI and BVI markets and in the United States (principally in the state of Florida). Of the total gross loans held for investment of $8.9 billion as of June 30, 2016, approximately 80% have credit risk concentration in Puerto Rico, 13% in the United States, and 7% in the USVI and BVI.

As of June 30, 2016, the Corporation had $145.9 million of credit facilities extended to the Puerto Rico government, its municipalities, and public corporations, of which $138.1million was outstanding (book value of

$131.7 million), compared to $153.2 million outstanding as of December 31, 2015. In addition, the outstanding balance of credit facilities granted to the government of the Virgin Islands amounted to $64.8 million as of June 30, 2016, compared to $126.2 million as of December 31, 2015. Approximately $91.9 million of the granted credit facilities outstanding ($85.6million book value) consisted of loans to public corporations, including a direct exposure to the Puerto Rico Electric Power Authority (“PREPA”) with a book value of $68.3 million as of June 30, 2016, and approximately $9.7 million consisted of loans to units of the Puerto Rico central government. The PREPA credit facility was placed in non-accrual status in the first quarter of 2015 and interest payments are recorded on a cost-recovery basis. In addition, the Corporation had $36.5 million of loans extended to municipalities in Puerto Rico, which in most cases are supported by assigned property tax revenues. Municipalities’ revenues are independent of the Puerto Rico central government. These municipalities are required by law to levy special property taxes in such amounts as are required for the payment of all of their respective general obligation bonds and loans. Late in 2015, the GDB and the Municipal Revenue Collection Center (CRIM) signed a deed of trust. Through this deed, the GDB, as fiduciary, is bound to keep the CRIM funds separate from any other deposits and must distribute the funds pursuant to the applicable law.

Furthermore, as of June 30, 2016, the Corporation had $127.3 million in financings to the hotel industry in Puerto Rico where the borrower and the operations of the underlying collateral are the primary sources of repayment and the Puerto Rico Tourism Development Fund (“TDF”) provides a secondary guarantee for payment performance, compared to $129.4 million as of December 31, 2015. This exposure, consisting of three facilities, was placed in non-accrual status and classified as impaired in the first quarter of 2016 and interest payments are now applied against principal. Approximately $1.0 million of interest payments received on loans guaranteed by the TDF since late March 2016 have been applied against principal. The TDF is a subsidiary of the GDB that facilitates private sector financings to Puerto Rico’s hotel industry. Recent developments related to the Puerto Rico government’s fiscal situation introduced additional uncertainty regarding the TDF’s ability to honor its guarantee, including the enactment of the Puerto Rico Emergency Moratorium and Financial Rehabilitation Act (“Act 21”), which gives Puerto Rico’s governor emergency powers to deal with Puerto Rico’s challenging fiscal situation, including the ability to declare a moratorium on all bonds and other payments. On June 30, 2016, pursuant to Act 21, the Puerto Rico governor ordered a moratorium on the payment of $780 million of the Puerto Rico Government’s general obligations and the debt of certain other instrumentalities due on July 1, 2016. This followed a default on the principal payment of $367 million of GDB notes due on May 1, 2016. Puerto Rico’s governor also issued an executive order intended to protect the GDB’s liquidity by allowing withdrawals only to fund necessary costs for essential services such as health, public safety and education services. Recently, the GDB defaulted on a $28 million payment of interest due to its creditors on August 1, 2016,

including interest due on GDB bonds held by the Corporation. The Corporation's collections of principal and interest from the TDF in the first half of 2016 amounted to $0.6 million compared to $5.3 million in the entire year 2015. These loans have been adversely classified since the third quarter of 2015.

The general reserve for commercial loans was increased in the fourth quarter of 2015 due to qualitative factors that stressed the historical loss rates applied to the Puerto Rico Government-related exposure, including the TDF-guaranteed portfolio. The migration of the loans guaranteed by the TDF to non-accrual status and impaired classification in the first quarter of 2016 did not result in a significant increase to the allowance for loan losses. As of June 30, 2016, the total reserve coverage ratio related to commercial loans extended to or guaranteed by the Puerto Rico Government (excluding municipalities) was 19.5%.

In addition, the Corporation had $122.7 million in indirect exposure to residential mortgage loans that are guaranteed by the Puerto Rico Housing Finance Authority. Residential mortgage loans guaranteed by the Puerto Rico Housing Finance Authority are secured by the underlying properties and the guarantees serve to cover shortfalls in collateral in the event of a borrower default. The Puerto Rico government guarantees up to $75 million of the principal insured by the mortgage loans insurance program. According to the most recently released audited financial statements of the Puerto Rico Housing Financing Authority, as of June 30, 2015, the Puerto Rico Housing Finance Authority's mortgage loans insurance program covered loans aggregating approximately $552 million. The regulations adopted by the Puerto Rico Housing Finance Authority require the establishment of adequate reserves to guarantee the solvency of the mortgage loans insurance fund. As of June 30, 2015, the Puerto Rico Housing Finance Authority had a restricted net position for such purposes of approximately $77.4 million.

The Corporation cannot predict at this time the impact that the current fiscal situation of the Commonwealth of Puerto Rico, including the payment defaults on certain bonds, the uncertainty about the debt restructuring process, and the various legislative and other measures adopted and to be adopted by the Puerto Rico government in response to such fiscal situation, will have on the Puerto Rico economy and on the Corporation's financial condition and results of operations.

**Troubled Debt Restructurings**

The Corporation provides homeownership preservation assistance to its customers through a loss mitigation program in Puerto Rico that is similar to the U.S. government's Home Affordable Modification Program guidelines. Depending upon the nature of borrowers' financial condition, restructurings or loan modifications through this program as well as other restructurings of individual commercial, commercial mortgage, construction, and residential mortgage loans in the U.S. mainland fit the definition of a TDR. A restructuring of a debt constitutes a TDR if the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not

otherwise consider. Modifications involve changes in one or more of the loan terms that bring a defaulted loan current and provide sustainable affordability. Changes may include the refinancing of any past-due amounts, including interest and escrow, the extension of the maturity of the loan and modifications of the loan rate. As of June 30, 2016, the Corporation's total TDR loans held for investment of $671.0 million consisted of $381.8 million of residential mortgage loans, $160.9 million of commercial and industrial loans, $45.0 million of commercial mortgage loans, $41.7 million of construction loans, and $41.7 million of consumer loans. Outstanding unfunded commitments on TDR loans amounted to $8.0 million as of June 30, 2016.

The Corporation's loss mitigation programs for residential mortgage and consumer loans can provide for one or a combination of the following: movement of interest past due to the end of the loan, extension of the loan term, deferral of principal payments and reduction of interest rates either permanently or for a period of up to four years (increasing back in step-up rates). Additionally, in certain cases, the restructuring may provide for the forgiveness of contractually due principal or interest. Uncollected interest is added to the end of the loan term at the time of the restructuring and not recognized as income until collected or when the loan is paid off. These programs are available only to those borrowers who have defaulted, or are likely to default, permanently on their loan and would lose their homes in a foreclosure action absent some lender concession. Nevertheless, if the Corporation is not reasonably assured that the borrower will comply with its contractual commitment, properties are foreclosed.

Prior to permanently modifying a loan, the Corporation may enter into trial modifications with certain borrowers. Trial modifications generally represent a six-month period during which the borrower makes monthly payments under the anticipated modified payment terms prior to a formal modification. Upon successful completion of a trial modification, the Corporation and the borrower enter into a permanent modification. TDR loans that are participating in or that have been offered a binding trial modification are classified as TDRs when the trial offer is made and continue to be classified as TDRs regardless of whether the borrower enters into a permanent modification. As of June 30, 2016, we classified an additional $8.3 million of residential mortgage loans as TDRs that were participating in or had been offered a trial modification.

For the commercial real estate, commercial and industrial, and construction loan portfolios, at the time of a restructuring, the Corporation determines, on a loan-by-loan basis, whether a concession was granted for economic or legal reasons related to the borrower's financial difficulty. Concessions granted for commercial loans could include: reductions in interest rates to rates that are considered below market; extension of repayment schedules and maturity dates beyond original contractual terms; waivers of borrower covenants; forgiveness of principal or interest; or other contractual changes that would be considered a concession. The Corporation mitigates loan defaults for its commercial loan portfolios through its collection function. The function's objective is to

minimize both early stage delinquencies and losses upon default of commercial loans. In the case of the commercial and industrial, commercial mortgage, and construction loan portfolios, the Corporation's Special Asset Group ("SAG") focuses on strategies for the accelerated reduction of non-performing assets through note sales, short sales, loss mitigation programs, and sales of OREO. In addition to the management of the resolution process for problem loans, the SAG oversees collection efforts for all loans to prevent migration to the non-performing and/or adversely classified status. The SAG utilizes relationship officers, collection specialists, and attorneys. In the case of residential construction projects, the workout function monitors project specifics, such as project management and marketing, as deemed necessary. The SAG utilizes its collections infrastructure of workout collection officers, credit work-out specialists, in-house legal counsel, and third-party consultants. In the case of residential construction projects and large commercial loans, the SAG function also utilizes third-party specialized consultants to monitor the residential and commercial construction projects in terms of construction, marketing and sales, and to assist with the restructuring of large commercial loans.

In addition, the Corporation extends, renews, and restructures loans with satisfactory credit profiles. Many commercial loan facilities are structured as lines of credit, which are mainly one year in term and, therefore, are required to be renewed annually. Other facilities may be restructured or extended from time to time based upon changes in the borrower's business needs, use of funds, timing of completion of projects, and other factors. If the borrower is not deemed to have financial difficulties, extensions, renewals, and restructurings are done in the normal course of business and are not considered to be concessions, and the loans continue to be recorded as performing.

Selected information on TDRs that includes the recorded investment by loan class and modification type is summarized in the following tables. This information reflects all TDRs:

| | June 30, 2016 | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| (In thousands) | | **Interest rate below market** | | **Maturity or term extension** | | **Combination of reduction in interest rate and extension of maturity** | | **Forgiveness of principal and/or interest** | | **Other (1)** | | **Total** |
| Troubled Debt Restructurings: | | | | | | | | | | | | |
| Non-FHA/VA Residential Mortgage loans | $ | 29,727 | $ | 7,750 | $ | 291,870 | $ | - | $ | 52,411 | $ | 381,758 |
| Commercial Mortgage Loans | | 5,846 | | 1,227 | | 25,227 | | - | | 12,729 | | 45,029 |
| Commercial and Industrial Loans | | 2,185 | | 71,285 | | 27,972 | | 3,009 | | 56,413 | | 160,864 |
| Construction Loans: | | | | | | | | | | | | |
| Land | | - | | 226 | | 2,153 | | - | | 325 | | 2,704 |

| | Interest rate below market | Maturity or term extension | Combination of reduction in interest rate and extension of maturity | Forgiveness of principal and/or interest | Other (1) | Total |
|---|---|---|---|---|---|---|
| Construction-commercial | - | - | - | 38,607 | - | 38,607 |
| Construction-residential | - | - | - | - | 357 | 357 |
| Consumer Loans - Auto | - | 2,049 | 14,246 | - | 8,075 | 24,370 |
| Finance Leases | - | 431 | 1,881 | - | - | 2,312 |
| Consumer Loans - Other | 347 | 1,775 | 10,667 | 274 | 1,927 | 14,990 |
| Total Troubled Debt Restructurings | $ 38,105 | $ 84,743 | $ 374,016 | $ 41,890 | $ 132,237 | $ 670,991 |

(1) Other concessions granted by the Corporation include deferral of principal and/or interest payments for a period longer than what would be considered insignificant, payment plans under judicial stipulation or a combination of the concessions listed in the table.

| | December 31, 2015 | | | | | |
|---|---|---|---|---|---|---|
| (In thousands) | **Interest rate below market** | **Maturity or term extension** | **Combination of reduction in interest rate and extension of maturity** | **Forgiveness of principal and/or interest** | **Other (1)** | **Total** |
| Troubled Debt Restructurings: | | | | | | |
| Non-FHA/VA Residential Mortgage loans | $ 29,066 | $ 6,027 | $ 297,310 | $ - | $ 50,269 | $ 382,672 |
| Commercial Mortgage Loans | 4,379 | 1,244 | 26,109 | - | 12,766 | 44,498 |
| Commercial and Industrial Loans | 2,163 | 75,104 | 27,214 | 3,027 | 42,746 | 150,254 |
| Construction Loans: | | | | | | |
| Land | - | 229 | 2,165 | - | 372 | 2,766 |
| Construction-commercial | - | - | - | 39,466 | - | 39,466 |
| Construction-residential | - | - | 3,046 | - | 436 | 3,482 |
| Consumer Loans - Auto | - | 2,330 | 12,388 | - | 6,864 | 21,582 |
| Finance Leases | - | 621 | 1,456 | - | - | 2,077 |
| Consumer Loans - Other | 89 | 1,604 | 11,026 | 327 | 1,748 | 14,794 |
| Total Troubled Debt Restructurings | $ 35,697 | $ 87,159 | $ 380,714 | $ 42,820 | $ 115,201 | $ 661,591 |

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

(1) Other concessions granted by the Corporation include deferral of principal and/or interest payments for a period longer than what would be considered insignificant, payment plans under judicial stipulation or a combination of the concessions listed in the table.

The following table presents the Corporation's TDR loans activity:

| (In thousands) | Quarter Ended June 30, 2016 | Quarter Ended June 30, 2015 | Six-Month Period Ended June 30, 2016 | Six-Month Period Ended June 30, 2015 |
|---|---|---|---|---|
| Beginning balance of TDRs | $ 659,104 | $ 705,123 | $ 661,591 | $ 694,453 |
| New TDRs | 34,260 | 34,195 | 50,479 | 65,796 |
| Increases to existing TDRs - additional disbursements | 355 | - | 1,056 | 335 |
| Charge-offs post modification (1) | (4,632) | (49,599) | (10,454) | (53,380) |
| Sales, net of charge-offs | - | (44,048) | - | (44,048) |
| Foreclosures | (4,579) | (3,096) | (7,400) | (10,252) |
| Removed from the TDR classification | (3,031) | - | (3,031) | - |
| Paid-off and partial payments | (10,486) | (7,814) | (21,250) | (18,143) |
| Ending balance of TDRs | $ 670,991 | $ 634,761 | $ 670,991 | $ 634,761 |

(1) Includes $45.3 million of charge offs related to TDRs included in the bulk sale of assets completed in the second quarter of 2015.

TDR loans are classified as either accrual or nonaccrual loans. Loans in accrual status may remain in accrual status when their contractual terms have been modified in a TDR if the loan had demonstrated performance prior to the restructuring and payment in full under the restructured terms is expected. Otherwise, loans on non-accrual 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 loan being returned to accrual status 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 non-accrual loan. Loan modifications increase the Corporation's interest income by returning a non-performing loan to performing status, if applicable, increase cash flows by providing for payments to be made by the borrower, and limit increases in foreclosure and OREO costs. The Corporation continues to consider a modified loan as an impaired loan for purposes of estimating the allowance for loan and lease losses. A TDR loan that specifies an interest rate that at the time of the restructuring is greater than or equal to the rate the Corporation is willing to accept for a new loan with comparable risk may not be reported as a TDR, or an impaired loan in the calendar years subsequent to the restructuring, if it is in compliance with its modified terms. During the first half of 2016, the Corporation removed a $3.0 million loan from the TDR classification as the borrower is no longer experiencing financial difficulties and the loan was refinanced at market terms and does not contain any concession to the borrower.

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

The following table provides a breakdown between accrual and nonaccrual status of TDR loans:

| (In thousands) | As of June 30, 2016 | | | | | |
|---|---|---|---|---|---|---|
| | Accrual | | Nonaccrual (1) | | Total TDRs | |
| Non-FHA/VA Residential Mortgage loans | $ | 301,318 | $ | 80,440 | $ | 381,758 |
| Commercial Mortgage Loans | | 29,915 | | 15,114 | | 45,029 |
| Commercial and Industrial Loans | | 57,991 | | 102,873 | | 160,864 |
| Construction Loans: | | | | | | |
| Land | | 909 | | 1,795 | | 2,704 |
| Construction-commercial | | - | | 38,607 | | 38,607 |
| Construction-residential | | - | | 357 | | 357 |
| Consumer Loans - Auto | | 16,320 | | 8,050 | | 24,370 |
| Finance Leases | | 2,244 | | 68 | | 2,312 |
| Consumer Loans - Other | | 12,275 | | 2,715 | | 14,990 |
| Total Troubled Debt Restructurings | $ | 420,972 | $ | 250,019 | $ | 670,991 |

(1) Included in non-accrual loans are $120.3 million in loans that are performing under the terms of the restructuring agreement but are reported in non-accrual status until the restructured loans meet the criteria of sustained payment performance under the revised terms for reinstatement to accrual status and are deemed fully collectible.

| (In thousands) | As of December 31, 2015 | | | | | |
|---|---|---|---|---|---|---|
| | Accrual | | Nonaccrual (1) | | Total TDRs | |
| Non- FHA/VA Residential Mortgage loans | $ | 303,885 | $ | 78,787 | $ | 382,672 |
| Commercial Mortgage Loans | | 29,121 | | 15,377 | | 44,498 |
| Commercial and Industrial Loans | | 48,392 | | 101,862 | | 150,254 |
| Construction Loans: | | | | | | |
| Land | | 924 | | 1,842 | | 2,766 |
| Construction-commercial | | - | | 39,466 | | 39,466 |
| Construction-residential | | 3,046 | | 436 | | 3,482 |
| Consumer Loans - Auto | | 14,823 | | 6,759 | | 21,582 |
| Finance Leases | | 1,980 | | 97 | | 2,077 |
| Consumer Loans - Other | | 12,737 | | 2,057 | | 14,794 |
| Total Troubled Debt Restructurings | $ | 414,908 | $ | 246,683 | $ | 661,591 |

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

| (1) | Included in non-accrual loans are $118.2 million in loans that are performing under the terms of the restructuring agreement but are reported in non-accrual status until the restructured loans meet the criteria of sustained payment performance under the revised terms for reinstatement to accrual status and there is no doubt about full collectability. |
|---|---|

TDR loans exclude restructured residential mortgage loans that are guaranteed by the U.S. federal government (i.e., FHA/VA loans) totaling $70.9 million as of June 30, 2016 (December 31, 2015 - $77.6 million). The Corporation excludes FHA/VA guaranteed loans from TDR loans statistics given that, in the event that the borrower defaults on the loan, the principal and interest (at the specified debenture rate) are guaranteed by the U.S. government; therefore, the risk of loss on these types of loans is very low. The Corporation does not consider loans with U.S. federal government guarantees to be impaired loans for the purpose of calculating the allowance for loan and lease losses.

Loan modifications that are considered TDRs completed during the quarter and six-month period ended June 30, 2016 and 2015 were as follows:

| (Dollars in thousands) | **Quarter ended June 30, 2016** | | | | | |
|---|---|---|---|---|---|---|
| | **Number of contracts** | | **Pre-modification Outstanding Recorded Investment** | | **Post-Modification Outstanding Recorded Investment** | |
| Troubled Debt Restructurings: | | | | | | |
| Non-FHA/VA Residential Mortgage loans | 54 | $ | 7,397 | $ | 7,132 | |
| Commercial Mortgage Loans | 3 | | 2,672 | | 2,668 | |
| Commercial and Industrial Loans | 19 | | 20,261 | | 20,261 | |
| Consumer Loans - Auto | 165 | | 2,718 | | 2,718 | |
| Finance Leases | 12 | | 242 | | 242 | |
| Consumer Loans - Other | 269 | | 1,222 | | 1,239 | |
| Total Troubled Debt Restructurings | 522 | $ | 34,512 | $ | 34,260 | |
| | | | | | | |
| (Dollars in thousands) | **Six-Month period ended June 30, 2016** | | | | | |
| | **Number of contracts** | | **Pre-modification Outstanding Recorded Investment** | | **Post-Modification Outstanding Recorded Investment** | |
| Troubled Debt Restructurings: | | | | | | |
| Non-FHA/VA Residential Mortgage loans | 112 | $ | 16,409 | $ | 15,591 | |
| Commercial Mortgage Loans | 3 | | 2,672 | | 2,668 | |
| Commercial and Industrial Loans | 19 | | 20,261 | | 20,261 | |
| Consumer Loans - Auto | 423 | | 7,699 | | 7,699 | |
| Finance Leases | 48 | | 1,182 | | 1,182 | |
| Consumer Loans - Other | 605 | | 3,043 | | 3,078 | |
| Total Troubled Debt Restructurings | 1,210 | $ | 51,266 | $ | 50,479 | |

40

| (Dollars in thousands) | Quarter ended June 30, 2015 | | | | |
|---|---|---|---|---|---|
| | Number of contracts | Pre-modification Outstanding Recorded Investment | | Post-Modification Outstanding Recorded Investment | |
| Troubled Debt Restructurings: | | | | | |
| Non-FHA/VA Residential Mortgage loans | 171 | $ | 28,647 | $ | 27,136 |
| Commercial Mortgage Loans | 1 | | 131 | | 131 |
| Commercial and Industrial Loans | 2 | | 1,316 | | 898 |
| Construction Loans: | | | | | |
| Land | 5 | | 430 | | 427 |
| Consumer Loans - Auto | 198 | | 3,214 | | 3,137 |
| Finance Leases | 16 | | 461 | | 454 |
| Consumer Loans - Other | 355 | | 2,015 | | 2,012 |
| Total Troubled Debt Restructurings | 748 | $ | 36,214 | $ | 34,195 |

| (Dollars in thousands) | Six-Month period ended June 30, 2015 | | | | |
|---|---|---|---|---|---|
| | Number of contracts | Pre-modification Outstanding Recorded Investment | | Post-Modification Outstanding Recorded Investment | |
| Troubled Debt Restructurings: | | | | | |
| Non-FHA/VA Residential Mortgage loans | 252 | $ | 40,142 | $ | 38,401 |
| Commercial Mortgage Loans | 9 | | 12,952 | | 13,062 |
| Commercial and Industrial Loans | 3 | | 2,997 | | 2,579 |
| Construction Loans: | | | | | |
| Land | 6 | | 494 | | 491 |
| Consumer Loans - Auto | 344 | | 5,387 | | 5,267 |
| Finance Leases | 24 | | 694 | | 638 |
| Consumer Loans - Other | 732 | | 5,406 | | 5,358 |
| Total Troubled Debt Restructurings | 1,370 | $ | 68,072 | $ | 65,796 |

Recidivism, or the borrower defaulting on its obligation pursuant to a modified loan, results in the loan once again becoming a non-performing loan. Recidivism occurs at a notably higher rate than do defaults on new origination loans, so modified loans present a higher risk of loss than do new origination loans. The Corporation considers a loan to have defaulted if the borrower has failed to make payments of either principal, interest, or both for a period of 90 days or more.

