FIRST BANCORP /PR/
Form 10-K
April 15, 2011

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K

(Mark one)

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

For the Fiscal Year Ended December 31, 2010

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

For the transition period from __________ to __________

COMMISSION FILE NUMBER 001-14793

FIRST BANCORP.

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

Puerto Rico (State or other jurisdiction of incorporation or organization)	**66-0561882** (I.R.S. Employer Identification No.)
1519 Ponce de León Avenue, Stop 23 **Santurce, Puerto Rico** (Address of principal executive office)	**00908** (Zip Code)

Registrant s telephone number, including area code:
(787) 729-8200

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

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock ($0.10 par value)	New York Stock Exchange
7.125% Noncumulative Perpetual Monthly Income Preferred Stock, Series A (Liquidation Preference $25 per share)	New York Stock Exchange
8.35% Noncumulative Perpetual Monthly Income Preferred Stock, Series B (Liquidation Preference $25 per share)	New York Stock Exchange
7.40% Noncumulative Perpetual Monthly Income Preferred Stock, Series C (Liquidation Preference $25 per share)	New York Stock Exchange
7.25% Noncumulative Perpetual Monthly Income Preferred Stock, Series D (Liquidation Preference $25 per share)	New York Stock Exchange
7.00% Noncumulative Perpetual Monthly Income Preferred Stock, Series E (Liquidation Preference $25 per share)	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:
NONE

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

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

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

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

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

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

Large accelerated filer o	Accelerated filer o	Non-accelerated filer þ (Do not check if a smaller reporting company)	Smaller reporting company o

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

The aggregate market value of the voting common equity held by non-affiliates of the registrant as of June 30, 2010 (the last day of the registrant s most recently completed second quarter) was $44,548,687 based on the closing price of $7.95 per share of common stock on the New York Stock Exchange on June 30, 2010 (on a post reverse-split basis). The registrant had no nonvoting common equity outstanding as of June 30, 2010. For the purposes of the foregoing calculation only, registrant has treated as common stock held by affiliates only common stock of the registrant held by its directors and executive officers and voting stock held by the registrant s employee benefit plans. The registrant s response to this item is not intended to be an admission that any person is an affiliate of the registrant for any purposes other than this response.

Indicate the number of shares outstanding of each of the registrant s classes of common stock, as of the latest practicable date: 21,303,669 shares as of January 31, 2011.

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Forward-Looking Statements

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

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

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

uncertainty as to whether the Corporation will be able to issue $350 million of equity so as to meet the remaining substantive condition necessary to compel the United States Department of the Treasury (the U.S. Treasury) to convert into common stock the shares of the Corporation s Fixed Rate Cumulative Mandatorily Convertible Preferred Stock, Series G (the Series G Preferred Stock), that the Corporation issued to the U.S. Treasury;

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

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

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

the risk of not being able to fulfill the Corporation s cash obligations or pay dividends to the Corporation s stockholders due to the Corporation s inability to receive approval from the FED to receive dividends from the Corporation s banking subsidiary, FirstBank;

the risk of being subject to possible additional regulatory actions;

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

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

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

a decrease in demand for the Corporation s products and services and lower revenues and earnings

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because of the continued recession in Puerto Rico and the current fiscal problems and budget deficit of the Puerto Rico government;

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

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

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

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

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

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

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

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

the adverse effect of litigation;

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

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

general competitive factors and industry consolidation; and

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

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

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

PART I

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

Item 1. *Business*

GENERAL

First BanCorp is a publicly-owned financial holding company that is subject to regulation, supervision and examination by the Federal Reserve Board (the FED or Federal Reserve). The Corporation was incorporated under the laws of the Commonwealth of Puerto Rico to serve as the bank holding company for FirstBank Puerto Rico (FirstBank or the Bank). The Corporation is a full service provider of financial services and products with operations in Puerto Rico, the United States and the U.S. and British Virgin Islands. As of December 31, 2010, the Corporation had total assets of $15.6 billion, total deposits of $12.1 billion and total stockholders equity of $1.1 billion.

The Corporation provides a wide range of financial services for retail, commercial and institutional clients. As of December 31, 2010, the Corporation controlled two wholly-owned subsidiaries: FirstBank and FirstBank Insurance Agency, Inc. (FirstBank Insurance Agency). FirstBank is a Puerto Rico-chartered commercial bank and FirstBank Insurance Agency is a Puerto Rico-chartered insurance agency.

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

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

Effective July 1, 2010, the operations conducted by First Leasing and Grupo Empresas de Servicios Financieros as separate subsidiaries were merged with and into FirstBank. On March 2, 2011 the Bank sold substantially all the assets of its USVI insurance subsidiary First Insurance Agency VI to Marshall and Sterling Insurance.

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BUSINESS SEGMENTS

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

Commercial and Corporate Banking

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

Mortgage Banking

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

Mortgage loans that do not qualify under these programs are commonly referred to as conventional loans. Conventional real estate loans could be conforming and non-conforming. Conforming loans are residential real estate loans that meet the standards for sale under the Fannie Mae (FNMA) and Freddie Mac (FHLMC) programs whereas loans that do not meet the standards are referred to as non-conforming residential real estate loans. The Corporation s strategy is to penetrate markets by providing customers with a variety of high quality mortgage products to serve their financial needs faster and simpler and at competitive prices. The Mortgage Banking segment also acquires and sells mortgages in the secondary markets. Residential real estate conforming loans are sold to investors like FNMA