Loan modifications considered TDR loans that defaulted during the quarters and six-month periods ended June 30, 2016 and June 30, 2015 and had become TDR during the 12-months preceding the default date were as follows:

| | Quarter ended June 30, | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| (Dollars in thousands) | 2016 | | | | | 2015 | | |
| | Number of contracts | | Recorded Investment | | | Number of contracts | | Recorded Investment |
| Non-FHA/VA Residential Mortgage loans | 10 | | $ | 1,178 | | 15 | $ | 2,129 |
| Commercial Mortgage Loans | - | | | - | | - | | - |
| Commercial and Industrial Loans | - | | | - | | - | | - |
| Construction Loans: | | | | | | | | |
| Land | - | | | - | | - | | - |
| Construction-commercial | - | | | - | | - | | - |
| Construction-residential | - | | | - | | - | | - |
| Consumer Loans - Auto | 31 | | | 498 | | 5 | | 32 |
| Consumer Loans - Other | 34 | | | 116 | | 37 | | 141 |
| Finance Leases | - | | | - | | 2 | | 25 |
| Total | 75 | | $ | 1,792 | | 59 | $ | 2,327 |

| | Six-Month Period Ended June 30, | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| (Dollars in thousands) | 2016 | | | | | 2015 | | |
| | Number of contracts | | Recorded Investment | | | Number of contracts | | Recorded Investment |
| Non-FHA/VA Residential Mortgage loans | 21 | | $ | 3,156 | | 27 | $ | 3,902 |
| Commercial Mortgage Loans | - | | | - | | - | | - |
| Commercial and Industrial Loans | - | | | - | | 4 | | 5,745 |
| Construction Loans: | | | | | | | | |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Land | - | | | - | | - | | | - |
| Construction-commercial | - | | | - | | - | | | - |
| Construction-residential | - | | | - | | - | | | - |
| Consumer Loans - Auto | 40 | | | 634 | | 7 | | | 40 |
| Consumer Loans - Other | 67 | | | 246 | | 90 | | | 370 |
| Finance Leases | 1 | | | 13 | | 3 | | | 40 |
| Total | 129 | | $ | 4,049 | | 131 | | $ | 10,097 |
| | | | | | | | | | |
| | | | | | | | | | |

For certain TDR loans, the Corporation splits the loans into two new notes, A and B notes. The A note is restructured to comply with the Corporation's lending standards at current market rates, and is tailored to suit the customer's ability to make timely interest and principal payments. The B note includes the granting of the concession to the borrower and varies by situation. The B note is charged off but the obligation is not forgiven to the borrower, and any payments collected are accounted for as recoveries. At the time of the restructuring, the A note is identified and classified as a TDR loan. If the loan performs for at least six months according to the modified terms, the A note may be returned to accrual status. The borrower's payment performance prior to the restructuring is included in assessing whether the borrower can meet the new terms and may result in the loan being returned to accrual status at the time of the restructuring. In the periods following the calendar year in which a loan was restructured, the A note may no longer be reported as a TDR loan if it is in accrual status, is in compliance with its modified terms, and yields a market rate (as determined and documented at the time of the restructuring).

The recorded investment in loans held for investment restructured using the A/B note restructure workout strategy was approximately $38.3 million as of June 30, 2016. The following table provides additional information about the volume of this type of loan restructuring and the effect on the allowance for loan and lease losses in the first six months of 2016 and 2015:

| (In thousands) | June 30, 2016 | | | | June 30, 2015 |
|---|---|---|---|---|---|
| Principal balance deemed collectible at end of period | $ | 38,259 | | $ | 41,000 |
| Amount charged off | $ | - | | $ | - |
| Charges (reductions) to the provision for loan losses | $ | 1,948 | | $ | (62) |
| Allowance for loan losses at end of period | $ | 2,809 | | $ | 669 |

Of the loans comprising the $38.3 million that have been deemed collectible, approximately $38.1 million were placed in accrual status as the borrowers have exhibited a period of sustained performance. These loans continue to be individually evaluated for impairment purposes.

**NOTE 7 – ALLOWANCE FOR LOAN AND LEASE LOSSES**

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

| (In thousands) | Residential Mortgage Loans | Commercial Mortgage Loans | Commercial & Industrial Loans | Construction Loans | Consumer Loans | Total |
|---|---|---|---|---|---|---|
| **Quarter ended June 30, 2016** | | | | | | |
| **Allowance for loan and lease losses:** | | | | | | |
| Beginning balance | $ 38,548 | $ 68,744 | $ 71,098 | $ 3,013 | $ 56,722 | $ 238,125 |
| Charge-offs | (11,532) | (1,437) | (1,914) | (513) | (12,970) | (28,366) |
| Recoveries | 841 | 33 | 676 | 144 | 2,015 | 3,709 |
| Provision (release) | 11,098 | 2,459 | (71) | 103 | 7,397 | 20,986 |
| Ending balance | $ 38,955 | $ 69,799 | $ 69,789 | $ 2,747 | $ 53,164 | $ 234,454 |
| Ending balance: specific reserve for impaired loans | $ 11,972 | $ 40,071 | $ 27,750 | $ 1,114 | $ 5,465 | $ 86,372 |
| Ending balance: purchased credit-impaired loans (1) | $ 6,638 | $ 219 | $ - | $ - | $ - | $ 6,857 |
| Ending balance: general allowance | $ 20,345 | $ 29,509 | $ 42,039 | $ 1,633 | $ 47,699 | $ 141,225 |
| **Loans held for investment:** | | | | | | |
| Ending balance | $ 3,323,844 | $ 1,523,676 | $ 2,133,623 | $ 137,406 | $ 1,752,198 | $ 8,870,747 |
| Ending balance: impaired loans | $ 452,280 | $ 211,348 | $ 197,368 | $ 49,216 | $ 43,562 | $ 953,774 |

| (In thousands) | Residential Mortgage Loans | Commercial Mortgage Loans | Commercial & Industrial Loans | Construction Loans | Consumer Loans | Total |
|---|---|---|---|---|---|---|
| Ending balance: purchased credit-impaired loans | $ 166,556 | $ 3,134 | $ - | $ - | $ - | $ 169,690 |
| Ending balance: loans with general allowance | $ 2,705,008 | $ 1,309,194 | $ 1,936,255 | $ 88,190 | $ 1,708,636 | $ 7,747,283 |

| (In thousands) | Residential Mortgage Loans | Commercial Mortgage Loans | Commercial & Industrial Loans | Construction Loans | Consumer Loans | Total |
|---|---|---|---|---|---|---|
| **Six-Month period ended June 30, 2016** | | | | | | |
| **Allowance for loan and lease losses:** | | | | | | |
| Beginning balance | $ 39,570 | $ 68,211 | $ 68,768 | $ 3,519 | $ 60,642 | $ 240,710 |
| Charge-offs | (18,838) | (2,012) | (5,673) | (604) | (27,774) | (54,901) |
| Recoveries | 1,187 | 79 | 956 | 161 | 4,223 | 6,606 |
| Provision (release) | 17,036 | 3,521 | 5,738 | (329) | 16,073 | 42,039 |
| Ending balance | $ 38,955 | $ 69,799 | $ 69,789 | $ 2,747 | $ 53,164 | $ 234,454 |
| Ending balance: specific reserve for impaired loans | $ 11,972 | $ 40,071 | $ 27,750 | $ 1,114 | $ 5,465 | $ 86,372 |
| Ending balance: purchased credit-impaired loans (1) | $ 6,638 | $ 219 | $ - | $ - | $ - | $ 6,857 |
| Ending balance: general allowance | $ 20,345 | $ 29,509 | $ 42,039 | $ 1,633 | $ 47,699 | $ 141,225 |
| **Loans held for investment:** | | | | | | |
| Ending balance | $ 3,323,844 | $ 1,523,676 | $ 2,133,623 | $ 137,406 | $ 1,752,198 | $ 8,870,747 |
| Ending balance: | $ 452,280 | $ 211,348 | $ 197,368 | $ 49,216 | $ 43,562 | $ 953,774 |

| impaired loans | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Ending balance: purchased credit-impaired loans | $ | 166,556 | $ | 3,134 | $ | - | $ | - | $ | - | $ | 169,690 |
| Ending balance: loans with general allowance | $ | 2,705,008 | $ | 1,309,194 | $ | 1,936,255 | $ | 88,190 | $ | 1,708,636 | $ | 7,747,283 |

(1) Refer to Note 6 - Loans Held for Investment -PCI loans for a detail of changes in the allowance for loan losses related to PCI loans.

| (In thousands) | Residential Mortgage Loans | Commercial Mortgage Loans | Commercial & Industrial Loans | Construction Loans | Consumer Loans | Total |
|---|---|---|---|---|---|---|
| **Quarter ended June 30, 2015** | | | | | | |
| **Allowance for loan and lease losses:** | | | | | | |
| Beginning balance | $ 28,682 | $ 45,027 | $ 70,179 | $ 13,639 | $ 68,537 | $ 226,064 |
| Charge-offs | (3,529) | (46,432) | (24,370) | (4,079) | (14,538) | (92,948) |
| Recoveries | 272 | 6,219 | 2,501 | 1,996 | 3,148 | 14,136 |
| Provision | 8,358 | 44,278 | 15,590 | 309 | 5,731 | 74,266 |
| Ending balance | $ 33,783 | $ 49,092 | $ 63,900 | $ 11,865 | $ 62,878 | $ 221,518 |
| Ending balance: specific reserve for impaired loans | $ 17,136 | $ 6,711 | $ 15,510 | $ 2,256 | $ 8,305 | $ 49,918 |
| Ending balance: purchased credit-impaired loans | $ 3,061 | $ 102 | $ - | $ - | $ - | $ 3,163 |
| Ending balance: general allowance | $ 13,586 | $ 42,279 | $ 48,390 | $ 9,609 | $ 54,573 | $ 168,437 |
| **Loans held for investment:** | | | | | | |
| Ending balance | $ 3,327,350 | $ 1,518,151 | $ 2,185,701 | $ 120,848 | $ 1,899,215 | $ 9,051,265 |
| Ending balance: impaired loans | $ 447,311 | $ 130,743 | $ 183,119 | $ 26,190 | $ 37,453 | $ 824,816 |
| Ending balance: purchased credit-impaired loans | $ 175,234 | $ 3,260 | $ - | $ - | $ - | $ 178,494 |
| Ending balance: loans | $ 2,704,805 | $ 1,384,148 | $ 2,002,582 | $ 94,658 | $ 1,861,762 | $ 8,047,955 |

| with general allowance | | | | | | |
|---|---|---|---|---|---|---|
| (In thousands) | **Residential Mortgage Loans** | **Commercial Mortgage Loans** | **Commercial & Industrial Loans** | **Construction Loans** | **Consumer Loans** | **Total** |
| **Six-Month period ended June 30, 2015** | | | | | | |
| **Allowance for loan and lease losses:** | | | | | | |
| Beginning balance | $ 27,301 | $ 50,894 | $ 63,721 | $ 12,822 | $ 67,657 | $ 222,395 |
| Charge-offs | (8,721) | (50,438) | (28,823) | (4,684) | (32,295) | (124,961) |
| Recoveries | 370 | 6,495 | 3,059 | 2,203 | 4,721 | 16,848 |
| Provision | 14,833 | 42,141 | 25,943 | 1,524 | 22,795 | 107,236 |
| Ending balance | $ 33,783 | $ 49,092 | $ 63,900 | $ 11,865 | $ 62,878 | $ 221,518 |
| Ending balance: specific reserve for impaired loans | $ 17,136 | $ 6,711 | $ 15,510 | $ 2,256 | $ 8,305 | $ 49,918 |
| Ending balance: purchased credit-impaired loans | $ 3,061 | $ 102 | $ - | $ - | $ - | $ 3,163 |
| Ending balance: general allowance | $ 13,586 | $ 42,279 | $ 48,390 | $ 9,609 | $ 54,573 | $ 168,437 |
| **Loans held for investment:** | | | | | | |
| Ending balance | $ 3,327,350 | $ 1,518,151 | $ 2,185,701 | $ 120,848 | $ 1,899,215 | $ 9,051,265 |
| Ending balance: impaired loans | $ 447,311 | $ 130,743 | $ 183,119 | $ 26,190 | $ 37,453 | $ 824,816 |
| Ending balance: purchased credit-impaired loans | $ 175,234 | $ 3,260 | $ - | $ - | $ - | $ 178,494 |
| Ending | $ 2,704,805 | $ 1,384,148 | $ 2,002,582 | $ 94,658 | $ 1,861,762 | $ 8,047,955 |

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

| balance: loans with general allowance | | | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | | | | | | | | | |
| | | | | | | | | | | | | | | | |

As discussed in Note 6, under the heading “Bulk Sale of Assets,” during the second quarter of 2015, the Corporation completed the sale of commercial and construction loans with a book value of $147.5 million, mostly comprised of non-performing and adversely classified loans. This transaction resulted in charge-offs of approximately $61.4 million. The inclusion of the $61.4 million of charge-offs from the bulk sale in the historical loss rates had an impact of approximately $15.5 million on the general reserve for loan losses determined for loans collectively evaluated for impairment.

The Corporation incorporated the charge-offs information from the second quarter 2015 bulk sale in its measurement of credit impairment for loans collectively measured. The total bulk sale charge offs were included in the determination of historical loss rates with no reduction for the additional market discount related to the bulk sale resolution; in the past, the Corporation had separated the market component of the loss. The decision to include total charge-offs, with no qualitative adjustment for the steep discount on this bulk sale, considered the potential use of similar credit resolution strategies in the future in light of the current economic conditions in Puerto Rico. The effect of this position resulted in an increase of $15.5 million in the related allowance in the second quarter of 2015.

As of June 30, 2016, the Corporation maintained a $1.1million reserve for unfunded loan commitments ($0.5 million as of June 30, 2015) mainly related to an outstanding floor plan relationship. The reserve for unfunded loan commitments is an estimate of the losses inherent in off-balance sheet loan commitments to borrowers that are experiencing financial difficulties at the balance sheet date. It is calculated by multiplying an estimated loss factor by an estimated probability of funding, and then by the period-end amounts for unfunded commitments. The reserve for unfunded loan commitments is included as part of accounts payable and other liabilities in the consolidated statement of financial condition.

**NOTE 8 – LOANS HELD FOR SALE**

The Corporation's loans held-for-sale portfolio was composed of:

| (In thousands) | June 30, 2016 | | December 31, 2015 | |
|---|---|---|---|---|
| Residential mortgage loans | $ | 29,879 | $ | 27,734 |
| Construction loans | | 8,079 | | 8,135 |
| Total | $ | 37,958 | $ | 35,869 |

Non-performing loans held for sale totaled $8.1million as of June 30, 2016 and December 31, 2015.

**NOTE 9 – OTHER REAL ESTATE OWNED**

The following table presents OREO inventory as of the dates indicated:

| (In thousands) | June 30, 2016 | | December 31, 2015 | |
|---|---|---|---|---|
| **OREO** | | | | |
| OREO balances, carrying value: | | | | |
| Residential (1) | $ | 42,913 | $ | 43,563 |
| Commercial | | 82,054 | | 87,849 |
| Construction | | 14,192 | | 15,389 |
| Total | $ | 139,159 | $ | 146,801 |

(1) Excludes $13.0 million and $8.9 million as of June 30, 2016 and December 31, 2015, respectively, of foreclosures that meet the conditions of ASC 310-40 and are presented as a receivable (other assets) in the statement of financial condition.

**NOTE 10 – DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES**

One of the market risks facing the Corporation is interest rate risk, which includes the risk that changes in interest rates will result in changes in the value of the Corporation's assets or liabilities and the risk that net interest income from its loan and investment portfolios will be adversely affected by changes in interest rates. The overall objective of the Corporation's interest rate risk management activities is to reduce the variability of earnings caused by changes in interest rates.

The Corporation designates a derivative as a fair value hedge, cash flow hedge or economic undesignated hedge when it enters into the derivative contract. As of June 30, 2016 and December 31, 2015, all derivatives held by the Corporation were considered economic undesignated hedges. These undesignated hedges are recorded at fair value with the resulting gain or loss recognized in current earnings.

The following summarizes the principal derivative activities used by the Corporation in managing interest rate risk:

*Interest rate cap agreements* - Interest rate cap agreements provide the right to receive cash if a reference interest rate rises above a contractual rate. The value increases as the reference interest rate rises. The Corporation enters into interest rate cap agreements for protection from rising interest rates.

*Forward Contracts* - Forward contracts are sales of to-be-announced ("TBA") mortgage-backed securities that will settle over the standard delivery date and do not qualify as "regular way" security trades. Regular-way security trades are contracts that have no net settlement provision and no market mechanism to facilitate net settlement and that provide for delivery of a security within the time frame generally established by regulations or conventions in the market place or exchange in which the transaction is being executed. The forward sales are considered derivative instruments that need to be marked to market. These securities are used to economically hedge the FHA/VA residential mortgage loan securitizations of the mortgage-banking operations. Unrealized gains (losses) are recognized as part of mortgage banking activities in the consolidated statement of income.

To satisfy the needs of its customers, the Corporation may enter into non-hedging transactions. On these transactions, generally, the Corporation generally participates as a buyer in one of the agreements and as a seller in the other agreement under the same terms and conditions.

In addition, the Corporation enters into certain contracts with embedded derivatives that do not require separate accounting as these are clearly and closely related to the economic characteristics of the host contract. When the embedded derivative possesses economic characteristics that are not clearly and closely related to the economic characteristics of the host contract, it is bifurcated, carried at fair value, and designated as a trading or non-hedging derivative instrument.

The following table summarizes the notional amounts of all derivative instruments:

| | Notional Amounts (1) | | | | |
|---|---|---|---|---|---|
| | As of June 30, 2016 | | | As of December 31, 2015 | |
| | (In thousands) | | | | |
| **Undesignated economic hedges:** | | | | | |
| Interest rate contracts: | | | | | |
| Written interest rate cap agreements | $ | 91,510 | | $ | 120,816 |
| Purchased interest rate cap agreements | | 91,510 | | | 120,816 |
| Forward Contracts: | | | | | |
| Sale of TBA GNMA MBS pools | | 33,000 | | | 30,000 |
| | $ | 216,020 | | $ | 271,632 |

(1) Notional amounts are presented on a gross basis with no netting of offsetting exposure positions.

The following table summarizes the fair value of derivative instruments and the location in the statement of financial condition as of the indicated dates:

| | Asset Derivatives | | | | | | | Liability Derivatives | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Statement of Financial Condition Location | | June 30, 2016 Fair Value | | | December 31, 2015 Fair Value | | | Statement of Financial Condition Location | | June 30, 2016 Fair Value | | | December 31, 2015 Fair Value |
| (In thousands) | | | | | | | | | | | | | | |
| **Undesignated economic hedges:** | | | | | | | | | | | | | | |
| Interest rate contracts: | | | | | | | | | | | | | | |
| | | $ | - | | $ | - | | | | $ | 217 | | $ | 798 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Written interest rate cap agreements | Other assets | | | Accounts payable and other liabilities | | |
| Purchased interest rate cap agreements | Other assets | 212 | 806 | Accounts payable and other liabilities | - | - |
| Forward Contracts: | | | | | | |
| Sales of TBA GNMA MBS pools | Other assets | - | - | Accounts payable and other liabilities | 359 | 123 |
| | | $ 212 | $ 806 | | $ 576 | $ 921 |

The following table summarizes the effect of derivative instruments on the statement of income:

| | | Gain (or Loss) | | Gain (or Loss) | |
|---|---|---|---|---|---|
| | **Location of Gain or (loss)** | **Quarter Ended** | | **Six-Month Period Ended** | |
| | **Recognized in Income on** | **June 30,** | | **June 30,** | |
| (In thousands) | **Derivatives** | **2016** | **2015** | **2016** | **2015** |
| **Undesignated economic hedges:** | | | | | |
| Interest rate contracts: | | | | | |
| Written and purchased interest rate cap agreements | Interest income - Loans | $ (3) | $ - | $ (7) | $ - |
| Forward contracts: | | | | | |
| Sales of TBA GNMA MBS pools | Mortgage banking activities | (87) | 254 | (236) | 182 |
| Total (loss) gain on derivatives | | $ (90) | $ 254 | $ (243) | $ 182 |

Derivative instruments are subject to market risk. As is the case with investment securities, the market value of derivative instruments is largely a function of the financial market's expectations regarding the future direction of interest rates. Accordingly, current market values are not necessarily indicative of the future impact of derivative instruments on earnings. This will depend, for the most part, on the shape of the yield curve, the level of interest rates, as well as the expectations for rates in the future.

**NOTE 11 – OFFSETTING OF ASSETS AND LIABILITIES**

The Corporation enters into master agreements with counterparties, primarily related to derivatives and repurchase agreements that may allow for netting of exposures in the event of default. In an event of default, each party has a right of set-off against the other party for amounts owed under the related agreement and any other amount or obligation owed in respect of any other agreement or transaction between them. The following table presents information about the offsetting of financial assets and liabilities as well as derivative assets and liabilities:

**Offsetting of Financial Assets and Derivative Assets**

| | | | | Gross Amounts Not Offset in the Statement of Financial Position | | |
|---|---|---|---|---|---|---|
| **As of June 30, 2016**<br>(In thousands) | **Gross Amounts of Recognized Assets** | **Gross Amounts Offset in the Statement of Financial Position** | **Net Amounts of Assets Presented in the Statement of Financial Position** | **Financial Instruments** | **Cash Collateral** | **Net Amount** |
| **Description** | | | | | | |
| Derivatives | $ 212 | $ - | $ 212 | $ (212) | $ - | $ - |
| Securities purchased under agreements to resell | 200,000 | (200,000) | - | - | - | - |
| Total | $ 200,212 | $ (200,000) | $ 212 | $ (212) | $ - | $ - |

| | | | | Gross Amounts Not Offset in the Statement of Financial Position | | |
|---|---|---|---|---|---|---|
| | **Gross Amounts of Recognized** | **Gross Amounts Offset in the** | **Net Amounts of Assets Presented** | **Financial** | **Cash** | |

| As of December 31, 2015 | Assets | Statement of Financial Position | in the Statement of Financial Position | Instruments | Collateral | Net Amount |
|---|---|---|---|---|---|---|
| (In thousands) | | | | | | |
| **Description** | | | | | | |
| Derivatives | $ 806 | $ - | $ 806 | $ (806) | $ - | $ - |
| Securities purchased under agreements to resell | 200,000 | (200,000) | - | - | - | - |
| Total | $ 200,806 | $ (200,000) | $ 806 | $ (806) | $ - | $ - |

48

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

**Offsetting of Financial Liabilities and Derivative Liabilities**

| As of June 30, 2016 (In thousands) | Gross Amounts of Recognized Liabilities | Gross Amounts Offset in the Statement of Financial Position | Net Amounts of Liabilities Presented in the Statement of Financial Position | Gross Amounts Not Offset in the Statement of Financial Position: Financial Instruments | Gross Amounts Not Offset in the Statement of Financial Position: Cash Collateral | Net Amount |
|---|---|---|---|---|---|---|
| **Description** | | | | | | |
| Securities sold under agreements to repurchase | $ 600,000 | $ (200,000) | $ 400,000 | $ (400,000) | $ - | $ - |

| As of December 31, 2015 (In thousands) | Gross Amounts of Recognized Liabilities | Gross Amounts Offset in the Statement of Financial Position | Net Amounts of Liabilities Presented in the Statement of Financial Position | Gross Amounts Not Offset in the Statement of Financial Position: Financial Instruments | Gross Amounts Not Offset in the Statement of Financial Position: Cash Collateral | Net Amount |
|---|---|---|---|---|---|---|
| **Description** | | | | | | |
| Securities sold under agreements to repurchase | $ 600,000 | $ (200,000) | $ 400,000 | $ (400,000) | $ - | $ - |



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

**NOTE 12 – GOODWILL AND OTHER INTANGIBLES**

Goodwill as of June 30, 2016 and December 31, 2015 amounted to $28.1 million, recognized as part of “Other Assets” in the consolidated statement of financial condition. The Corporation conducted its annual evaluation of goodwill and intangibles during the fourth quarter of 2015. The Corporation’s goodwill is related to the acquisition of FirstBank Florida in 2005.

There have been no events related to the Florida reporting unit that could indicate potential goodwill impairment since the date of the last evaluation; therefore, no goodwill impairment evaluation was performed during the first half of 2016. Goodwill and other indefinite life intangibles are reviewed at least annually for impairment.

In connection with the acquisition of the FirstBank-branded credit card loan portfolio in the second quarter of 2012, the Corporation recognized a purchased credit card relationship intangible of $24.5 million, which is being amortized over the remaining estimated life of 5.4 years on an accelerated basis based on the estimated attrition rate of the purchased credit card accounts, which reflects the pattern in which the economic benefits of the intangible asset are consumed. These benefits are consumed as the revenue stream generated by the cardholder relationship is realized.

The core deposit intangible acquired in the February 2015 Doral Bank transaction amounted to $5.8 million ($4.7 million as of June 30, 2016).

In the first quarter of 2016, FirstBank Insurance Agency acquired certain insurance customer accounts and related customer records and recognized an insurance customer relationship intangible of $1.1 million ($1.0 million as of June 30, 2016), which is being amortized over the next 6.6 years on a straight-line basis. The list of accounts acquired has a direct relationship to the previous mortgage loan portfolio acquisitions from Doral Bank and Doral Financial in 2015 and 2014.

The following table shows the gross amount and accumulated amortization of the Corporation’s intangible assets recognized as part of Other Assets in the consolidated statement of financial condition:

| | | | | | |
|---|---|---|---|---|---|
| | **As of June 30, 2016** | | | **As of December 31, 2015** | |
| (Dollars in thousands) | | | | | |
| Core deposit intangible: | | | | | |
| Gross amount, beginning of period | $ | 51,664 | | $ | 45,844 |

| | | | | | |
|---|---|---|---|---|---|
| Addition as a result of acquisition | | - | | | 5,820 |
| Accumulated amortization | | (43,482) | | | (42,498) |
| Net carrying amount | $ | 8,182 | | $ | 9,166 |
| | | | | | |
| Remaining amortization period | | 8.5 years | | | 9.0 years |
| | | | | | |
| Purchased credit card relationship intangible: | | | | | |
| Gross amount | $ | 24,465 | | $ | 24,465 |
| Accumulated amortization | | (12,540) | | | (11,146) |
| Net carrying amount | $ | 11,925 | | $ | 13,319 |
| | | | | | |
| Remaining amortization period | | 5.4 years | | | 5.8 years |
| | | | | | |
| Insurance Customer relationship intangible: | | | | | |
| Gross amount | $ | 1,067 | | $ | - |
| Accumulated amortization | | (64) | | | - |
| Net carrying amount | $ | 1,003 | | $ | - |
| | | | | | |
| Remaining amortization period | | 6.6 years | | | - |
| | | | | | |
| | | | | | |
| | | | | | |

For the quarter and six-month period ended June 30, 2016, the amortization expense of core deposit intangibles amounted to $0.5 million and $ 1.0 million, respectively, (2015 - $0.6 million and $1.0 million, respectively). For the quarter and six-month period ended June 30, 2016, the amortization expense of the purchased credit card relationship intangible amounted to $0.7 million and $1.4 million, respectively, (2015 - $0.8 million and $1.5 million, respectively). For the quarter and six-month period ended June 30, 2016, the amortization expense of insurance customer relationship intangible amounted to $39 thousand and $64 thousand, respectively.

The estimated aggregate amortization expense related to these intangible assets for future periods is as follows:

| | | | Amount | |
|---|---|---|---|---|
| | | | (In thousands) | |
| | 2016 | $ | 2,453 | |
| | 2017 | | 4,495 | |
| | 2018 | | 3,519 | |
| | 2019 | | 3,067 | |
| | 2020 | | 2,851 | |
| | 2021 and after | | 4,725 | |

**NOTE 13 – NON CONSOLIDATED VARIABLE INTEREST ENTITIES AND SERVICING ASSETS**

The Corporation transfers residential mortgage loans in sale or securitization transactions in which it has continuing involvement, including servicing responsibilities and guarantee arrangements. All such transfers have been accounted for as sales as required by applicable accounting guidance.

When evaluating the need to consolidate counterparties to which the Corporation has transferred assets or with which the Corporation has entered into other transactions, the Corporation first determines if the counterparty is an entity for which a variable interest exists. If no scope exception is applicable and a variable interest exists, the Corporation then evaluates if it is the primary beneficiary of the VIE and whether the entity should be consolidated or not.

Below is a summary of transfers of financial assets to VIEs for which the Corporation has retained some level of continuing involvement:

GNMA

The Corporation typically transfers first lien residential mortgage loans in conjunction with GNMA securitization transactions in which the loans are exchanged for cash or securities that are readily redeemed for cash proceeds and servicing rights. The securities issued through these transactions are guaranteed by the issuer and, as such, under seller/servicer agreements, the Corporation is required to service the loans in accordance with the issuers' servicing guidelines and standards. As of June 30, 2016, the Corporation serviced loans securitized through GNMA with a principal balance of $1.4 billion.

Trust-Preferred Securities

In 2004, FBP Statutory Trust I, a financing trust that is wholly owned by the Corporation, sold to institutional investors $100 million of its variable rate trust-preferred securities. The proceeds of the issuance, together with the proceeds of the purchase by the Corporation of $3.1 million of FBP Statutory Trust I variable rate common securities, were used by FBP Statutory Trust I to purchase $103.1 million aggregate principal amount of the Corporation’s Junior Subordinated Deferrable Debentures. Also in 2004, FBP Statutory Trust II, a financing trust that is wholly owned by the Corporation, sold to institutional investors $125 million of its variable rate trust-preferred securities. The proceeds of the issuance, together with the proceeds of the purchase by the Corporation of $3.9 million of FBP Statutory Trust II variable rate common securities, were used by FBP Statutory Trust II to purchase $128.9 million aggregate principal amount of the Corporation’s Junior Subordinated Deferrable Debentures. The debentures are presented in the Corporation’s consolidated statement of financial condition as Other Borrowings, net of related issuance costs. The variable rate trust-preferred securities are fully and unconditionally guaranteed by the Corporation. The Junior Subordinated Deferrable Debentures issued by the Corporation in April 2004 and in September 2004 mature on June 17, 2034 and September 20, 2034, respectively; however, under certain circumstances, the maturity of Junior Subordinated Deferrable Debentures may be shortened (such shortening would result in a mandatory redemption of the variable rate trust-preferred securities). During the first quarter of 2016, the Corporation completed the repurchase of $10 million in trust-preferred securities of the FBP Statutory Trust II that were auctioned in a public sale at which the Corporation was invited to participate. The Corporation repurchased and cancelled the repurchased trust preferred securities, resulting in a commensurate reduction in the related Floating Rate Junior Subordinated Debentures. The Corporation’s winning bid equated to 70% of the $10 million par value. The 30% discount, plus accrued interest, resulted in a gain of approximately $4.2 million, which is reflected in the statement of income as a “Gain on early extinguishment of debt.” During the second quarter of 2015, the Corporation issued 852,831 shares of the Corporation’s common stock in exchange for $5.3 million of trust preferred securities (FBP Statutory Trust I), which enabled the Corporation to cancel $5.5 million of the carrying value of the debentures underlying the purchased trust preferred securities. The Collins Amendment to the Dodd-Frank Wall Street Reform and Consumer Protection Act eliminates certain trust-preferred securities from Tier 1 Capital; however, these instruments may remain in Tier 2 capital until the instruments are redeemed or mature. Under the indentures, the Corporation has the right, from time to time, and without causing an event of default, to defer payments of interest on the Junior 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. During the second quarter of 2016, the Corporation received approval from the Federal Reserve and paid $31.2

million for all the accrued but deferred interest payments plus the interest for the second quarter on the Corporation's subordinated debentures associated with its trust preferred securities. As of June 30, 2016, the Corporation is current on all interest payments due related to its subordinated debt. Future interest payments are subject to the Federal Reserve approval.

Grantor Trusts

During 2004 and 2005, a third party to the Corporation, referred to in this subsection as the seller, established a series of statutory trusts to effect the securitization of mortgage loans and the sale of trust certificates. The seller initially provided the servicing for a fee, which is senior to the obligations to pay trust certificate holders. The seller then entered into a sales agreement through which it sold and issued the trust certificates in favor of the Corporation's banking subsidiary. Currently, the Bank is the sole owner of the trust certificates; the servicing of the underlying residential mortgages that generate the principal and interest cash flows is performed by another third party, which receives a servicing fee. The securities are variable rate securities indexed to 90-day LIBOR plus a spread. The principal payments from the underlying loans are remitted to a paying agent (servicer) who then remits interest to the Bank; interest income is shared to a certain extent with the FDIC, which has an interest only strip ("IO") tied to the cash flows of the underlying loans and is entitled to receive the excess of the interest income less a servicing fee over the variable rate income that the Bank earns on the securities. This IO is limited to the weighted-average coupon of the securities. The FDIC became the owner of the IO upon its intervention of the seller, a failed financial institution. No recourse agreement exists and the risks from losses on non-accruing loans and repossessed collateral are absorbed by the Bank as the sole holder of the certificates. As of June 30, 2016, the amortized cost and fair value of Grantor Trusts amounted to $31.7 million and $23.7 million, respectively, with a weighted average yield of 2.34%.

Investment in unconsolidated entity

On February 16, 2011, FirstBank sold an asset portfolio consisting of performing and non-performing construction, commercial mortgage and commercial and industrial loans with an aggregate book value of $269.3 million to CPG/GS, an entity organized under the laws of the Commonwealth of Puerto Rico and majority owned by PRLP Ventures LLC ("PRLP"), a company created by Goldman, Sachs & Co. and Caribbean Property Group. In connection with the sale, the Corporation received $88.5 million in cash and a 35% interest in CPG/GS, and made a loan in the amount of $136.1 million representing seller financing provided by FirstBank. The loan has a seven-year maturity and bears variable interest at 30-day LIBOR plus 300 basis points and is secured by a pledge of all of the acquiring entity's assets as well as the PRLP's 65% ownership interest in CPG/GS. As of June 30, 2016, the carrying amount of the loan was $7.9 million, which was included in the Corporation's Commercial and Industrial loans held for investment portfolio. FirstBank's equity interest in CPG/GS is accounted for under the equity method. When applying the equity method, the Bank follows the Hypothetical Liquidation Book Value method ("HLBV") to determine its share of CPG/GS's earnings or loss. The loss recorded in 2014 reduced to zero the carrying amount of the Bank's investment in CPG/GS. No negative investment needs to be reported as the Bank has no legal obligation or commitment to provide further financial support to this entity; thus, no further losses have been or will be recorded on this investment. Any potential increase in the carrying value of the investment in CPG/GS, under the HLBV method, would depend upon

how better off the Bank is at the end of the period than it was at the beginning of the period after the waterfall calculation performed to determine the amount of gain allocated to the investors.

FirstBank also provided an $80 million advance facility to CPG/GS to fund unfunded commitments and costs to complete projects under construction, which was fully disbursed in 2011, and a $20 million working capital line of credit to fund certain expenses of CPG/GS. The working capital line of credit was renewed and reduced to $7 million for a period of two years expiring on September 2016. During 2012, CPG/GS repaid the outstanding balance of the advance facility to fund unfunded commitments, and the funds became available for rewithdrawal under a one-time revolver agreement. These loans bear variable interest at 30-day LIBOR plus 300 basis points. As of June 30, 2016, the carrying value of the revolver agreement was $13.3 million, which was included in the Corporation's commercial and industrial loans held for investment portfolio. The carrying value of the working capital line was $0 as of June 30, 2016.

Cash proceeds received by CPG/GS are first used to cover operating expenses and debt service payments, including those related to the note receivable, the advance facility, and the working capital line, described above, which must be substantially repaid before proceeds can be used for other purposes, including the return of capital to both PRLP and FirstBank. FirstBank will not receive any return on its equity interest until PRLP receives an aggregate amount equivalent to its initial investment and a priority return of at least 12%, resulting in FirstBank’s interest in CPG/GS being subordinate to PRLP’s interest. CPG/GS will then begin to make payments pro rata to PRLP and FirstBank, 35% and 65%, respectively, until FirstBank has achieved a 12% return on its invested capital and the aggregate amount of distributions is equal to FirstBank’s capital contributions to CPG/GS.

The Bank has determined that CPG/GS is a VIE in which the Bank is not the primary beneficiary. In determining the primary beneficiary of CPG/GS, the Bank considered applicable guidance that requires the Bank to qualitatively assess the determination of the primary beneficiary (or consolidator) of CPG/GS based on whether it has both the power to direct the activities of CPG/GS that most significantly impact the entity's economic performance and the obligation to absorb losses of CPG/GS that could potentially be significant to the VIE or the right to receive benefits from the entity that could potentially be significant to the VIE.

The Bank determined that it does not have the power to direct the activities that most significantly impact the economic performance of CPG/GS as it does not have the right to manage the loan portfolio, impact foreclosure proceedings, or manage the construction and sale of the property; therefore, the Bank concluded that it is not the primary beneficiary of CPG/GS. As a creditor to CPG/GS, the Bank has certain rights related to CPG/GS; however, these are intended to be protective in nature and do not provide the Bank with the ability to manage the operations of CPG/GS. Since CPG/GS is not a consolidated subsidiary of the Bank and the transaction met the criteria for sale accounting under authoritative guidance, the Bank accounted for this transaction as a true sale, recognizing the cash received, the notes receivable, and the interest in CPG/GS, and derecognizing the loan portfolio sold.

Servicing Assets

The Corporation sells residential mortgage loans to GNMA, which generally securitizes the transferred loans into mortgage-backed securities. Also, certain conventional conforming loans are sold to FNMA or FHLMC with servicing retained. The Corporation recognizes as separate assets the rights to service loans for others, whether those servicing assets are originated or purchased.

The changes in servicing assets are shown below:

| | Quarter ended June 30, | | | | Six-Month period ended June 30, | | | |
|---|---|---|---|---|---|---|---|---|
| (In thousands) | 2016 | | 2015 | | 2016 | | 2015 | |
| Balance at beginning of period | $ | 24,692 | $ | 22,973 | $ | 24,282 | $ | 22,838 |
| Capitalization of servicing assets | | 1,297 | | 1,474 | | 2,458 | | 2,547 |
| Amortization | | (809) | | (795) | | (1,607) | | (1,651) |
| Adjustment to fair value | | (151) | | (109) | | (124) | | (147) |
| Other (1) | | 15 | | (24) | | 35 | | (68) |
| Balance at end of period | $ | 25,044 | $ | 23,519 | $ | 25,044 | $ | 23,519 |

(1) Amount represents the adjustment to fair value related to the repurchase of loans serviced for others.

Impairment charges are recognized through a valuation allowance for each individual stratum of servicing assets. The valuation allowance is adjusted to reflect the amount, if any, by which the cost basis of the servicing asset for a given stratum of loans being serviced exceeds its fair value. Any fair value in excess of the cost basis of the servicing asset for a given stratum is not recognized.

Changes in the impairment allowance were as follows:

| (In thousands) | Quarter ended June 30, 2016 | Quarter ended June 30, 2015 | Six-Month Period Ended June 30, 2016 | Six-Month Period Ended June 30, 2015 |
|---|---|---|---|---|
| Balance at beginning of period | $ 109 | $ 93 | $ 136 | $ 55 |
| Temporary impairment charges | 167 | 128 | 194 | 186 |
| Recoveries | (16) | (19) | (70) | (39) |
| Balance at end of period | $ 260 | $ 202 | $ 260 | $ 202 |

The components of net servicing income are shown below:

| (In thousands) | Quarter ended June 30, 2016 | Quarter ended June 30, 2015 | Six-Month Period Ended June 30, 2016 | Six-Month Period Ended June 30, 2015 |
|---|---|---|---|---|
| Servicing fees | $ 1,865 | $ 1,780 | $ 3,727 | $ 3,544 |
| Late charges and prepayment penalties | 163 | 177 | 305 | 367 |
| Adjustment for loans repurchased | 15 | (24) | 35 | (68) |
| Other (1) | (1) | (14) | (1) | (103) |
| Servicing income, gross | 2,042 | 1,919 | 4,066 | 3,740 |
| Amortization and impairment of servicing assets | (960) | (904) | (1,731) | (1,798) |
| Servicing income, net | $ 1,082 | $ 1,015 | $ 2,335 | $ 1,942 |

(1) Mainly consisted of compensatory fees imposed by GSEs.

The Corporation's servicing assets are subject to prepayment and interest rate risks. Key economic assumptions used in determining the fair value at the time of sale of the related mortgages ranged as follows:

| | Maximum | Minimum |
|---|---|---|
| **Six-Month Period Ended June 30, 2016:** | | |
| **Constant prepayment rate:** | | |
| Government guaranteed mortgage loans | 7.6 % | 7.6 % |
| Conventional conforming mortgage loans | 8.0 % | 8.0 % |
| Conventional non-conforming mortgage loans | 14.1 % | 14.0 % |
| **Discount rate:** | | |
| Government guaranteed mortgage loans | 11.5 % | 11.5 % |
| Conventional conforming mortgage loans | 9.5 % | 9.5 % |
| Conventional non-conforming mortgage loans | 13.8 % | 13.8 % |
| | | |
| **Six-Month Period Ended June 30, 2015:** | | |
| **Constant prepayment rate:** | | |
| Government guaranteed mortgage loans | 9.2 % | 7.9 % |
| Conventional conforming mortgage loans | 9.0 % | 7.9 % |
| Conventional non-conforming mortgage loans | 14.0 % | 12.9 % |
| **Discount rate:** | | |
| Government guaranteed mortgage loans | 11.5 % | 11.5 % |
| Conventional conforming mortgage loans | 9.5 % | 9.5 % |
| Conventional non-conforming mortgage loans | 13.8 % | 13.8 % |

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

| | | | | | |
|---|---|---|---|---|---|

As of June 30, 2016, fair values of the Corporation's servicing assets were based on a valuation model that incorporates market driven assumptions regarding discount rates and mortgage prepayment rates, adjusted by the particular characteristics of the Corporation's servicing portfolio. The weighted-averages of the key economic assumptions used by the Corporation in its valuation model and the sensitivity of the current aggregate fair value to immediate 10% and 20% adverse changes in those assumptions for mortgage loans as of June 30, 2016 were as follows:

| | (Dollars in thousands) | | |
|---|---|---|---|
| Carrying amount of servicing assets | $ | 25,044 | |
| Fair value | $ | 27,695 | |
| Weighted-average expected life (in years) | | 8.22 | |
| | | | |
| **Constant prepayment rate (weighted-average annual rate)** | | 10.56 | % |
| Decrease in fair value due to 10% adverse change | $ | 913 | |
| Decrease in fair value due to 20% adverse change | $ | 1,776 | |
| | | | |
| **Discount rate (weighted-average annual rate)** | | 10.67 | % |
| Decrease in fair value due to 10% adverse change | $ | 1,220 | |
| Decrease in fair value due to 20% adverse change | $ | 2,346 | |

These sensitivities are hypothetical and should be used with caution. As the figures indicate, changes in fair value based on a 10% variation in assumptions generally cannot be extrapolated because the relationship between the change in assumption and the change in fair value may not be linear. Also, in this table, the effect of a variation in a particular assumption on the fair value of the servicing asset is calculated without changing any other assumption; in reality, changes in one factor may result in changes in another (for example, increases in market interest rates may result in lower prepayments), which may magnify or counteract the sensitivities.

**NOTE 14 – DEPOSITS**

The following table summarizes deposit balances:

| (In thousands) | | June 30, 2016 | | December 31, 2015 |
|---|---|---|---|---|
| Type of account: | | | | |
| Non-interest bearing checking accounts | $ | 1,409,072 | $ | 1,336,559 |
| Savings accounts | | 2,505,378 | | 2,459,186 |
| Interest-bearing checking accounts | | 1,105,926 | | 1,088,651 |
| Certificates of deposit | | 2,395,510 | | 2,356,245 |
| Brokered CDs | | 1,809,133 | | 2,097,483 |
| | $ | 9,225,019 | $ | 9,338,124 |

Brokered CDs mature as follows:

| (In thousands) | | June 30, 2016 |
|---|---|---|
| Three months or less | $ | 351,319 |
| Over three months to six months | | 355,899 |
| Over six months to one year | | 423,879 |
| One to three years | | 608,010 |
| Three to five years | | 69,840 |
| Over five years | | 186 |
| Total | $ | 1,809,133 |

The following are the components of interest expense on deposits:

| | Quarter Ended June 30, | | | | Six-Month Period Ended June 30, | | | |
|---|---|---|---|---|---|---|---|---|
| (In thousands) | | 2016 | | 2015 | | 2016 | | 2015 |
| Interest expense on deposits | $ | 16,494 | $ | 16,096 | $ | 32,974 | $ | 32,455 |
| Accretion of premium from acquisition | | (57) | | (285) | | (138) | | (285) |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Amortization of broker placement fees | | 787 | | 1,169 | | 1,645 | | 2,504 |
| Interest expense on deposits | $ | 17,224 | $ | 16,980 | $ | 34,481 | $ | 34,674 |

**NOTE 15 – SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE**

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

| (Dollars in thousands) | | June 30, 2016 | | | December 31, 2015 | |
|---|---|---|---|---|---|---|
| Repurchase agreements, interest ranging from 1.96% to 3.72% | | | | | | |
| (December 31, 2015- 1.96% to 3.41%) (1)(2) | | $ | 700,000 | | $ | 700,000 |

(1) Reported net of securities purchased under agreements to repurchase (reverse repurchase agreements) by counterparty, when applicable, pursuant to ASC 210-20-45-11.

(2) As of June 30, 2016, includes $600 million with an average rate of 2.89% that lenders have the right to call before their contractual maturities at various dates beginning on July 19, 2016. In addition, $500 million is tied to variable rates.

Repurchase agreements mature as follows:

| | June 30, 2016 | |
|---|---|---|
| | (In thousands) | |
| One month to three months | $ | 100,000 |
| Over three months to six months | | 300,000 |
| One year to three years | | 100,000 |
| Over five years | | 200,000 |
| Total | $ | 700,000 |

As of June 30, 2016 and December 31, 2015, the securities underlying such agreements were delivered to the dealers with which the repurchase agreements were transacted.

Repurchase agreements as of June 30, 2016, grouped by counterparty, were as follows:

| (Dollars in thousands) | | | Weighted-Average |
|---|---|---|---|
| **Counterparty** | _ | **Amount** | **Maturity (In Months)** |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | | Credit Suisse First Boston | | $ | 100,000 | | 1 | |
| | | Citigroup Global Markets | | | 300,000 | | 4 | |
| | | Dean Witter / Morgan Stanley | | | 100,000 | | 16 | |
| | | JP Morgan Chase | | | 200,000 | | 67 | |
| | | | | $ | 700,000 | | | |
| | | | | | | | | |
| | | | | | | | | |
| | | | | | | | | |

**NOTE 16 – ADVANCES FROM THE FEDERAL HOME LOAN BANK (FHLB)**

The following is a summary of the advances from the FHLB:

| (Dollars in thousands) | | June 30, 2016 | | | December 31, 2015 |
|---|---|---|---|---|---|
| Fixed-rate advances from FHLB, with a weighted-average interest rate of 1.30% | $ | 455,000 | | $ | 455,000 |

Advances from FHLB mature as follows:

| (In thousands) | | June 30, 2016 |
|---|---|---|
| Over one month to three months | $ | 100,000 |
| Over one year to three years | | 225,000 |
| Over three to four years | | 130,000 |
| Total | $ | 455,000 |

As of June 30, 2016, the Corporation had additional capacity of approximately $652.6 million on this credit facility based on collateral pledged at the FHLB, including a haircut reflecting the perceived risk associated with holding the collateral.

**NOTE 17 – OTHER BORROWINGS**

Other borrowings consist of:

| (In thousands) | June 30, 2016 | | December 31, 2015 |
|---|---|---|---|

| | | | | |
|---|---|---|---|---|
| Junior subordinated debentures due in 2034, | | | | |
| interest-bearing at a floating rate of 2.75% | | | | |
| over 3-month LIBOR (3.41% as of June 30, 2016 | | | | |
| and 3.28% as of December 31, 2015) | $ | 97,626 | $ | 97,626 |
| Junior subordinated debentures due in 2034, | | | | |
| interest-bearing at a floating rate of 2.50% | | | | |
| over 3-month LIBOR (3.15% as of June 30, 2016 | | | | |
| and 3.07% as of December 31, 2015) (1) | | 118,561 | | 128,866 |
| | $ | 216,187 | $ | 226,492 |

(1) Refer to Note 13 - Non-Consolidated Variable Interest Entities and Servicing Assets - Trust Preferred Securities for additional information about the Corporation's repurchase and cancellation of $10 million of trust preferred securities associated with these junior subordinated debentures.

**NOTE 18 – STOCKHOLDERS' EQUITY**

***Common Stock***

As of June 30, 2016 and December 31, 2015, the Corporation had 2,000,000,000 authorized shares of common stock with a par value of $0.10 per share. As of June 30, 2016 and December 31, 2015, there were 218,278,207 and 216,051,128 shares issued, respectively, and 217,129,074 and 215,088,698 shares outstanding, respectively. On July 30, 2009, the Corporation announced the suspension of common and preferred stock dividends effective with the preferred dividend for the month of August 2009. Refer to Note 3 for information about transactions related to common stock under the Omnibus Plan.

***Preferred Stock***

The Corporation has 50,000,000 authorized shares of preferred stock with a par value of $1.00, redeemable at the Corporation's option subject to certain terms. This stock may be issued in series and the shares of each series will have such rights and preferences as are fixed by the Board of Directors when authorizing the issuance of that particular series. As of June 30, 2016, the Corporation has five outstanding series of non-convertible, non-cumulative preferred stock: 7.125% non-cumulative perpetual monthly income preferred stock, Series A; 8.35% non-cumulative perpetual monthly income preferred stock, Series B; 7.40% non-cumulative perpetual monthly income preferred stock, Series C; 7.25% non-cumulative perpetual monthly income preferred stock, Series D; and 7.00% non-cumulative perpetual monthly income preferred stock, Series E. The liquidation value per share is $25.

Effective January 17, 2012, the Corporation delisted all of its outstanding series of non-convertible, non-cumulative preferred stock from the New York Stock Exchange. The Corporation has not arranged for listing and/or registration on another national securities exchange or for quotation of the Series A through E Preferred Stock in a quotation medium.

***Treasury stock***

During the first half of 2016 and 2015, the Corporation withheld an aggregate of 186,703 shares and 117,858 shares, respectively, of the common stock paid to certain senior officers as additional compensation and vested restricted stock to cover employees' payroll and income tax withholding liabilities; these shares are held as treasury shares. As of June 30, 2016 and December 31, 2015, the Corporation had 1,149,133 and 962,430 shares held as treasury stock, respectively.

***FirstBank Statutory Reserve (Legal Surplus)***

The Banking Law 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, including for payment as dividends to the stockholders, without the prior consent of the Puerto Rico Commissioner of Financial Institutions. The Puerto Rico Banking Law 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 the Bank cannot pay dividends until it can replenish the reserve fund to an amount of at least 20% of the original capital contributed. During the fourth quarter of 2015, $2.8 million was transferred to the legal surplus reserve. FirstBank's legal surplus reserve, included as part of retained earnings in the Corporation's statement of financial condition, amounted to $42.8 million as of June 30, 2016. There were no transfers to the legal surplus reserve during the first half of 2016.

**NOTE 19 - INCOME TAXES**

Income tax expense includes Puerto Rico and USVI 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. and USVI income tax purposes and is generally subject to U.S. and USVI income tax only on its income from sources within the U.S. and USVI or income effectively connected with the conduct of a trade or business in those regions. Any tax paid in the U.S. and USVI is also creditable against the Corporation's Puerto Rico tax liability, subject to certain conditions and limitations.

Under the Puerto Rico Internal Revenue Code of 2011, as amended (the "2011 PR Code"), the Corporation and its subsidiaries are treated as separate taxable entities and are not entitled to file consolidated tax returns and, thus, the Corporation is not able to utilize losses from one subsidiary to offset gains in another subsidiary. Accordingly, in order to obtain a tax benefit from a net operating loss ("NOL"), a particular subsidiary must be able to demonstrate sufficient taxable income within the applicable NOL carry forward period. 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.

The Corporation has maintained an effective tax rate lower than the maximum statutory rate in Puerto Rico mainly by investing in government obligations and mortgage-backed securities exempt from U.S. and Puerto Rico income taxes and by doing business through an International Banking Entity ("IBE") unit of the Bank, and through the Bank's subsidiary, FirstBank Overseas Corporation, whose interest income and gain on sales is exempt from Puerto Rico income taxation. 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 on the specific activities identified in the IBE Act. An IBE that operates as a unit of a bank pays income taxes at the corporate standard rates to the extent that the IBE's net income exceeds 20% of the bank's total net taxable income.

As of June 30, 2016, the deferred tax assets, net of a valuation allowance of $198.2 million, amounted to $299.3 million and management concluded, based upon the assessment of all positive and negative evidence, that it is more likely than not that the Corporation will generate sufficient taxable income within the applicable NOL carry-forward periods to realize such amount.

The Corporation recorded an income tax expense of $7.5 million and $13.2 million in the second quarter and first six months of 2016, respectively, compared to an income tax benefit of $9.8 million and $1.8 million for the same periods in 2015. The increase in income tax expense for the quarter and first six months of 2016, as compared to the same periods in 2015, was mainly attributable to a higher taxable income mainly due to the impact in 2015 of realized losses on the bulk sale of assets. For the six-month period ended June 30, 2016, the Corporation calculated the provision for income taxes by applying the estimated annual effective tax rate for the full fiscal year to ordinary

income or loss. The income tax expense as a percentage of the income before income taxes for the first half of 2016 is 23% compared to 18% for the same period in 2015. In the computation of the consolidated worldwide estimated annual effective tax rate, ASC 740-270 requires the exclusion of legal entities with pre-tax losses from which a tax benefit cannot be recognized. The consolidated worldwide estimated annual effective tax rate, excluding entities with pre-tax losses from which a tax benefit cannot be recognized, is 22% for the six-month period ended June 30, 2016, compared to 30% for the same period in 2015.

As of June 30, 2016, the Corporation did not have Unrecognized Tax Benefits ("UTBs") recorded on its books. Audit periods remain open for review until the statute of limitations has passed. The statute of limitations under the 2011 PR code is 4 years; the statute of limitations for each of Virgin Islands and U.S. income tax purposes is 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 the results of operations for any given quarterly or annual period based, in part, upon the results of operations for the given period. For Virgin Islands and U.S. income tax purposes, all tax years subsequent to 2011 remain open to examination. The 2012 U.S. federal tax return is currently under examination by the IRS. For Puerto Rico tax purposes, all tax years subsequent to 2011 remain open to examination.

**NOTE 20 – FAIR VALUE**

***Fair Value Measurement***

The FASB authoritative guidance for fair value measurement defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. This guidance also establishes a fair value hierarchy for classifying financial instruments. The hierarchy is based on whether the inputs to the valuation techniques used to measure fair value are observable or unobservable. Three levels of inputs may be used to measure fair value:

| | |
|---|---|
| **Level 1** | Valuations of Level 1 assets and liabilities are obtained from readily available pricing sources for market transactions involving identical assets or liabilities. Level 1 assets and liabilities include equity securities that trade in an active exchange market, as well as certain U.S. Treasury and other U.S. government and agency securities and corporate debt securities that are traded by dealers or brokers in active markets. |
| | |
| **Level 2** | Valuations of Level 2 assets and liabilities are based on observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include (i) mortgage-backed securities for which the fair value is estimated based on the value of identical or comparable assets, (ii) debt securities with quoted prices that are traded less frequently than exchange-traded instruments, and (iii) derivative contracts whose value is determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data. |
| | |
| **Level 3** | Valuations of Level 3 assets and liabilities are based on unobservable inputs that are supported by little or no market activity and are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined by using pricing models for which the determination of fair value required significant management judgments estimation. |
| | |

For 2016, there were no transfers into or out of Level 1, Level 2 or Level 3 of the fair value hierarchy.

***Financial Instruments Recorded at Fair Value on a Recurring Basis***

*Investment securities available for sale*

The fair value of investment securities was the market value based on quoted market prices (as is the case with equity securities, Treasury notes, and non-callable U.S. Agency debt securities), when available (Level 1), or, when available, 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. During the first half of 2016, the Corporation recorded OTTI charges of $6.3 million on certain Puerto Rico Government debt securities, specifically bonds of the GDB and the Puerto Rico Public Buildings Authority. The credit impairment loss was based on the probability of default and loss severity in the event of default in consideration of the latest information available about the Puerto Rico Government's financial condition. Refer to Note 4 - Investment Securities, for significant assumptions used to determine the credit impairment portion, including default rates and recovery rates, which are unobservable inputs. 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 the table below for further information regarding qualitative information for all assets and liabilities measured at fair value using significant unobservable inputs (Level 3).

*Derivative instruments*

The fair value of most of the Corporation's derivative instruments is based on observable market parameters and takes into consideration the credit risk component of paying counterparties, when appropriate, except when collateral is pledged. On interest caps, only the seller's credit risk is considered. The caps were valued using a discounted cash flow approach using the related LIBOR and swap rate for each cash flow.

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 for the quarter and six-month periods ended June 30, 2016 and 2015 was immaterial.

Assets and liabilities measured at fair value on a recurring basis are summarized below:

| | As of June 30, 2016 | | | | As of December 31, 2015 | | | |
|---|---|---|---|---|---|---|---|---|
| | Fair Value Measurements Using | | | | Fair Value Measurements Using | | | |
| (In thousands) | Level 1 | Level 2 | Level 3 | Assets/Liabilities at Fair Value | Level 1 | Level 2 | Level 3 | Assets/Liabilities at Fair Value |
| Assets: | | | | | | | | |
| Securities available for sale : | | | | | | | | |
| Equity securities | $ 418 | $ - | $ - | $ 418 | $ - | $ - | $ - | $ - |
| U.S. Treasury Securities | 7,523 | - | - | 7,523 | 7,497 | - | - | 7,497 |
| Noncallable U.S. agency debt | - | 369,285 | - | 369,285 | - | 315,467 | - | 315,467 |
| Callable U.S. agency debt and | - | 1,573,360 | - | 1,573,360 | - | 1,509,807 | - | 1,509,807 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| MBS | | | | | | | | |
| Puerto Rico government obligations | - | 26,443 | 2,104 | 28,547 | - | 26,327 | 1,890 | 28,217 |
| Private label MBS | - | - | 23,816 | 23,816 | - | - | 25,307 | 25,307 |
| Other investments | - | - | 100 | 100 | - | - | 100 | 100 |
| Derivatives, included in assets: | | | | | | | | |
| Purchased interest rate cap agreements | - | 212 | - | 212 | - | 806 | - | 806 |
| Liabilities: | | | | | | | | |
| Derivatives, included in liabilities: | | | | | | | | |
| Written interest rate cap agreement | - | 217 | - | 217 | - | 798 | - | 798 |
| Forward contracts | - | 359 | - | 359 | - | 123 | - | 123 |
| | | | | | | | | |

The table below presents a reconciliation for all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the quarters and six-month periods ended June 30, 2016 and 2015:

| | Quarter Ended June 30, | |
|---|---|---|
| | **2016** | **2015** |
| **Level 3 Instruments Only** | **Securities** | **Securities** |
| (In thousands) | **Available For Sale[(1)]** | **Available For Sale[(1)]** |
| Beginning balance | $ 26,663 | $ 34,314 |
| Total gains or (losses) (realized/unrealized): | | |
| Included in earnings | - | (241) |
| Included in other comprehensive income | 558 | 525 |
| Principal repayments and amortization | (1,201) | (2,858) |
| Ending balance | $ 26,020 | $ 31,740 |

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

| | Six-Month Period Ended June 30, | |
|---|---|---|
| | **2016** | **2015** |
| **Level 3 Instruments Only** | **Securities** | **Securities** |
| (In thousands) | **Available For Sale[(1)]** | **Available For Sale[(1)]** |
| Beginning balance | $ 27,297 | $ 36,212 |
| Total gains or (losses) (realized/unrealized): | | |
| Included in earnings | (387) | (397) |
| Included in other comprehensive income | 1,816 | 1,144 |
| Purchases | - | 100 |
| Principal repayments and amortization | (2,706) | (5,319) |
| Ending balance | $ 26,020 | $ 31,740 |

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

The table below presents qualitative information for significant assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) at June 30, 2016:

| | June 30, 2016 | | | |
|---|---|---|---|---|
| (In thousands) | **Fair Value** | **Valuation Technique** | **Unobservable Input** | **Range** |
| **Investment securities available-for-sale:** | | | | |
| Private label MBS | $ 23,732 | Discounted cash flow | Discount rate | 14.5% |
| | | | Prepayment rate | 21.83% -100.00% (Weighted Average 31.0%) |
| | | | Projected cumulative loss rate | 0.52% -80.00% (Weighted Average 7.0%) |
| Puerto Rico Government Obligations | 2,104 | Discounted cash flow | Prepayment rate | 3.00% |

***Information about Sensitivity to Changes in Significant Unobservable Inputs***

Private label MBS: The significant unobservable inputs in the valuation include probability of default, the loss severity assumption, and prepayment rates. Shifts in those inputs would result in different fair value measurements. Increases in the probability of default, loss severity assumptions, and prepayment rates in isolation would generally result in an adverse effect on the fair value of the instruments. Meaningful and possible shifts of each input were modeled to assess the effect on the fair value estimation.

Puerto Rico Government Obligations: The significant unobservable input used in the fair value measurement is the assumed prepayment rate of the underlying residential mortgage loans collateral on these obligations which are guaranteed by the Puerto Rico Housing Finance Authority ("PRHFA"). A significant increase (decrease) in the assumed rate would lead to a higher (lower) fair value estimate. Loss severity and probability of default are not included as significant unobservable variables due to the guarantee of the PRHFA. The PRHFA credit risk is modeled by discounting the cash flows using a curve appropriate to the PRHFA credit rating.

The tables below summarize changes in unrealized gains and losses recorded in earnings for the quarters and six-month periods ended June 30, 2016 and 2015 for Level 3 assets and liabilities that are still held at the end of each period:

| | Changes in Unrealized Losses | | Changes in Unrealized Losses | |
|---|---|---|---|---|
| | (Quarter ended June 30, 2016) | | (Quarter ended June 30, 2015) | |
| **Level 3 Instruments Only** | **Securities** | | **Securities** | |
| (In thousands) | **Available For Sale** | | **Available For Sale** | |
| **Changes in unrealized losses relating to assets still held at reporting date:** | | | | |
| Net impairment losses on available-for-sale investment securities (credit component) | $ | - | $ | (241) |

| | Changes in Unrealized Losses | | Changes in Unrealized Losses | |
|---|---|---|---|---|
| | (Six-Month Period Ended June 30, 2016) | | (Six-Month Period Ended June 30, 2015) | |
| **Level 3 Instruments Only** | **Securities** | | **Securities** | |
| (In thousands) | **Available For Sale** | | **Available For Sale** | |
| **Changes in unrealized losses relating to assets still held at reporting date:** | | | | |
| Net impairment losses on available-for-sale investment securities (credit component) | $ | (387) | $ | (397) |

Additionally, fair value is used on a nonrecurring basis to evaluate certain assets in accordance with GAAP. Adjustments to fair value usually result from the application of lower-of-cost or market accounting (e.g., loans held for sale carried at the lower-of-cost or fair value and repossessed assets) or write downs of individual assets (e.g., goodwill, loans).

As of June 30, 2016, impairment or valuation adjustments were recorded for assets recognized at fair value on a non-recurring basis as shown in the following table:

| | Carrying value as of June 30, 2016 | | | (Losses) recorded for the Quarter Ended June 30, 2016 | (Losses) recorded for the Six-Month Period Ended June 30, 2016 |
|---|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | | |
| | (In thousands) | | | | |
| Loans receivable [1] | $ - | $ - | $ 464,467 | $ (7,870) | $ (27,536) |
| OREO [2] | - | - | 139,159 | (3,436) | (5,727) |
| Mortgage servicing rights [3] | - | - | 25,044 | (151) | (124) |

(1) Consist mainly of impaired commercial and construction loans. The impairment was generally measured based on the fair value of the collateral. The fair value was derived from external appraisals that take into consideration prices in observed transactions involving similar assets in similar locations but adjusted for specific characteristics and assumptions of the collateral (e.g. absorption rates), which are not market observable.

(2) The fair value was derived from appraisals that take into consideration prices in observed transactions involving similar assets in similar locations but adjusted for specific characteristics and assumptions of the properties (e.g. absorption rates and net operating income of income producing properties) which are not market observable. Losses were related to market valuation adjustments after the transfer of the loans to the OREO portfolio.

(3) Fair value adjustments to mortgage servicing rights were mainly due to assumptions associated with mortgage prepayment rates. The Corporation carries its mortgage servicing rights at the lower of cost or market, measured at fair value on a non-recurring basis. Assumptions for the value of mortgage servicing rights include: Prepayment rate-10.56%, Discount Rate-10.67%.

As of June 30, 2015, impairment or valuation adjustments were recorded for assets recognized at fair value on a non-recurring basis as shown in the following table:

| | Carrying value as of June 30, 2015 | | | (Losses) recorded for the Quarter Ended June 30, 2015 | (Losses) recorded for the Six-Month Period Ended June 30, 2015 |
|---|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | | |

| | (In thousands) | | | | |
|---|---|---|---|---|---|
| Loans receivable [1] | $ - | $ - | $ 298,935 | $ (3,586) | $ (15,850) |
| OREO [2] | - | - | 122,129 | (1,906) | (5,751) |
| Mortgage servicing rights [3] | - | - | 23,519 | (109) | (147) |
| Loans Held For Sale [4] | - | - | 48,032 | - | - |

(1) Consist mainly of impaired commercial and construction loans. The impairment was generally measured based on the fair value of the collateral. The fair value was derived from external appraisals that take into consideration prices in observed transactions involving similar assets in similar locations but adjusted for specific characteristics and assumptions of the collateral (e.g. absorption rates), which are not market observable.

(2) The fair value was derived from appraisals that take into consideration prices in observed transactions involving similar assets in similar locations but adjusted for specific characteristics and assumptions of the properties (e.g. absorption rates and net operating income of income producing properties) which are not market observable. Losses were related to market valuation adjustments after the transfer of the loans to the OREO portfolio.

(3) Fair value adjustments to the mortgage servicing rights were mainly due to assumptions associated with mortgage prepayments rates. The Corporation carries its mortgage servicing rights at the lower of cost or market, measured at fair value on a non-recurring basis. Assumptions for the value of mortgage servicing rights include: Prepayment Rate-9.16%, Discount Rate-10.63%.

(4) The value of these loans was derived from external appraisals, adjusted for specific characteristics of the loans.

| Qualitative information regarding the fair value measurements for Level 3 financial instruments is as follows: | | | |
|---|---|---|---|
| | | | |
| | **June 30, 2016** | | |
| | **Method** | | **Inputs** |
| Loans | Income, Market, Comparable Sales, Discounted Cash Flows | | External appraised values; probability weighting of broker price opinions; management assumptions regarding market trends or other relevant factors |
| OREO | Income, Market, Comparable Sales, Discounted Cash Flows | | External appraised values; probability weighting of broker price opinions; management assumptions regarding market trends or other relevant factors |
| Mortgage servicing rights | Discounted Cash Flow | | Weighted average prepayment rate of 10.56%; weighted average discount rate of 10.67% |

The following is a description of the valuation methodologies used for instruments that are not measured or reported at fair value on a recurring basis or that are reported at fair value on a non-recurring basis. The estimated fair value was calculated using certain facts and assumptions, which vary depending on the specific financial instrument.

*Cash and due from banks and money market investments*

The carrying amounts of cash and due from banks and money market investments are reasonable estimates of their fair value. Money market investments include held-to-maturity securities, which have a contractual maturity of three months or less. The fair value of these securities is based on quoted market prices in active markets that incorporate the risk of nonperformance.

*Investment securities held to maturity*

Investment securities held to maturity consist of financing arrangements with Puerto Rico municipalities issued in bond form, but underwritten as loans with features that are typically found in commercial loan transactions. These obligations typically are not issued in bearer form, nor are they registered with the SEC and are not rated by external credit agencies. The fair value of these financing arrangements was based on a discounted cash flow analysis using risk-adjusted discount rates (Level 3). A security with similar characteristics traded in the open market is used as a proxy for each municipal bond. Then the cash flow is discounted at the average spread over the discount curve exhibited by the proxy security at the end of each quarter.

*Other equity securities*

Equity or other securities that do not have a readily available fair value are stated at their net realizable value, which management believes is a reasonable proxy for their fair value. This category is principally composed of stock that is owned by the Corporation to comply with FHLB regulatory requirements. The realizable value of the FHLB stock equals its cost as this stock can be freely redeemed at par.

*Loans receivable, including loans held for sale*

The fair value of loans held for investment and of mortgage loans held for sale was estimated using discounted cash flow analyses, based on interest rates currently being offered for loans with similar terms and credit quality and with adjustments that the Corporation's management believes a market participant would consider in determining fair value. Loans were classified by type, such as commercial, residential mortgage, and automobile. These asset categories were further segmented into fixed- and adjustable-rate categories. Valuations are carried out based on categories and not on a loan-by-loan basis. The fair values of performing fixed-rate and adjustable-rate loans were calculated by discounting expected cash flows through the estimated maturity date. This fair value is not currently an indication of an exit price as that type of assumption could result in a different fair value estimate. The fair value of credit card loans was estimated using a discounted cash flow method and excludes any value related to a customer account relationship. Other loans with no stated maturity, like credit lines, were valued at book value. Prepayment assumptions were considered for non-residential loans. For residential mortgage loans, prepayment estimates were based on a prepayment model that combined both a historical calibration and current market prepayment expectations. Discount rates were based on the U.S. Treasury and LIBOR/Swap Yield Curves at the date of the analysis, and included appropriate adjustments for expected credit losses and liquidity. For impaired collateral dependent loans, the impairment was primarily measured based on the fair value of the collateral, which is derived from appraisals that take into consideration prices in observable transactions involving similar assets in similar locations.

*Deposits*

The estimated fair value of demand deposits and savings accounts, which are deposits with no defined maturities, equals the amount payable on demand at the reporting date. The fair values of retail fixed-rate time deposits, with stated maturities, are based on the present value of the future cash flows expected to be paid on the deposits. The cash flows were based on contractual maturities; no early repayments were assumed. Discount rates were based on the LIBOR yield curve.

The estimated fair value of total deposits excludes the fair value of core deposit intangibles, which represent the value of the customer relationship. The fair value of total deposits is measured by the value of demand deposits and savings deposits that bear a low or zero rate of interest and do not fluctuate in response to changes in interest rates.

The fair value of brokered CDs, which are included within deposits, is determined using discounted cash flow analyses over the full term of the CDs. The fair value of the CDs is computed using the outstanding principal amount. The discount rates used were based on brokered CD market rates as of June 30, 2016. The fair value does not incorporate the risk of nonperformance, since interests in brokered CDs are generally sold by brokers in amounts of less than $250,000 and, therefore, are insured by the FDIC.

*Securities sold under agreements to repurchase*

Some repurchase agreements reprice at least quarterly, and their outstanding balances are estimated to be their fair value. Where longer commitments are involved, fair value is estimated using exit price indications of the cost of unwinding the transactions as of the end of the reporting period. The brokers who are the counterparties provide these indications and are evaluated by the Corporation. Securities sold under agreements to repurchase are fully collateralized by investment securities.

*Advances from FHLB*

The fair value of advances from the FHLB with fixed maturities is determined using discounted cash flow analyses over the full term of the borrowings, using indications of the fair value of similar transactions. The cash flows assume no early repayment of the borrowings. Discount rates are based on the LIBOR yield curve. Advances from the FHLB are fully collateralized by mortgage loans and, to a lesser extent, investment securities.

*Other borrowings*

Other borrowings consist of junior subordinated debentures. Projected cash flows from the debentures were discounted using the Bloomberg BB Finance curve plus a credit spread. This credit spread was estimated using the difference in yield curves between swap rates and a yield curve that considers the industry and credit rating of the Corporation as issuer of the debentures at a tenor comparable to the time to maturity of the debentures.



---

The following table presents the carrying value and the estimated fair value of financial instruments as of June 30, 2016 and December 31, 2015:

| | Total Carrying Amount in Statement of Financial Condition June 30, 2016 | Fair Value Estimate June 30, 2016 | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|---|
| | (In thousands) | | | | |
| **Assets:** | | | | | |
| Cash and due from banks and money market investments | $ 827,914 | $ 827,914 | $ 827,914 | $ - | $ - |
| Investment securities available for sale | 2,003,049 | 2,003,049 | 7,941 | 1,969,088 | 26,020 |
| Investment securities held to maturity | 161,342 | 137,965 | - | - | 137,965 |
| Other equity securities | 32,379 | 32,379 | - | 32,379 | - |
| Loans held for sale | 37,958 | 41,700 | - | 31,280 | 10,420 |
| Loans held for investment | 8,870,747 | | | | |
| Less: allowance for loan and lease losses | (234,454) | | | | |
| Loans held for investment, net of allowance | $ 8,636,293 | 8,524,462 | - | - | 8,524,462 |
| Derivatives, included in assets | 212 | 212 | - | 212 | - |
| | | | | | |
| **Liabilities:** | | | | | |
| Deposits | 9,225,019 | 9,256,396 | - | 9,256,396 | - |
| Securities sold under agreements to repurchase | 700,000 | 751,689 | - | 751,689 | - |
| Advances from FHLB | 455,000 | 457,842 | - | 457,842 | - |
| Other borrowings | 216,187 | 161,420 | - | - | 161,420 |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Derivatives, included in liabilities | | 576 | | 576 | | - | | 576 | | - |

| | Total Carrying Amount in Statement of Financial Condition December 31, 2015 | | Fair Value Estimate December 31, 2015 | | Level 1 | | Level 2 | | Level 3 |
|---|---|---|---|---|---|---|---|---|---|
| | (In thousands) | | | | | | | | |
| **Assets:** | | | | | | | | | |
| Cash and due from banks and money market investments | $ | 752,458 | $ | 752,458 | $ | 752,458 | $ | - | $ | - |
| Investment securities available for sale | | 1,886,395 | | 1,886,395 | | 7,497 | | 1,851,601 | | 27,297 |
| Investment securities held to maturity | | 161,483 | | 131,544 | | - | | - | | 131,544 |
| Other equity securities | | 32,169 | | 32,169 | | - | | 32,169 | | - |
| Loans held for sale | | 35,869 | | 36,844 | | - | | 28,709 | | 8,135 |
| Loans held for investment | | 9,112,382 | | | | | | | | |
| Less: allowance for loan and lease losses | | (240,710) | | | | | | | | |
| Loans held for investment, net of allowance | $ | 8,871,672 | | 8,768,152 | | - | | - | | 8,768,152 |
| Derivatives, included in assets | | 806 | | 806 | | - | | 806 | | - |
| **Liabilities:** | | | | | | | | | |
| Deposits | | 9,338,124 | | 9,334,073 | | - | | 9,334,073 | | - |
| Securities sold under agreements to repurchase | | 700,000 | | 752,048 | | - | | 752,048 | | - |
| Advances from FHLB | | 455,000 | | 453,182 | | - | | 453,182 | | - |

| | | | | | |
|---|---|---|---|---|---|
| Other borrowings | 226,492 | 142,846 | - | - | 142,846 |
| Derivatives, included in liabilities | 921 | 921 | - | 921 | - |
| | | | | | |

# NOTE 21 – SUPPLEMENTAL CASH FLOW INFORMATION

## Supplemental cash flow information is as follows:

| | Six-Month Period Ended June 30, | | | | |
|---|---|---|---|---|---|
| | 2016 | | | 2015 | |
| | (In thousands) | | | | |
| Cash paid for: | | | | | |
| Interest on borrowings | $ | 77,960 | | $ | 48,648 |
| Income tax | | 558 | | | 2,439 |
| Non-cash investing and financing activities: | | | | | |
| Additions to other real estate owned | | 22,018 | | | 27,625 |
| Additions to auto and other repossessed assets | | 28,658 | | | 39,928 |
| Capitalization of servicing assets | | 2,458 | | | 2,547 |
| Loan securitizations | | 146,277 | | | 130,999 |
| Trust preferred securities exchanged for new common stock issued: | | | | | |
| Trust preferred securities exchanged | | - | | | 5,303 |
| New common stock issued | | - | | | 5,628 |
| Fair value of assets acquired (liabilities assumed) in the Doral Bank transaction: | | | | | |
| Loans | | - | | | 311,410 |
| Premises and equipment, net | | - | | | 5,450 |
| Core Deposit intangible | | - | | | 5,820 |
| Deposits | | - | | | (523,517) |

69

**NOTE 22 – SEGMENT INFORMATION**

Based upon the Corporation's organizational structure and the information provided to the Chief Executive Officer of the Corporation and, to a lesser extent, the Board of Directors, the operating segments are driven primarily by the Corporation's lines of business for its operations in Puerto Rico, the Corporation's principal market, and by geographic areas for its operations outside of Puerto Rico. As of June 30, 2016, the Corporation had six reportable segments: Commercial and Corporate Banking; Mortgage Banking; Consumer (Retail) Banking; Treasury and Investments; United States Operations; and Virgin Islands Operations. Management determined the reportable segments based on the internal reporting used to evaluate performance and to assess where to allocate resources. Other factors such as the Corporation's organizational chart, nature of the products, distribution channels, and the economic characteristics of the products were also considered in the determination of the reportable segments.

The Commercial and Corporate Banking segment consists of the Corporation's lending and other services for large customers represented by specialized and middle-market clients and the public sector. The Commercial and Corporate Banking segment offers commercial loans, including commercial real estate and construction loans, and floor plan financings, as well as other products, such as cash management and business management services. The Mortgage Banking segment consists of the origination, sale, and servicing of a variety of residential mortgage loans. The Mortgage Banking segment also acquires and sells mortgages in the secondary markets. In addition, the Mortgage Banking segment includes mortgage loans purchased from other local banks and mortgage bankers. The Consumer (Retail) Banking segment consists of the Corporation's consumer lending and deposit-taking activities conducted mainly through its branch network and loan centers. The Treasury and Investments segment is responsible for the Corporation's investment portfolio and treasury functions executed to manage and enhance liquidity. This segment lends funds to the Commercial and Corporate Banking, Mortgage Banking and Consumer (Retail) Banking segments to finance their lending activities and borrows from those segments and from the United States Operations segment. The Consumer (Retail) Banking and the United States Operations segments also lend funds to other segments. The interest rates charged or credited by Treasury and Investments, the Consumer (Retail) Banking and the United States Operations segments are allocated based on market rates. The difference between the allocated interest income or expense and the Corporation's actual net interest income from centralized management of funding costs is reported in the Treasury and Investments segment. The United States Operations segment consists of all banking activities conducted by FirstBank in the United States mainland, including commercial and retail banking services. The Virgin Islands Operations segment consists of all banking activities conducted by the Corporation in the USVI and BVI, including commercial and retail banking services.

The accounting policies of the segments are the same as those referred to in Note 1, "Basis of Presentation and Significant Accounting Policies," in the audited consolidated financial statements of the Corporation for the year ended December 31, 2015, which are included in the Corporation's 2015 Annual Report on Form 10-K.

The Corporation evaluates the performance of the segments based on net interest income, the 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.

---

Supplemental cash flow information is as follows:

The following table presents information about the reportable segments:

| (In thousands) | Mortgage Banking | Consumer (Retail) Banking | Commercial and Corporate | Treasury and Investments | United States Operations | Virgin Islands Operations | Total |
|---|---|---|---|---|---|---|---|
| **For the quarter ended June 30, 2016:** | | | | | | | |
| Interest income | $ 35,041 | $ 45,134 | $ 31,386 | $ 12,917 | $ 13,423 | $ 9,033 | $ 146,934 |
| Net (charge) credit for transfer of funds | (12,675) | 3,854 | (5,416) | 13,861 | 376 | - | - |
| Interest expense | - | (6,280) | - | (15,872) | (3,714) | (840) | (26,706) |
| Net interest income | 22,366 | 42,708 | 25,970 | 10,906 | 10,085 | 8,193 | 120,228 |
| (Provision) release for loan and lease losses | (11,608) | (7,259) | (2,020) | - | (251) | 152 | (20,986) |
| Non-interest income (loss) | 4,672 | 11,290 | 913 | 62 | 732 | 2,109 | 19,778 |
| Direct non-interest expenses | (10,131) | (28,029) | (11,659) | (1,498) | (8,253) | (6,671) | (66,241) |
| Segment income | $ 5,299 | $ 18,710 | $ 13,204 | $ 9,470 | $ 2,313 | $ 3,783 | $ 52,779 |
| | | | | | | | |
| Average earning assets | $ 2,577,067 | $ 1,978,803 | $ 2,653,482 | $ 2,780,102 | $ 1,171,788 | $ 607,915 | $ 11,769,157 |

| (In thousands) | Mortgage Banking | Consumer (Retail) Banking | Commercial and Corporate | Treasury and Investments | United States Operations | Virgin Islands Operations | Total |
|---|---|---|---|---|---|---|---|
| **For the quarter ended June 30, 2015:** | | | | | | | |
| Interest | $ 36,296 | $ 49,031 | $ 32,753 | $ 11,709 | $ 12,017 | $ 9,826 | $ 151,632 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| income | | | | | | | |
| Net (charge) credit for transfer of funds | (12,347) | 4,797 | (3,893) | 7,619 | 3,824 | - | - |
| Interest expense | - | (5,853) | - | (14,522) | (4,056) | (724) | (25,155) |
| Net interest income | 23,949 | 47,975 | 28,860 | 4,806 | 11,785 | 9,102 | 126,477 |
| (Provision) release for loan and lease losses | (7,944) | (5,957) | (63,722) | - | 3,275 | 82 | (74,266) |
| Non-interest income (loss) | 4,232 | 11,952 | 555 | (12,519) | 730 | 1,720 | 6,670 |
| Direct non-interest expenses | (9,228) | (32,462) | (11,138) | (1,045) | (7,196) | (8,871) | (69,940) |
| Segment income (loss) | $ 11,009 | $ 21,508 | $ (45,445) | $ (8,758) | $ 8,594 | $ 2,033 | $ (11,059) |
| | | | | | | | |
| Average earning assets | $ 2,669,391 | $ 2,005,232 | $ 2,916,014 | $ 2,697,611 | $ 984,329 | $ 636,090 | $ 11,908,667 |
| | | | | | | | |
| | | | | | | | |

| | **Mortgage Banking** | **Consumer (Retail) Banking** | **Commercial and Corporate** | **Treasury and Investments** | **United States Operations** | **Virgin Islands Operations** | **Total** |
|---|---|---|---|---|---|---|---|
| **Six-Month Period Ended June 30, 2016:** | | | | | | | |
| Interest income | $ 70,260 | $ 91,200 | $ 64,934 | $ 26,677 | $ 26,147 | $ 18,547 | $ 297,765 |
| Net (charge) credit for transfer of funds | (25,599) | 7,736 | (11,512) | 28,387 | 988 | - | - |
| Interest expense | - | (12,442) | - | (31,341) | (7,403) | (1,703) | (52,889) |
| Net interest income | 44,661 | 86,494 | 53,422 | 23,723 | 19,732 | 16,844 | 244,876 |
| (Provision) | (17,748) | (15,796) | (9,568) | - | (461) | 1,534 | (42,039) |

| | Mortgage Banking | Consumer (Retail) Banking | Commercial and Corporate | Treasury and Investments | United States Operations | Virgin Islands Operations | Total |
|---|---|---|---|---|---|---|---|
| release for loan and lease losses | | | | | | | |
| Non-interest income (loss) | 9,159 | 24,026 | 1,474 | (2,339) | 1,915 | 4,012 | 38,247 |
| Direct non-interest expenses | (20,964) | (60,118) | (21,323) | (2,548) | (15,514) | (13,660) | (134,127) |
| Segment income | $ 15,108 | $ 34,606 | $ 24,005 | $ 18,836 | $ 5,672 | $ 8,730 | $ 106,957 |
| | | | | | | | |
| Average earning assets | $ 2,589,671 | $ 1,998,955 | $ 2,527,919 | $ 2,845,682 | $ 1,156,209 | $ 618,476 | $ 11,736,912 |

| | Mortgage Banking | Consumer (Retail) Banking | Commercial and Corporate | Treasury and Investments | United States Operations | Virgin Islands Operations | Total |
|---|---|---|---|---|---|---|---|
| **Six-Month Period Ended June 30, 2015:** | | | | | | | |
| Interest income | $ 70,172 | $ 98,867 | $ 67,556 | $ 24,776 | $ 23,248 | $ 19,498 | $ 304,117 |
| Net (charge) credit for transfer of funds | (23,583) | 8,481 | (7,688) | 15,373 | 7,417 | - | - |
| Interest expense | - | (11,510) | - | (30,529) | (8,395) | (1,559) | (51,993) |
| Net interest income | 46,589 | 95,838 | 59,868 | 9,620 | 22,270 | 17,939 | 252,124 |
| (Provision) release for loan and lease losses | (14,907) | (22,642) | (72,815) | - | 5,408 | (2,280) | (107,236) |
| Non-interest income (loss) | 7,631 | 23,745 | 1,703 | (12,619) | 1,254 | 4,242 | 25,956 |
| Direct non-interest expenses | (17,293) | (64,021) | (19,117) | (2,384) | (14,379) | (17,451) | (134,645) |
| Segment income (loss) | $ 22,020 | $ 32,920 | $ (30,361) | $ (5,383) | $ 14,553 | $ 2,450 | $ 36,199 |

Supplemental cash flow information is as follows:

| | | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Average earning assets | $ | 2,581,309 | $ | 1,971,815 | $ | 3,025,204 | $ | 2,730,699 | $ | 978,178 | $ | 637,617 | $ | 11,924,822 |

71

Supplemental cash flow information is as follows:

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

| | Quarter Ended June 30, | | Six-Month Period Ended June 30, | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| **Net income :** | | | | |
| Total segment income (loss) | $ 52,779 | $ (11,059) | $ 106,957 | $ 36,199 |
| Other non-interest income (loss) (1) | - | - | - | 13,443 |
| Other operating expenses (2) | (23,303) | (32,859) | (48,414) | (59,882) |
| Income before income taxes | 29,476 | (43,918) | 58,543 | (10,240) |
| Income tax (expense) benefit | (7,523) | 9,844 | (13,246) | 1,812 |
| Total consolidated net income (loss) | $ 21,953 | $ (34,074) | $ 45,297 | $ (8,428) |
| **Average assets:** | | | | |
| Total average earning assets for segments | $ 11,769,157 | $ 11,908,667 | $ 11,736,912 | $ 11,924,822 |
| Average non-earning assets | 972,711 | 945,660 | 961,237 | 940,335 |
| Total consolidated average assets | $ 12,741,868 | $ 12,854,327 | $ 12,698,149 | $ 12,865,157 |

(1) The bargain purchase gain on the acquisition of assets and assumption of deposits from Doral Bank in 2015 is presented as an Other non-interest gain (loss) the table above.

(2) Expenses pertaining to corporate administrative functions that support the operating segments 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.

**NOTE 23 – REGULATORY MATTERS, COMMITMENTS AND CONTINGENCIES**

The Corporation is subject to various regulatory capital requirements imposed by the federal banking agencies. Failure to meet minimum capital requirements can result in certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material adverse effect on the Corporation's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Corporation must meet specific capital guidelines that involve quantitative measures of the Corporation's assets and liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Corporation's capital amounts and classification are also subject to qualitative judgments and adjustment by the regulators with respect to minimum capital requirements, components, risk weightings, and other factors.

First BanCorp. is subject to the Written Agreement that the Corporation entered into with the New York FED on June 3, 2010. The Written Agreement provides, among other things, that the holding company must serve as a source of strength to FirstBank, and that, except with the consent generally of the New York FED and the Federal Reserve Board, (1) the holding company may not pay dividends to stockholders or receive dividends from FirstBank, (2) the holding company and its nonbank subsidiaries may not make payments on trust-preferred securities or subordinated debt, and (3) the holding company cannot incur, increase, or guarantee debt or repurchase any capital securities. The Written Agreement also required that the holding company submit a capital plan acceptable to the New York FED that reflected sufficient capital at First BanCorp. on a consolidated basis and followed 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, which has been filed with the SEC.

The Corporation submitted its Capital Plan setting forth its plans for how to improve its capital positions to comply with the Written Agreement over 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 June 30, 2016, the Corporation had completed all of the items included in the Capital Plan and is continuing to work on reducing non-performing loans. The Written Agreement also requires the submission to the regulators of quarterly progress reports.

Although the Corporation and FirstBank became subject to the U.S. Basel III capital rules ("Basel III rules") beginning on January 1, 2015, certain requirements of the Basel III rules will be phased in over several years. The phase-in period for certain deductions and adjustments to regulatory capital (such as certain intangible assets and deferred tax assets that arise from net operating losses and tax credit carryforwards) will be completed on January 1, 2018. The Corporation and FirstBank compute risk-weighted assets using the Standardized Approach required by the Basel III rules.

The Basel III rules require the Corporation to maintain an additional capital conservation buffer of 2.5% to avoid limitations on both (i) capital distributions (e.g. repurchases of capital instruments or dividend or interest payments on capital instruments) and (ii) discretionary bonus payments to executive officers and heads of major business lines. The phase-in of the capital conservation buffer began on January 1, 2016 with a first year requirement of 0.625% of additional Common Equity Tier 1 Capital ("CET1"), which will

Supplemental cash flow information is as follows:

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.

Under the fully phased-in Basel III rules, the Corporation will be required to maintain: (i) a minimum CET1 capital 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%, (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%, (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%, 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.

In addition, as required under the Basel III rules, the Corporation's trust preferred securities ("TRuPs") were fully phased out from Tier 1 capital on January 1, 2016. However, the Corporation's TRuPs may continue to be included in Tier 2 capital until the instruments are redeemed or mature.

In March 2016, the FDIC adopted a final rule that imposes a deposit insurance assessment surcharge on banks with at least $10 billion in assets, of 4.5 cents per $100 of their assessment base, after making certain adjustments. For purposes of this surcharge, the first $10 billion of assets are subtracted from the regular insurance assessment base to determine the surcharge base. The final rule became effective on July 1, 2016 and applies to FirstBank. The FDIC also implemented a reduced initial base assessment rate, which reduce the standard risk-based assessment rate. The adoption of this rule is expected to result in a decrease on the total FDIC insurance premium expense (standard risk-based assessment + assessment surcharge expense) of approximately $3.0 million, on an annual basis, based on the Bank's current surcharge base which is slightly higher than the $10 billion threshold.

Other Recent Regulatory Developments

In May 2016, the federal banking agencies proposed regulations governing incentive-based compensation practices at covered banking institutions. These proposed rules are intended to better align the financial rewards for covered employees with an institution's long-term safety and soundness. Portions of these proposed rules would apply to the Corporation and FirstBank. Those applicable provisions would generally (i) prohibit types and features of incentive-based compensation arrangements that encourage inappropriate risk because they are "excessive" or "could lead to material financial loss" at the banking institution; (ii) require incentive-based compensation arrangements to adhere to three basic principles: (1) a balance between risk and reward; (2) effective risk management and controls; (3) effective governance; and (iii) require appropriate board of directors (or committee) oversight and recordkeeping and disclosures to the banking institution's primary regulatory agency. The nature and substance of any final action to adopt these proposed rules and the timing of any such action, are not known at this time.

Please refer to the discussion in “Part I – Item 7 – Business – Supervision and Regulation” in the Corporation’s 2015 Form 10-K for a more complete discussion of supervision and regulatory matters and activities that affect the Corporation and its subsidiaries.



---

The Corporation's and its banking subsidiary's regulatory capital positions as of June 30, 2016 and December 31, 2015 were as follows:

| | Regulatory Requirements | | | | | |
|---|---|---|---|---|---|---|
| | Actual | | For Capital Adequacy Purposes | | To be Well-Capitalized-Regular Thresholds | |
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| | (Dollars in thousands) | | | | | |
| **As of June 30, 2016** | | | | | | |
| Total Capital (to Risk-Weighted Assets) | | | | | | |
| First BanCorp. | $ 1,867,840 | 20.72% | $ 721,043 | 8.0% | N/A | N/A |
| FirstBank | $ 1,819,385 | 20.19% | $ 720,852 | 8.0% | $ 901,065 | 10.0% |
| Common Equity Tier 1 Capital (to Risk-Weighted Assets) | | | | | | |
| First BanCorp. | $ 1,543,152 | 17.12% | $ 405,587 | 4.5% | N/A | N/A |
| FirstBank | $ 1,470,831 | 16.32% | $ 405,479 | 4.5% | $ 585,692 | 6.5% |
| Tier I Capital (to Risk-Weighted Assets) | | | | | | |
| First BanCorp. | $ 1,543,152 | 17.12% | $ 540,783 | 6.0% | N/A | N/A |
| FirstBank | $ 1,704,423 | 18.92% | $ 540,639 | 6.0% | $ 720,852 | 8.0% |
| Leverage ratio | | | | | | |
| First BanCorp. | $ 1,543,152 | 12.34% | $ 500,222 | 4.0% | N/A | N/A |
| FirstBank | $ 1,704,423 | 13.65% | $ 499,590 | 4.0% | $ 624,488 | 5.0% |
| | | | | | | |
| **As of December 31, 2015** | | | | | | |
| Total Capital (to Risk-Weighted Assets) | | | | | | |
| First BanCorp. | $ 1,828,559 | 20.01% | $ 731,164 | 8.0% | N/A | N/A |
| FirstBank | $ 1,802,711 | 19.73% | $ 730,824 | 8.0% | $ 913,530 | 10.0% |
| Common Equity Tier 1 Capital (to Risk-Weighted Assets) | | | | | | |
| First BanCorp. | $ 1,546,678 | 16.92% | $ 411,280 | 4.5% | N/A | N/A |
| FirstBank | $ 1,493,478 | 16.35% | $ 411,088 | 4.5% | $ 593,794 | 6.5% |
| Tier I Capital (to Risk-Weighted Assets) | | | | | | |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| First BanCorp. | $ | 1,546,678 | 16.92% | $ | 548,373 | 6.0% | | N/A | N/A |
| FirstBank | $ | 1,685,656 | 18.45% | $ | 548,118 | 6.0% | $ | 730,824 | 8.0% |
| Leverage ratio | | | | | | | | | |
| First BanCorp. | $ | 1,546,678 | 12.22% | $ | 506,322 | 4.0% | | N/A | N/A |
| FirstBank | $ | 1,685,656 | 13.33% | $ | 505,648 | 4.0% | $ | 632,060 | 5.0% |
| | | | | | | | | | |

The Corporation enters into financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments may include commitments to extend credit and commitments to sell mortgage loans at fair value. As of June 30, 2016, commitments to extend credit amounted to approximately $1.2 billion, of which $646.3 million relates to credit card loans. Commercial and Financial standby letters of credit amounted to approximately $35.3 million. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any conditions established in the contract. Commitments generally have fixed expiration dates or other termination clauses. Since certain commitments are expected to expire without being drawn upon, the total commitment amount does not necessarily represent future cash requirements. For most of the commercial lines of credit, the Corporation has the option to reevaluate the agreement prior to additional disbursements. In the case of credit cards and personal lines of credit, the Corporation can cancel the unused credit facility at any time and without cause. Generally, the Corporation does not enter into interest rate lock agreements with prospective borrowers in connection with its mortgage banking activities.

As of June 30, 2016, First BanCorp. and its subsidiaries were defendants in various legal proceedings arising in the ordinary course of business. Management believes that the final disposition of these matters, to the extent not previously provided for, will not have a material adverse effect, individually or in the aggregate, on the Corporation’s financial position, results of operations or cash flows.

**NOTE 24 – FIRST BANCORP. (HOLDING COMPANY ONLY) FINANCIAL INFORMATION**

The following condensed financial information presents the financial position of the Holding Company only as of June 30, 2016 and December 31, 2015 and the results of its operations for the quarters and six-month periods ended June 30, 2016 and 2015.

| Statements of Financial Condition | | | | |
|---|---|---|---|---|
| | As of June 30, | | | As of December 31, |
| | 2016 | | | 2015 |
| | (In thousands) | | | |
| **Assets** | | | | |
| Cash and due from banks | $ | 28,430 | $ | 29,103 |
| Money market investments | | 6,111 | | 6,111 |
| Other investment securities | | 285 | | 285 |
| Loans held for investment, net | | 246 | | 266 |
| Investment in First Bank Puerto Rico, at equity | | 1,947,122 | | 1,888,036 |
| Investment in First Bank Insurance Agency, at equity | | 9,578 | | 14,382 |
| Investment in FBP Statutory Trust I | | 2,929 | | 2,929 |
| Investment in FBP Statutory Trust II | | 3,561 | | 3,866 |
| Other assets | | 5,210 | | 4,632 |
| Total assets | $ | 2,003,472 | $ | 1,949,610 |
| **Liabilities and Stockholders' Equity** | | | | |
| Liabilities: | | | | |
| Other borrowings | $ | 216,187 | $ | 226,492 |
| Accounts payable and other liabilities | | 832 | | 28,984 |
| Total liabilities | | 217,019 | | 255,476 |
| Stockholders' equity | | 1,786,453 | | 1,694,134 |
| Total liabilities and stockholders' equity | $ | 2,003,472 | $ | 1,949,610 |

**Statement of Income**

| | Quarter Ended June 30, | | Six-Month Period Ended June 30, | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| | (In thousands) | | (In thousands) | |
| **Income:** | | | | |
| Interest income on money market investments | $ 5 | $ 5 | $ 10 | $ 10 |
| Dividend income from subsidiaries | 31,158 | - | 38,158 | - |
| Other income | 63 | 325 | 123 | 381 |
| | 31,226 | 330 | 38,291 | 391 |
| **Expense:** | | | | |
| Other borrowings | 1,982 | 1,843 | 3,960 | 3,660 |
| Other operating expenses | 978 | 753 | 1,628 | 1,357 |
| | 2,960 | 2,596 | 5,588 | 5,017 |
| Gain on early extinguishment of debt | - | - | 4,217 | - |
| **Income (loss) before income taxes and equity in undistributed earnings (losses) of subsidiaries** | 28,266 | (2,266) | 36,920 | (4,626) |
| **Equity in undistributed (losses) earnings of subsidiaries** | (6,313) | (31,808) | 8,377 | (3,802) |
| **Net income (loss)** | $ 21,953 | $ (34,074) | $ 45,297 | $ (8,428) |
| Other Comprehensive income (loss), net of tax | 13,875 | (10,168) | 44,266 | (3,028) |
| Comprehensive income (loss) | $ 35,828 | $ (44,242) | $ 89,563 | $ (11,456) |

**NOTE 25 – SUBSEQUENT EVENTS**

The Corporation has performed an evaluation of events occurring subsequent to June 30, 2016; management has determined that there are no events occurring in this period that require disclosure in or adjustment to the accompanying financial statements.

76

Supplemental cash flow information is as follows:

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

| **SELECTED FINANCIAL DATA** | | | | | |
|---|---|---|---|---|---|
| | **Quarter ended** | | | **Six-Month Period Ended** | |
| **(In thousands, except for per share and financial ratios)** | **June 30,** | | | **June 30,** | |
| | **2016** | **2015** | | **2016** | **2015** |
| **Condensed Income Statements:** | | | | | |
| Total interest income | $ 146,934 | $ 151,632 | | $ 297,765 | $ 304,117 |
| Total interest expense | 26,706 | 25,155 | | 52,889 | 51,993 |
| Net interest income | 120,228 | 126,477 | | 244,876 | 252,124 |
| Provision for loan and lease losses | 20,986 | 74,266 | | 42,039 | 107,236 |
| Non-interest income | 19,778 | 6,670 | | 38,247 | 39,399 |
| Non-interest expenses | 89,544 | 102,799 | | 182,541 | 194,527 |
| Income (loss) before income taxes | 29,476 | (43,918) | | 58,543 | (10,240) |
| Income tax (expense) benefit | (7,523) | 9,844 | | (13,246) | 1,812 |
| Net income (loss) | 21,953 | (34,074) | | 45,297 | (8,428) |
| Net income (loss) attributable to common stockholders | 21,953 | (34,074) | | 45,297 | (8,428) |
| **Per Common Share Results:** | | | | | |
| Net earnings (loss) per share-basic | $ 0.10 | $ (0.16) | | $ 0.21 | $ (0.04) |
| Net earnings (loss) per share-diluted | $ 0.10 | $ (0.16) | | $ 0.21 | $ (0.04) |
| Cash dividends declared | $ - | $ - | | $ - | $ - |
| Average shares outstanding | 212,768 | 211,247 | | 212,558 | 210,968 |
| Average shares outstanding diluted | 215,923 | 211,247 | | 214,598 | 210,968 |
| Book value per common share | $ 8.06 | $ 7.60 | | $ 8.06 | $ 7.60 |
| Tangible book value per common share (1) | $ 7.83 | $ 7.35 | | $ 7.83 | $ 7.35 |
| **Selected Financial Ratios (In Percent):** | | | | | |
| **Profitability:** | | | | | |
| Return on Average Assets | 0.69 | (1.06) | | 0.72 | (0.13) |
| Interest Rate Spread | 3.76 | 3.98 | | 3.85 | 3.98 |

Supplemental cash flow information is as follows:

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Net Interest Margin | 4.01 | | 4.18 | | 4.09 | | 4.18 |
| | Interest Rate Spread - tax equivalent basis (2) | 3.88 | | 4.13 | | 3.99 | | 4.12 |
| | Net Interest Margin - tax equivalent basis (2) | 4.13 | | 4.33 | | 4.24 | | 4.32 |
| | Return on Average Total Equity | 5.03 | | (8.06) | | 5.24 | | (1.00) |
| | Return on Average Common Equity | 5.14 | | (8.23) | | 5.35 | | (1.03) |
| | Average Total Equity to Average Total Assets | 13.78 | | 13.19 | | 13.69 | | 13.16 |
| | Tangible common equity ratio (1) | 13.65 | | 12.61 | | 13.65 | | 12.61 |
| | Dividend payout ratio | - | | - | | - | | - |
| | Efficiency ratio (3) | 63.96 | | 77.21 | | 64.47 | | 66.73 |
| **Asset Quality:** | | | | | | | | |
| | Allowance for loan and lease losses to total loans held for investment | 2.64 | | 2.45 | | 2.64 | | 2.45 |
| | Net charge-offs (annualized) to average loans (4) (5) | 1.11 | | 3.41 | | 1.08 | | 2.34 |
| | Provision for loan and lease losses to net charge-offs (6) | 85.11 | | 94.23 | | 87.05 | | 99.19 |
| | Non-performing assets to total assets (4) | 6.05 | | 5.12 | | 6.05 | | 5.12 |
| | Non-performing loans held for investment to total loans held for investment (4) | 6.74 | | 5.12 | | 6.74 | | 5.12 |
| | Allowance to total non-performing loans held for investment (4) | 39.19 | | 47.79 | | 39.19 | | 47.79 |
| | Allowance to total non-performing loans held for investment, | | | | | | | |
| | excluding residential real estate loans (4) | 54.05 | | 76.77 | | 54.05 | | 76.77 |
| **Other Information:** | | | | | | | | |
| | Common Stock Price: End of period | $ 3.97 | | $ 4.82 | | $ 3.97 | | $ 4.82 |
| | | | | | | | | |
| | | **As of June 30, 2016** | | **As of December 31, 2015** | | | | |
| **Balance Sheet Data:** | | | | | | | | |
| | Loans, including loans held for sale | $ 8,908,705 | | $ 9,148,251 | | | | |
| | | 234,454 | | 240,710 | | | | |

| | | |
|---|---|---|
| Allowance for loan and lease losses | | |
| Money market and investment securities | 2,406,857 | 2,299,520 |
| Intangible assets | 49,208 | 50,583 |
| Deferred tax asset, net | 299,291 | 311,263 |
| Total assets | 12,508,702 | 12,573,019 |
| Deposits | 9,225,019 | 9,338,124 |
| Borrowings | 1,371,187 | 1,381,492 |
| Total preferred equity | 36,104 | 36,104 |
| Total common equity | 1,733,832 | 1,685,779 |
| Accumulated other comprehensive income (loss), net of tax | 16,517 | (27,749) |
| Total equity | 1,786,453 | 1,694,134 |

(1) Non-GAAP financial measures. Refer to "Capital" below for additional information about the components and a reconciliation of these measures.

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

(3) Non-interest expense 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.

(4) Loans used in the denominator in calculating each of these ratios include purchased credit-impaired ("PCI") loans. However, the Corporation separately tracks and reports PCI loans and excludes these from non-performing loan and non-performing asset statistics.

(5) The ratio of net charge-offs to average loans, excluding charge-offs associated with the bulk sale of assets, was 0.76% and 1.03% for the quarter and six-month period ended June 30, 2015, respectively.

(6) The ratio of the provision for loan and lease losses to net charge-offs, excluding the impact of the bulk sale of assets, was 157.21% and 129.16% for the quarter and six-month period ended June 30, 2015, respectively.

The following Management's Discussion and Analysis of Financial Condition and Results of Operations relates to the accompanying unaudited consolidated financial statements of First BanCorp. (the "Corporation" or "First BanCorp.") and should be read in conjunction with such financial statements and the notes thereto. This section also presents certain non-GAAP financial measures. Refer to "Basis of Presentation" below for additional information about why the non-GAAP financial measures are being presented.

**EXECUTIVE SUMMARY**

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

**OVERVIEW OF RESULTS OF OPERATIONS**

First BanCorp.'s results of operations depend primarily on 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, non-interest expenses (such as personnel, occupancy, deposit insurance premium 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.

The Corporation had net income of $22.0 million, or $0.10 per diluted common share, for the quarter ended June 30, 2016, compared to a net loss of $34.1 million, or $0.16 per diluted common share, for the same period in 2015. The Corporation's financial results for the second quarter of 2015 were impacted by several items that management believes are not reflective of core operating performance, are not expected to reoccur with any regularity or may reoccur at uncertain times and amounts, including: (i) a $48.7 million pre-tax loss on a bulk sale of assets, mostly comprised of non-performing and adversely classified commercial loans, including transaction expenses (a $19.0 million tax benefit related to this transaction was recorded in the second quarter of 2015), (ii) Other-than-temporary impairment ("OTTI") losses on debt securities of $13.1 million, primarily on Puerto Rico Government debt securities (no tax benefit was recognized for the OTTI charges), and (iii) pre-tax costs of approximately $2.6 million related to the conversion of loan and deposit accounts acquired from Doral Bank to the FirstBank systems (a $1.0 million tax

benefit associated with these costs was recorded in the second quarter of 2015).

The following table reconciles for the second quarter of 2016 and 2015, the reported net income to adjusted net income, a non-GAAP financial measure that excludes items that management believes are not reflective of core operating performance, are not expected to reoccur with any regularity or may reoccur at uncertain times and amounts:

| | Quarter Ended June 30, | | | | | |
|---|---|---|---|---|---|---|
| | 2016 | | | 2015 | | |
| (In thousands) | | | | | | |
| Net income (loss), as reported | $ | 21,953 | $ | (34,074) | | |
| Adjustments: | | | | | | |
| Loss on bulk sale of assets, including transaction expenses | | - | | 48,667 | | |
| Other-than-temporary impairment on debt securities | | - | | 13,097 | | |
| Conversion costs of loans and deposits assumed | | | | | | |
| from Doral Bank | | - | | 2,562 | | |
| Income tax impact of adjustments | | - | | (19,979) | | |
| Adjusted net income | $ | 21,953 | $ | 10,273 | | |



Supplemental cash flow information is as follows:

The key drivers of the Corporation's financial results for the quarter ended June 30, 2016, compared to the same period in 2015, include the following:

- Net interest income decreased $6.3 million to $120.2 million for the quarter ended June 30, 2016 compared to $126.5 million for the same period in 2015. The decrease in net interest income was primarily driven by a $5.9 million reduction in interest income on loans, including: (i) a $3.9 million decrease in interest income on consumer loans mainly attributable to a decrease of $149.3 million in the average balance of this portfolio, primarily auto loans, (ii) a $1.1 million decrease in interest income on commercial and construction loans reflecting a decline of $198.5 million in the average balance of these portfolios that resulted in a decrease of approximately $0.9 million in interest income and the adverse impact of large commercial relationships classified as non-performing in 2016, and (iii) a $1.0 million decrease in interest income on residential mortgage loans primarily reflecting both a decrease in cash collections on residential non-performing loans and a decrease of $13.5 million in the average balance of this portfolio. In addition, net interest income was adversely impacted by a $1.6 million increase in interest expense primarily reflecting the upward repricing of the repurchase agreements and a higher average balance of FHLB advances.

The aforementioned adverse variances were partially offset by: (i) a $0.8 million increase in interest income on interest-bearing cash balances, due to the increase in fed fund rates in December 2015 and a $280.8 million increase in the average balance of deposits maintained in the Federal Reserve Bank, and, (ii) a $0.4 million increase in interest income on investment securities primarily due to an increase of $114.5 million in the average balance of U.S. agencies debt securities, reflecting securities purchases in excess of investments called prior to maturity.

The net interest margin, excluding fair value adjustments, decreased 17 basis points to 4.01% for the second quarter of 2016 compared to the same period in 2015. The decline was primarily driven by a higher level of liquidity maintained during the second quarter of 2016, derived from loan repayments, and the adverse impact of large commercial relationships classified as non-performing in 2016. For a definition and reconciliation of this non-GAAP measure, refer to "Net Interest Income" discussion below.

- The provision for loan and lease losses decreased $53.3 million to $21.0 million for the second quarter of 2016 compared to $74.3 million for the same period in 2015. The provision for the second quarter of 2015 included a charge of $46.9 million associated with a bulk sale of assets. On June 5, 2015, the Corporation completed the bulk sale of commercial and construction loans with a book value of $147.5 million (principal balance of $196.5 million), comprised mostly of non-performing and adversely classified loans, as well as other real estate owned ("OREO") with a book value of $2.9 million in a cash transaction. The sale price of this bulk sale was $87.3 million. Approximately $15.3 million of reserves had been allocated to the loans. This transaction resulted in total charge-offs of $61.4 million and an incremental pre-tax loss of $48.7 million, including $0.9 million in professional service fees directly attributable to this bulk sale.

Excluding the impact of the bulk sale of assets in the second quarter of 2015, the provision of $21.0 million for the second quarter of 2016 decreased by $6.4 million compared to the adjusted provision of $27.4 million for the same period in 2015. The decrease reflects a reduction of $10.8 million in the adjusted provision for commercial and construction loans primarily due to the impact in the second quarter of 2015 of a $15.5 million charge to the provision as a result of the incorporation of the $61.4 million of net charge-offs from the bulk sale in the historical loss rates used to estimate the general reserve for commercial loans collectively evaluated for impairment, partially offset by lower loan loss recoveries in Florida as compared to the second quarter of 2015.

The aforementioned decrease in the adjusted provision for commercial and construction loans was partially offset by a $2.7 million increase in the provision for residential mortgage loans, primarily due to revisions to the quarterly home price index for Puerto Rico published by the Federal Housing Finance Agency, which is used as the basis for the estimated value of the underlying collateral of the portfolio for purposes of determining the general reserve. In addition, the provision for consumer loans increased by $1.7 million reflecting the impact in the second quarter of 2015 of loan loss recoveries of $2.7 million on the sale of certain fully charged-off auto and personal loans, partially offset by improvements in historical charge-offs trends and the decrease in the size of this portfolio, primarily auto loans.

Net charge-offs totaled $24.7 million for the second quarter of 2016, or 1.11% of average loans on an annualized basis, compared to $78.8 million, or 3.41% of average loans, for the same period in 2015. The bulk sale of assets added $61.4 million in net charge-offs in the second quarter of 2015. Excluding the impact of net charge-offs related to the bulk sale of assets, the $24.7 million of net charge-offs for the second quarter of 2016 increased by $7.3 million compared to adjusted net charge-offs of $17.4 million for the second quarter of 2015, primarily reflecting higher losses on residential mortgage loans.

Refer to “Basis of Presentation” below for a reconciliation of certain non-GAAP financial measures (“adjusted net charge-offs” and “adjusted provision for loan and lease losses,”), which reflect the exclusion of the realized loss on the bulk sale of assets, with the corresponding measures calculated and presented in accordance with GAAP. 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 non-interest income of $19.8 million for the second quarter of 2016, compared to $6.7 million for the same period in 2015. The increase primarily reflects the impact in the second quarter of 2015 of OTTI charges on debt securities amounting to $13.1 million, primarily on Puerto Rico Government debt securities. Refer to “Non-Interest Income” below for additional information.

- Non-interest expenses decreased by $13.2 million to $89.5 million for the second quarter of 2016 compared to the same period in 2015. Non-interest expenses for the second quarter of 2015 included $1.2 million of expenses and losses related to the bulk sale of assets and costs of $2.6 million related to the conversion of loan and deposit accounts acquired from Doral Bank to the FirstBank systems. Excluding the aforementioned items, the $89.5 million of non-interest expenses for the second quarter of 2016 decreased by $9.5 million compared to adjusted non-interest expenses of $99.0 million for the same period in 2015. The decrease was primarily related to: (i) a $4.8 million decrease in adjusted professional service fees primarily reflecting the impact in the second quarter of 2015 of interim servicing costs of $2.4 million related to loans and deposits acquired from Doral Bank and of $1.3 million of professional service fees incurred in special projects and strategic, stress testing and capital planning matters, (ii) a $2.0 million decrease in occupancy and equipment costs reflecting reductions in depreciation, electricity and repairs expenses, (iii) a $1.3 million decrease in adjusted losses on OREO operations primarily due to lower property tax expenses, and (iv) decreases in other operating expenses such as a reduction of $0.7 million in processing expenses mainly due to the sale of merchant contracts in the fourth quarter of 2015 and a $0.6 million decrease in supplies, printing and mailing costs. Refer to “Basis of Presentation” below for a reconciliation of the non-GAAP financial measures “adjusted non-interest expenses,” which reflects the exclusion in the second quarter of 2015 of expenses related to the bulk sale of assets and costs related to the conversion of loan and deposit accounts from Doral Bank to the FirstBank systems, to the corresponding GAAP measure. Also refer to “Non-Interest Expenses” below for additional information.

- For the second quarter of 2016, the Corporation recorded an income tax expense of $7.5 million, compared to an income tax benefit of $9.8 million for the same period in 2015. The variance reflects higher taxable income mainly due to the impact in 2015 of realized losses on the bulk sale of assets. The Corporation’s effective tax rate for the first six months of 2016 was 23% (22% excluding entities from which a tax benefit cannot be recognized), which approximates the expected effective tax rate for the year, compared to 18% (30% excluding entities from which a tax benefit cannot be recognized) for the first half of 2015. As of June 30, 2016, the Corporation had a net deferred tax asset of $299.3 million (net of a valuation allowance of $198.2 million). Refer to “Income Taxes” below for additional information.

- As of June 30, 2016, total assets were $12.5 billion, a decrease of $64.3 million from December 31, 2015. The decrease was mainly due to a $239.5 million decrease in total loans, including a $145.8 million reduction in commercial and construction loans and a $75.0 million decrease in consumer loans. The decrease in commercial and construction loans was mainly driven by the repayment of several large commercial loans in the first half of 2016,

including repayments totaling $145.3 million associated with six commercial relationships, partially offset by new loan originations. The decrease in total loans was partially offset by a $116.7 million increase in available-for-sale investment securities driven by purchases of debt securities issued or guaranteed by U.S. agencies and higher fair values on U.S. agencies MBS and debt securities. In addition, the balance of cash and cash equivalents increased by $75.5 million primarily tied to an increase in demand deposits and proceeds from loan repayments. Refer to "Financial Condition and Operating Data" below for additional information.

- As of June 30, 2016, total liabilities were $10.7 billion, a decrease of $156.6 million, from December 31, 2015. The decrease was mainly due to a $288.4 million decrease in brokered CDs, a $10 million decrease in junior subordinated debentures associated with the repurchase and cancellation of certain trust preferred securities, and the payment of interest on trust preferred securities amounting to $31.2 million that represents the aggregate amount of quarterly payments deferred and accrued since March 2012. As of June 30, 2016, the Corporation is current on all interest payments due related to its subordinated debt. These reductions were partially offset by a $99.7 million increase in deposits, excluding government deposits and brokered CDs, primarily reflected in the Puerto Rico region, and a $67.0 million increase in government deposits. Refer to "Risk Management – Liquidity and Capital Adequacy" below for additional information about the Corporation's funding sources.

- As of June 30, 2016, the Corporation's stockholders' equity was $1.8 billion, an increase of $92.3 million from December 31, 2015. The increase was mainly driven by the net income of $45.3 million for the first half of 2016 and a $36.0 million increase in the fair value of available-for-sale U.S. agency MBS and debt securities recorded as part of other comprehensive income.

- The Corporation's Total Capital, Common Equity Tier 1 Capital, Tier 1 Capital and Leverage ratios calculated under the Basel III rules were 20.72%, 17.12%, 17.12%, and 12.34%, respectively, as of June 30, 2016, compared to Total Capital, Common Equity Tier 1 Capital, Tier 1 Capital and Leverage ratios of 20.01%, 16.92%, 16.92%, and 12.22%, respectively, as of December 31,



---

2015. The Corporation's tangible common equity ratio increased to 13.65% as of June 30, 2016, from 12.84% as of December 31, 2015. Refer to "Risk Management – Capital" below for additional information.

- Total loan production, including purchases, refinancings, renewals and draws from existing revolving and non-revolving commitments, was $712.8 million for the quarter ended June 30, 2016, excluding the utilization activity on outstanding credit cards, compared to $762.5 million for the same period in 2015. The decrease was reflected in most of the principal loan categories in Puerto Rico, which showed an aggregate decrease of $43.8 million.

- Total non-performing assets were $756.2 million as of June 30, 2016, an increase of $146.3 million from December 31, 2015. The increase was primarily attributable to the inflow in the first quarter of 2016 of the Corporation's exposure to commercial mortgage loans guaranteed by the Puerto Rico Tourism Development Fund ("TDF") with a book value of $127.3 million as of June 30, 2016 and the inflow in the second quarter of 2016 of a $35.0 million commercial relationship in Puerto Rico. The increase resulting from the inflow of large commercial loans was partially offset by reductions in non-performing residential, consumer and OREO balances. Refer to "Risk Management - Non-accruing and Non-performing Assets" below for additional information.

- Adversely classified commercial and construction loans held for investment increased by $44.6 million to $566.8 million as of June 30, 2016 from $522.1 million as of December 31, 2015, including the migration to adverse classification categories of the aforementioned $35.0 million non-performing commercial relationship in Puerto Rico.

**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: 1) the allowance for loan and lease losses; 2) other-than-temporary impairments; 3) income taxes; 4) the classification and values of financial instruments; 5) income recognition on loans; 6) loans acquired; and 7) loans held for sale. These critical accounting policies involve judgments, estimates and assumptions made by management that affect the amounts recorded for assets, liabilities and contingent liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from estimates, if different assumptions or conditions prevail. Certain determinations inherently require greater reliance on the use of estimates, assumptions, and judgments and, as such, have a greater possibility of producing results that could be materially different than those originally reported.

The Corporation's critical accounting policies are described in Management's Discussion and Analysis of Financial Condition and Results of Operations included in First BanCorp.'s 2015 Annual Report on Form 10-K. There have not been any material changes in the Corporation's critical accounting policies since December 31, 2015.

During the second quarter of 2016, the Corporation reviewed its historical accounting treatment as loans for its $161.3 million of financing arrangements with Puerto Rico municipalities issued in bond form, but underwritten as loans with features that are typically found in commercial loan transactions. This review came as a result of the recent determination of the Federal Reserve Board that the transactions must be treated for regulatory reporting purposes as investment securities. The Puerto Rico Municipal Finance Act (the "Act") requires the designation of financing arrangements obtained by municipalities with maturities greater than 8 years as "special obligation bonds" subject to specific provisions under the Act. The Corporation has concluded that the impact of accounting for the transactions as investment securities rather than loans does not have a material effect on previously reported results of operations, financial condition, or cash flows and, accordingly, these financing arrangements are now accounted for and reported as held-to-maturity investment securities and not as loans as of June 30, 2016 and for prior periods.

**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 quarter and six-month period ended June 30, 2016 was $120.2 million and $244.9 million, respectively, compared to $126.5 million and $252.1 million for the comparable periods in 2015. On a tax-equivalent basis, and excluding the changes in the fair value of derivative instruments, net interest income for the quarter and six-month period ended June 30, 2016 was $123.7 million and $253.2 million, respectively, compared to $131.1 million and $260.7 million for the comparable periods in 2015.

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 the volume of interest-related assets and liabilities have affected the Corporation's net interest income. For each category of

interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to (i) changes in volume (changes in volume multiplied by prior period rates), and (ii) changes in rate (changes in rate multiplied by prior period volumes). Rate-volume variances (changes in rate multiplied by changes in volume) have been allocated to the changes in volume and rate based upon their respective percentage of the combined totals.

The net interest income is computed on an adjusted tax-equivalent basis and excluding the change in the fair value of derivative instruments. For a definition and reconciliation of this non-GAAP financial measure, refer to the discussions below.

| **Part I** | Average Volume | | Interest income [(1)] / expense | | Average Rate [(1)] | |
|---|---|---|---|---|---|---|
| **Quarter ended June 30,** | **2016** | **2015** | **2016** | **2015** | **2016** | **2015** |
| (Dollars in thousands) | | | | | | |
| Interest-earning assets: | | | | | | |
| Money market & other short-term investments | $ 1,009,398 | $ 737,227 | $ 1,271 | $ 510 | 0.51 % | 0.28 % |
| Government obligations (2) | 747,760 | 633,300 | 6,006 | 5,430 | 3.23 % | 3.44 % |
| Mortgage-backed securities | 1,380,043 | 1,508,831 | 9,898 | 10,297 | 2.88 % | 2.74 % |
| FHLB stock | 31,140 | 25,435 | 350 | 257 | 4.52 % | 4.05 % |
| Other investments | 1,727 | 818 | 2 | - | 0.47 % | - |
| Total investments (3) | 3,170,068 | 2,905,611 | 17,527 | 16,494 | 2.22 % | 2.28 % |
| | | | | | | |
| Residential mortgage loans | 3,307,788 | 3,321,269 | 45,261 | 46,310 | 5.50 % | 5.59 % |
| Construction loans | 144,788 | 169,890 | 1,301 | 1,566 | 3.61 % | 3.70 % |
| C&I and commercial mortgage loans | 3,664,699 | 3,838,121 | 38,818 | 40,493 | 4.26 % | 4.23 % |
| Finance leases | 229,892 | 228,749 | 4,308 | 4,507 | 7.54 % | 7.90 % |
| Consumer loans | 1,536,755 | 1,687,243 | 43,223 | 46,875 | 11.31 % | 11.14 % |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Total loans (4) (5) | 8,883,922 | 9,245,272 | | 132,911 | | 139,751 | 6.02 % | 6.06 % |
| Total interest-earning assets | $ 12,053,990 | $ 12,150,883 | $ | 150,438 | $ | 156,245 | 5.02 % | 5.16 % |
| | | | | | | | | |
| Interest-bearing liabilities: | | | | | | | | |
| Brokered CDs | $ 1,977,059 | $ 2,437,937 | $ | 5,847 | $ | 6,039 | 1.19 % | 0.99 % |
| Other interest-bearing deposits | 5,987,694 | 6,034,536 | | 11,377 | | 10,941 | 0.76 % | 0.73 % |
| Other borrowed funds | 988,711 | 971,194 | | 8,011 | | 7,231 | 3.26 % | 2.99 % |
| FHLB advances | 455,000 | 325,000 | | 1,471 | | 944 | 1.30 % | 1.17 % |
| Total interest-bearing liabilities | $ 9,408,464 | $ 9,768,667 | $ | 26,706 | $ | 25,155 | 1.14 % | 1.03 % |
| | | | | | | | | |
| Net interest income | | | $ | 123,732 | $ | 131,090 | | |
| | | | | | | | | |
| Interest rate spread | | | | | | | 3.88 % | 4.13 % |
| | | | | | | | | |
| Net interest margin | | | | | | | 4.13 % | 4.33 % |

| Six-Month Period Ended June 30, | Average Volume | | Interest income [(1)] / expense | | Average Rate [(1)] | |
|---|---|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 | 2016 | 2015 |
| (Dollars in thousands) | | | | | | |
| Interest-earning assets: | | | | | | |
| Money market & other short-term investments | $ 930,090 | $ 774,782 | $ 2,344 | $ 1,047 | 0.51 % | 0.27 % |
| Government obligations (2) | 723,761 | 608,706 | 11,484 | 9,611 | 3.19 % | 3.18 % |
| Mortgage-backed securities | 1,384,924 | 1,530,197 | 22,175 | 22,798 | 3.22 % | 3.00 % |
| FHLB stock | 31,212 | 25,451 | 698 | 552 | 4.50 % | 4.37 % |
| Other investments | 1,599 | 590 | 3 | - | 0.38 % | - |
| Total investments (3) | 3,071,586 | 2,939,726 | 36,704 | 34,008 | 2.40 % | 2.13 % |
| | | | | | | |
| Residential mortgage loans | 3,314,685 | 3,221,513 | 90,649 | 89,792 | 5.50 % | 5.62 % |
| Construction loans | 152,535 | 170,967 | 2,916 | 3,098 | 3.84 % | 3.65 % |
| C&I and commercial mortgage loans | 3,692,656 | 3,901,416 | 79,796 | 82,321 | 4.35 % | 4.26 % |
| Finance leases | 230,058 | 229,520 | 8,744 | 9,118 | 7.64 % | 8.01 % |
| Consumer loans | 1,556,726 | 1,708,229 | 87,255 | 94,398 | 11.27 % | 11.14 % |
| Total loans (4) (5) | 8,946,660 | 9,231,645 | 269,360 | 278,727 | 6.05 % | 6.08 % |
| Total interest-earning assets | $ 12,018,246 | $ 12,171,371 | $ 306,064 | $ 312,735 | 5.12 % | 5.18 % |
| | | | | | | |
| Interest-bearing liabilities: | | | | | | |
| Brokered CDs | $ 2,026,937 | $ 2,586,470 | $ 11,864 | $ 12,649 | 1.18 % | 0.99 % |
| Other interest-bearing deposits | 5,966,560 | 5,900,493 | 22,617 | 22,025 | 0.76 % | 0.75 % |

Supplemental cash flow information is as follows:

| | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Other borrowed funds | | 953,863 | | 1,051,132 | | 15,466 | | 15,441 | 3.26 | % | 2.96 | % |
| FHLB advances | | 455,000 | | 325,000 | | 2,942 | | 1,878 | 1.30 | % | 1.17 | % |
| Total interest-bearing liabilities | $ | 9,402,360 | $ | 9,863,095 | $ | 52,889 | $ | 51,993 | 1.13 | % | 1.06 | % |
| | | | | | | | | | | | | |
| Net interest income | | | | | $ | 253,175 | $ | 260,742 | | | | |
| | | | | | | | | | | | | |
| Interest rate spread | | | | | | | | | 3.99 | % | 4.12 | % |
| | | | | | | | | | | | | |
| Net interest margin | | | | | | | | | 4.24 | % | 4.32 | % |

(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 of 39.0% 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 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 $2.4 million and $2.5 million for the quarters ended June 30, 2016 and 2015, respectively, and $5.2 million for each of the six-month periods ended June 30, 2016 and 2015, of income from prepayment penalties and late fees related to the Corporation’s loan portfolio.

| Part II | Quarter ended June 30, 2016 compared to 2015 | | | Six-Month Period Ended June 30, 2016 compared to 2015 | | |
|---|---|---|---|---|---|---|
| | Increase (decrease) | | | Increase (decrease) | | |
| | Due to: | | | Due to: | | |
| (In thousands) | Volume | Rate | Total | Volume | Rate | Total |
| Interest income on interest-earning assets: | | | | | | |
| Money market & other short-term investments | $ 235 | $ 526 | $ 761 | $ 245 | $ 1,052 | $ 1,297 |
| Government obligations | 945 | (369) | 576 | 1,852 | 21 | 1,873 |
| Mortgage-backed securities | (918) | 519 | (399) | (2,227) | 1,604 | (623) |
| FHLB stock | 61 | 32 | 93 | 130 | 16 | 146 |
| Other investments | - | 2 | 2 | - | 3 | 3 |
| Total investments | 323 | 710 | 1,033 | - | 2,696 | 2,696 |
| Residential mortgage loans | (212) | (837) | (1,049) | 2,713 | (1,856) | 857 |
| Construction loans | (230) | (35) | (265) | (341) | 159 | (182) |
| C&I and commercial mortgage loans | (1,892) | 217 | (1,675) | (4,367) | 1,842 | (2,525) |
| Finance leases | 16 | (215) | (199) | 35 | (409) | (374) |
| Consumer loans | (4,278) | 626 | (3,652) | (8,339) | 1,196 | (7,143) |
| Total loans | (6,596) | (244) | (6,840) | (10,299) | 932 | (9,367) |
| Total interest income | (6,273) | 466 | (5,807) | (10,299) | 3,628 | (6,671) |
| Interest expense on interest-bearing liabilities: | | | | | | |
| Brokered CDs | (1,265) | 1,073 | (192) | (3,006) | 2,221 | (785) |
| Other interest-bearing deposits | (104) | 540 | 436 | 277 | 315 | 592 |
| Other borrowed funds | 129 | 651 | 780 | (1,492) | 1,517 | 25 |
| FHLB advances | 408 | 119 | 527 | 825 | 239 | 1,064 |
| Total interest expense | (832) | 2,383 | 1,551 | (3,396) | 4,292 | 896 |
| Change in net interest income | $ (5,441) | $ (1,917) | $ (7,358) | $ (6,903) | $ (664) | $ (7,567) |

Supplemental cash flow information is as follows:

Portions of the Corporation's interest-earning assets, mostly investments in obligations of some U.S. government agencies and sponsored entities, generate interest which is exempt from income tax, principally in Puerto Rico. Also, interest and gains on sales of investments held by the Corporation's international banking entities ("IBEs") are tax-exempt under the Puerto Rico tax law (refer to "Income Taxes" below for additional information). To facilitate the comparison of all interest data related to these assets, the interest income has been converted to an adjusted taxable equivalent basis. The tax equivalent yield was estimated by dividing the interest rate spread on exempt assets by 1 less the Puerto Rico statutory tax rate as adjusted for changes to enacted tax rates (39.0%) 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 ("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 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:

| (Dollars in thousands) | Quarter Ended | | Six-Month Period Ended | |
|---|---|---|---|---|
| | June 30, 2016 | June 30, 2015 | June 30, 2016 | June 30, 2015 |
| Interest Income - GAAP | $ 146,934 | $ 151,632 | $ 297,765 | $ 304,117 |
| Unrealized loss on derivative instruments | 2 | - | 6 | - |
| Interest income excluding valuations | 146,936 | 151,632 | 297,771 | 304,117 |
| Tax-equivalent adjustment | 3,502 | 4,613 | 8,293 | 8,618 |
| Interest income on a tax-equivalent basis excluding valuations | 150,438 | 156,245 | 306,064 | 312,735 |
| | | | | |
| Interest Expense - GAAP | 26,706 | 25,155 | 52,889 | 51,993 |
| | | | | |
| Net interest income - GAAP | $ 120,228 | $ 126,477 | $ 244,876 | $ 252,124 |
| | | | | |
| Net interest income excluding valuations | $ 120,230 | $ 126,477 | $ 244,882 | $ 252,124 |
| | | | | |
| Net interest income on a tax-equivalent basis excluding valuations | $ 123,732 | $ 131,090 | $ 253,175 | $ 260,742 |
| | | | | |
| **Average Balances** | | | | |
| Loans and leases | $ 8,883,922 | $ 9,245,272 | $ 8,946,660 | $ 9,231,645 |
| Total securities, other short-term investments and interest-bearing cash balances | 3,170,068 | 2,905,611 | 3,071,586 | 2,939,726 |
| Average Interest-Earning Assets | $ 12,053,990 | $ 12,150,883 | $ 12,018,246 | $ 12,171,371 |
| | | | | |
| Average Interest-Bearing Liabilities | $ 9,408,464 | $ 9,768,667 | $ 9,402,360 | $ 9,863,095 |
| | | | | |
| **Average Yield/Rate** | | | | |
| | 4.90 % | 5.01 % | 4.98 % | 5.04 % |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Average yield on interest-earning assets - GAAP | | | | | | | | |
| Average rate on interest-bearing liabilities - GAAP | 1.14 | % | 1.03 | % | 1.13 | % | 1.06 | % |
| Net interest spread - GAAP | 3.76 | % | 3.98 | % | 3.85 | % | 3.98 | % |
| Net interest margin - GAAP | 4.01 | % | 4.18 | % | 4.09 | % | 4.18 | % |
| | | | | | | | | |
| Average yield on interest-earning assets excluding valuations | 4.90 | % | 5.01 | % | 4.98 | % | 5.04 | % |
| Average rate on interest-bearing liabilities excluding valuations | 1.14 | % | 1.03 | % | 1.13 | % | 1.06 | % |
| Net interest spread excluding valuations | 3.76 | % | 3.98 | % | 3.85 | % | 3.98 | % |
| Net interest margin excluding valuations | 4.01 | % | 4.18 | % | 4.09 | % | 4.18 | % |
| | | | | | | | | |
| Average yield on interest-earning assets on a tax-equivalent basis | | | | | | | | |
| and excluding valuations | 5.02 | % | 5.16 | % | 5.12 | % | 5.18 | % |
| Average rate on interest-bearing liabilities excluding valuations | 1.14 | % | 1.03 | % | 1.13 | % | 1.06 | % |
| Net interest spread on a tax-equivalent basis and excluding valuations | 3.88 | % | 4.13 | % | 3.99 | % | 4.12 | % |
| Net interest margin on a tax-equivalent basis and excluding valuations | 4.13 | % | 4.33 | % | 4.24 | % | 4.32 | % |

Interest income on interest-earning assets primarily represents interest earned on loans held for investment 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 junior subordinated debentures.

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

For the quarter and six-month period ended June 30, 2016, net interest income decreased $6.2 million to $120.2 million, and $7.2 million to $244.9 million, respectively, compared to the same periods in 2015. The $6.2 million decrease in net interest income for the second quarter of 2016, compared to the same period in 2015 was primarily due to:

- A $3.9 million decrease in interest income on consumer loans and finance leases mainly attributable to the decrease of $149.3 million in the average balance of this portfolio, primarily auto loans.

- A $1.1 million decrease in interest income on commercial and construction loans, primarily reflecting a decline of $198.5 million in the average balance of these portfolios that resulted in a decrease of approximately $0.9 million in interest income and the adverse impact of large commercial relationships classified as non-performing in 2016, which are now accounted for on a cost-recovery basis.

- A $1.0 million decrease in interest income on residential mortgage loans primarily reflecting both a decrease in cash collections on residential non-performing loans and a decrease of $13.5 million in the average balance of this portfolio.



---

- A $1.6 million increase in interest expense primarily reflecting: (i) a $0.6 million increase in interest expense on repurchase agreements mainly attributable to the upward repricing of the agreements, (ii) a $0.5 million increase in interest expense on FHLB advances primarily attributable to the $130.0 million of advances obtained during the fourth quarter of 2015 with maturities of four years and at an average cost of 1.64%, (iii) a $0.4 million increase in interest expense on non-brokered deposits driven by the growth and pricing of new and renewed CDs in the current interest rate environment, and (iv) a $0.2 million increase in the interest expense on junior subordinated debentures that have been repricing at higher rates. These increases were partially offset by a $0.2 million decrease in the interest expense on brokered CDs mainly related to the effect of the $460.9 million decrease in the average balance, which more than offset higher costs due to both higher market interest rates, and, to a lesser extent, longer terms on new issuances compared to maturing CDs.

Partially offset by:

- A $0.8 million increase in interest income on interest-bearing cash balances, due to the increase in fed fund rates in December 2015 and the $280.8 million increase in the average balance of deposits maintained in the Federal Reserve Bank.

- A $0.4 million increase in interest income on investment securities primarily due to an increase of $114.5 million in the average balance of U.S. agencies debt securities, reflecting securities purchases in excess of investments called prior to maturity.

The $7.2 million decrease in net interest income for the first half of 2016, compared to the same period in 2015 was primarily due to:

- A $7.5 million decrease in interest income on consumer loans and finance leases mainly attributable to the decrease of $151.0 million in the average balance of this portfolio, primarily auto loans.

- A $1.7 million decrease in interest income on commercial and construction loans, primarily reflecting a decline of $227.2 million in the average balance of these portfolios that resulted in a decrease of approximately $2.0 million in interest income and the adverse impact of large commercial relationships classified as non-performing in 2016. Partially offsetting these variances were higher prepayments in 2016 that resulted in an increase of $1.5 million in prepayment penalties and deferred fees amortization and the upward repricing of commercial loans tied to short-term interest rates.

- A $0.9 million increase in interest expense primarily reflecting: (i) a $1.1 million increase in interest expense on FHLB advances primarily attributable to the aforementioned $130.0 million of advances obtained during the fourth quarter of 2015, and (ii) a $0.6 million increase in interest expense on non-brokered deposits attributable to both a $66.1 million increase in the average balance and the growth and pricing of new and renewed retail CDs at current market interest rates. These increases were partially offset by a $0.8 million decrease in the interest expense on brokered CDs mainly related to the effect of the $559.5 million decrease in the average balance that offset higher costs on new issuances. Over the past 12 months, the Corporation repaid $1.7 billion of maturing brokered CDs with an all-in cost of 0.90% and new issuances amounted to $1.2 billion with an all-in cost of 1.16%. The original average life of the brokered CDs outstanding as of June 30, 2016 was 2.4 years compared to an average life of 2.3 years a year ago.

Partially offset by:

- A $1.0 million increase in interest income on residential mortgage loans primarily reflecting the full period impact of the loans acquired from Doral Bank in late February 2015, partially offset by lower cash collections on residential non-performing loans for which interest income is accounted for on a cash basis.

- A $1.3 million increase in interest income on interest-bearing cash balances, due to the increase in fed fund rates in December 2015 and the $132.1 million increase in the average balance of deposits maintained in the Federal Reserve.

- A $0.6 million increase in interest income on investment securities mainly attributable to the $115.1 million increase in the average balance of U.S. agencies debt securities reflecting purchases in excess of securities called prior to maturity.

The net interest margin, excluding fair value adjustments, decreased by 17 basis points to 4.01% for the second quarter of 2016 compared to the same period in 2015, and decreased by 9 basis points to 4.09% for the first six months of 2016 compared to the same period in 2015. The decrease in net interest margin for both periods was primarily driven by higher liquidity levels and the adverse impact of large commercial relationships classified as non-performing in 2016 for which interest payments are now accounted for on a cost-recovery basis.

On an adjusted tax-equivalent basis, net interest income for the quarter ended June 30, 2016 decreased by $7.4 million to $123.7 million when compared to the same period in 2015 and by $7.6 million to $253.2 million for the first six months of 2016 compared to

Supplemental cash flow information is as follows:

the same period in 2015. In addition to the facts discussed above, the decrease also includes reductions of $1.1 million for the quarter and $0.3 million for the six-month period in the tax-equivalent adjustment attributable to a lower volume of tax-exempt assets.

**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.

For the second quarter ended June 30, 2016, the Corporation recorded a provision for loan and lease losses of $21.0 million compared to $74.3 million for the same period in 2015. The provision for the second quarter of 2015 included a charge of $46.9 million associated with the bulk sale of assets. Excluding the impact of the bulk sale of assets in the second quarter of 2015, the provision of $21.0 million for the second quarter of 2016 decreased by $6.4 million compared to the adjusted provision of $27.4 million for the same period in 2015.

The decrease of $6.4 million in the adjusted provision was driven by:

- A $10.8 million decrease in the adjusted provision for commercial and construction loans primarily due to the impact in the second quarter of 2015 of a $15.5 million charge to the provision as a result of the incorporation of the $61.4 million of net charge-offs from the bulk sale in the historical loss rates used to estimate the general reserve for commercial loans collectively evaluated for impairment, partially offset by a $1.6 million decrease in loan loss recoveries in Florida, as compared to the second quarter of 2015, and the impact in the prior year of lower historical loss rates applied to some asset classifications resulting from improvements in loans' migration experience.

Partially offset by:

- A $2.7 million increase in the provision for residential mortgage loans, primarily due to revisions to the quarterly home price index for Puerto Rico published by the Federal Housing Finance Agency used as the basis for the estimated value of the underlying collateral of the portfolio for purposes of determining the general reserve and

updated appraisals for loans evaluated for impairment based on delinquency and loan-to-value levels.

- A $1.7 million increase in the provision for consumer loans reflecting the impact in the second quarter of 2015 of $2.7 million in loan loss recoveries recorded on the sale of certain fully charged-off auto and personal loans, partially offset by improvements in historical charge-off trends and the decrease in the size of this portfolio, primarily auto loans.

Net charge-offs totaled $24.7 million for the second quarter of 2016, or 1.11% of average loans on an annualized basis, compared to $78.8 million, or 3.41% of average loans for the same period in 2015. The bulk sale of assets added $61.4 million in net charge-offs in the second quarter of 2015. Excluding the impact of net charge-offs related to the bulk sale of assets, the $24.7 million of net charge-offs for the second quarter of 2016 increased by $7.3 million compared to adjusted net charge-offs of $17.4 million for the second quarter of 2015 primarily reflecting higher losses on residential mortgage loans

For the six-month period ended June 30, 2016, the Corporation recorded a provision for loan and lease losses of $42.0 million compared to $107.2 million for the same period in 2015. Excluding the impact of the bulk sale of assets in the second quarter of 2015, the provision of $42.0 million for the first six months of 2016 decreased by $18.3 million compared to the adjusted provision of $60.3 million for the same period in 2015.

The decrease of $18.3 million in the adjusted provision was driven by:

- A $13.8 million decrease in the adjusted provision for commercial and construction loans primarily due to the aforementioned $15.5 million charge to the provision in the second quarter of 2015 as a result of the incorporation of the $61.4 million of net charge-offs from the bulk sale in the historical loss rates used to estimate the general reserve for commercial loans collectively evaluated for impairment and lower levels of charge-offs in the Puerto Rico region, partially offset by a $1.7 million decrease in loan loss recoveries in Florida.

- A $6.7 million decrease in the provision for consumer loans, primarily reflecting lower levels of charge-offs, declining loss severity rates on auto loans and the overall decrease in the size of these portfolios. Consumer loans net charge-offs decreased by $4.0 million for the first six months of 2016 compared to the same period in 2015.



---

Partially offset by:

- A $2.2 million increase in the provision for residential mortgage loans, primarily due to the aforementioned revision to the quarterly home price index for Puerto Rico and updated appraisals for loans evaluated for impairment based on delinquency and loan-to-value levels.

Refer to “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 “Financial Condition and Operating Analysis – Loan Portfolio” and “Risk Management — Credit Risk Management” below for additional information concerning the Corporation’s loan portfolio exposure in the geographic areas where the Corporation does business.

**Non-Interest Income**

| | Quarter Ended June 30, 2016 | Quarter Ended June 30, 2015 | Six-Month Period Ended June 30, 2016 | Six-Month Period Ended June 30, 2015 |
|---|---|---|---|---|
| | (In thousands) | | | |
| Service charges on deposit accounts | $ 5,618 | $ 5,219 | $ 11,418 | $ 9,774 |
| Mortgage banking activities | 4,893 | 4,763 | 9,646 | 8,381 |
| Insurance income | 1,542 | 1,522 | 4,811 | 4,544 |
| Other operating income | 7,725 | 8,263 | 14,834 | 16,510 |
| Non-interest income before net gain (loss) on investments, gain on early extinguishment of debt, and bargain purchase gain | 19,778 | 19,767 | 40,709 | 39,209 |
| Net gain on sale of investments | - | - | 8 | - |
| OTTI on debt securities | - | (13,097) | (6,687) | (13,253) |
| Net loss on investments | - | (13,097) | (6,679) | (13,253) |
| Bargain purchase gain | - | - | - | 13,443 |
| Gain on early extinguishment of debt | - | - | 4,217 | - |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Total | $ | 19,778 | $ | 6,670 | $ | 38,247 | $ | 39,399 |

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; and net gains and losses on investments and impairments.

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

Income from mortgage banking activities includes gains on sales and securitization of loans, 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 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.

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.

The gain on early extinguishment of debt is related to the repurchase and cancellation in the first quarter of 2016 of $10 million in trust preferred securities of the FBP Statutory Trust II that were auctioned in a public sale at which the Corporation was invited to participate. The Corporation repurchased and cancelled the repurchased trust preferred securities, resulting in a commensurate reduction in the related Floating Rate Junior Subordinated Debentures. The Corporation's winning bid equated to 70% of the $10 million par value. The 30% discount, plus accrued interest, resulted in a gain of $4.2 million, which is reflected in the statement of income as a "Gain on early extinguishment of debt." As of June 30, 2016, the Corporation still has Floating Rate Junior Subordinated Debentures ("subordinated debt") outstanding in the aggregate amount of $216.2 million.

The bargain purchase gain is related to assets acquired and deposits assumed from Doral Bank in the first quarter of 2015. On February 27, 2015, FirstBank acquired 10 Puerto Rico branches of Doral Bank, assumed $522.7 million in deposits related to such branches, acquired approximately $324.8 million in principal balance of loans, primarily residential mortgage loans, acquired $5.5 million of property, plant and equipment and received $217.7 million of cash, through an alliance with Banco Popular of Puerto Rico (“Popular”), who was the successful lead bidder with the FDIC on the failed Doral Bank, as well as other co-bidders. Under the FDIC’s bidding format, Popular was the lead bidder and party to the purchase and assumption agreement with the FDIC covering all assets and deposits to be acquired by Popular and its alliance co-bidders. Popular entered into back to back purchase assumption agreements with the alliance co-bidders, including FirstBank, for the transferred assets and deposits. There is no loss-share arrangement with the FDIC related to the acquired assets, meaning that FirstBank assumed all losses with respect to such assets, with no financial assistance from the FDIC. The gain of $13.4 million represents the excess of the estimated fair value of the assets acquired (including cash payments of $217.7 million received from the FDIC) over the estimated fair value of the liabilities assumed.

Non-interest income for the second quarter of 2016 amounted to $19.8 million, compared to $6.7 million for the second quarter of 2015. The increase in non-interest income of $13.1 million was primarily due to the following:

- The impact in the previous year second quarter of OTTI charges on debt securities amounting to $13.1 million, primarily on three Puerto Rico Government debt securities.

- The impact in the previous year second quarter of a $0.6 million loss on the sale of a commercial mortgage loan held for sale as part of the bulk sale of assets, included as a reduction of “Other operating income” in the table above.

- A $0.4 million increase in service charges on deposits primarily reflecting the implementation of new service and transactional fees on certain products implemented in November 2015.

- A $0.1 million increase in revenues from the mortgage banking business driven by a $0.9 million increase in gains on sales of residential mortgage loans in the secondary market associated with market expectations of lower long-term interest rates that resulted in higher gain margins, partially offset by a $0.8 million increase in losses on TBAs MBS forward contracts. Loans sold in the secondary market to U.S. government-sponsored entities amounted to $113.2 million with a related gain of $4.3 million in the second quarter of 2016, compared to $121.2 million with a related gain of $3.4 million in the comparable period of 2015.

Partially offset by:

- A $0.5 million decrease in “other operating income” in the table above, reflecting a $1.9 million decrease in fees from merchant transactions due to the sale of merchant contracts completed in the fourth quarter of 2015 (a reduction of approximately $1.1 million in processing costs, depreciation and other expenses related to the sale of merchant contracts was reflected in non-interest expenses). The decrease in fees from merchant contracts was partially offset by the impact in the previous year second quarter of a $0.6 million loss on the sale of a commercial mortgage loan held for sale as part of the bulk sale of assets and a $0.6 million gain on the sale of fixed assets recorded in the second quarter of 2016 primarily related to a real estate property sold in the Virgin Islands.

Non-interest income for the six-month period ended June 30, 2016 amounted to $38.2 million, compared to $39.4 million for the same period in 2015. The $1.2 million decrease in non-interest income was primarily due to:

- The impact in the first half of 2015 of the $13.4 million bargain purchase gain on assets acquired and deposits assumed from Doral.

- A $1.7 million decrease in “other operating income” in the table above, reflecting a $3.8 million decrease in fees from merchant transactions due to the sale of merchant contracts completed in the fourth quarter of 2015 (a reduction of approximately $2.2 million in processing costs, depreciation and other expenses related to the sale of merchant contracts was reflected in non-interest expenses). The decrease in fees from merchant contracts was partially offset by the aforementioned impact in the previous year of a $0.6 million loss on the sale of a commercial mortgage loan held for sale included in the bulk sale of assets, the $0.6 million gain on the sale of fixed assets recorded in the second quarter of 2016, a $0.4 million fee income recorded in the first quarter of 2016 related to a terminated credit agreement in which the Bank was committed to purchase a loan participation and higher interchange and ATM fee income.

Partially offset by:

- A $6.6 million decrease in OTTI charges on debt securities. During the first half of 2016, the Corporation has recorded OTTI charges of $6.3 million on three Puerto Rico Government debt securities held by the Corporation as part of its available-for-sale securities portfolio, specifically bonds of the Government Development Bank for Puerto Rico (the

"GDB") and the Puerto Rico Public Buildings Authority. This was the third OTTI charge on these securities recorded since June 30, 2015, as OTTI charges of $12.9 million and $3.0 million were booked in the second and fourth quarters of 2015, respectively. Refer to Note 4 of the Corporation's unaudited consolidated financial statements for the quarter ended June 30, 2016 for additional information about the determination of this charge.

- The $4.2 million gain recorded in the first quarter of 2016 on the repurchase and cancellation of $10 million in trust preferred securities.

- A $1.6 million increase in service charges on deposits primarily associated with the full period impact of deposits assumed from Doral Bank late in February 2015, as well as the aforementioned implementation of new service and transactional fees on certain products in November 2015.

- A $1.3 million increase in revenues from the mortgage banking business driven by a $2.3 million increase in gains on sales of residential mortgage loans in the secondary market associated with both a higher volume of sales and market expectations of lower long-term interest rates that resulted in higher gain margins, partially offset by a $1.3 million increase in losses on TBAs MBS forward contracts. Loans sold in the secondary market to U.S. government-sponsored entities amounted to $219.2 million with a related gain of $8.6 million in the first half of 2016, compared to $206.5 million with a related gain of $6.3 million in the comparable period of 2015. In addition, loan servicing fees increased by $0.2 million commensurate with the increase in the servicing portfolio.

- A $0.3 million increase in insurance commission income.

**Non-Interest Expenses**

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

| | Quarter Ended June 30, | | Six-Month Period Ended June 30, | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| | (In thousands) | | | |
| Employees' compensation and benefits | $ 37,401 | $ 37,945 | $ 75,836 | $ 73,599 |
| Occupancy and equipment | 13,043 | 15,059 | 27,226 | 29,408 |
| Insurance and supervisory fees | 7,066 | 6,796 | 14,409 | 13,656 |
| Taxes, other than income taxes | 3,756 | 3,131 | 7,548 | 6,132 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Professional service fees: | | | | | | | | |
| Collections, appraisals and other credit-related fees | | 2,898 | | 3,777 | | 5,279 | | 7,224 |
| Outsourcing technology services | | 4,937 | | 4,789 | | 9,705 | | 9,493 |
| Other professional fees | | 3,492 | | 10,439 | | 7,119 | | 17,506 |
| Credit and debit card processing expenses | | 3,274 | | 3,945 | | 6,556 | | 7,902 |
| Business promotion | | 4,048 | | 3,934 | | 8,051 | | 6,802 |
| Communications | | 1,725 | | 2,045 | | 3,533 | | 3,653 |
| Net loss on OREO and OREO operations | | 3,325 | | 4,874 | | 6,531 | | 7,502 |
| Other | | 4,579 | | 6,065 | | 10,748 | | 11,650 |
| Total | $ | 89,544 | $ | 102,799 | $ | 182,541 | $ | 194,527 |

Non-interest expenses decreased by $13.2 million to $89.5 million for the second quarter of 2016 compared to $102.8 million for the second quarter of 2015. Non-interest expenses in the second quarter of 2015 included $1.2 million of expenses and losses related to the bulk sale of assets and costs of $2.6 million related to the conversion of loan and deposit accounts acquired from Doral Bank to the FirstBank systems. Excluding the aforementioned items, the $89.5 million of non-interest expenses for the second quarter of 2016 decreased by $9.5 million compared to adjusted non-interest expenses of $99.0 million for the same period in 2015. The decrease of $9.5 million in adjusted non-interest expenses was principally attributable to:

- A $4.8 million decrease in adjusted professional service fees primarily reflecting the impact in the second quarter of 2015 of interim servicing costs of $2.4 million related to loans and deposits acquired from Doral Bank and of $1.3 million of professional service incurred in special projects and strategic, stress testing and capital planning matters, both included as part of “other professional service fees” in the table above.

- A $2.0 million decrease in occupancy and equipment costs reflecting reductions in depreciation, electricity and repairs expenses, including a reduction of approximately $0.4 million related to the depreciation of POS terminals sold as part of the sale of merchant contracts in the fourth quarter of 2015.

- A $1.3 million decrease in adjusted losses on OREO operations primarily due to lower property tax expenses.

- A $0.7 million decrease in processing expenses mainly due to the sale of merchant contracts in the fourth quarter of 2015.

- A $0.6 million decrease in supplies, printing and mailing costs included as part of "Other" in the table above.

Non-interest expenses decreased by $12.0 million to $182.5 million for the first six months of 2016 compared to $194.5 million for the same period in 2015. Excluding the aforementioned $1.2 million of expenses and losses related to the bulk sale of assets and $4.6 million of acquisition and conversion costs incurred in the first half of 2015 related to the Doral Bank transaction, the $182.5 million of non-interest expenses for the first half of 2016 decreased by $5.9 million compared to adjusted non-interest expenses of $188.4 million for the same period in 2015. The decrease of $5.9 million was principally attributable to:

- A $7.5 million decrease in adjusted professional service fees primarily reflecting the impact in the first half of 2015 of interim servicing costs of $3.6 million related to loans and deposits acquired from Doral Bank and of $1.3 million of professional service fees incurred with respect to special projects and strategic, stress testing and capital planning matters. In addition, collections, appraisals and other credit related professional service fees related to troubled loan resolution efforts decreased by $1.9 million.

- A $2.2 million decrease in occupancy and equipment costs reflecting reductions in depreciation, electricity and repairs expenses, including a reduction of approximately $0.8 million related to the depreciation of POS terminals sold as part of the sale of merchant contracts in the fourth quarter of 2015.

- A $1.3 million decrease in processing expenses mainly due to the sale of merchant contracts in the fourth quarter of 2015.

- A $0.7 million decrease in adjusted losses on OREO operations primarily reflecting a $1.1 million decrease in OREO-operating expenses, including lower property taxes, and a $0.7 million increase in rental income associated with both a higher inventory of income-producing properties and increased activity. These decreases were partially offset by the impact in the first half of 2015 of a $1.2 million gain realized at the time of sale of certain commercial OREO properties.

Supplemental cash flow information is as follows:

Partially offset by:

- A $2.3 million increase in employees' compensation mainly due to merit salary increases and the full period impact of personnel costs associated with branches acquired from Doral Bank in February 2015, partially offset by decreases in incentive-based compensation due to production levels.

- A $1.4 million increase in taxes, other than income taxes, mainly related to the increase in the sales tax rate from 7% to 11.5% effective since July 1, 2015.

- A $1.7 million increase in business promotion expenses.

- A $0.6 million increase in the FDIC insurance premium expense, included as part of "Insurance and Supervisory fees" in the table above, as the 2014 fourth quarter significant income is no longer part of the core earnings to average assets ratio component of the assessment that considers the most recent four quarters of earnings. In March 20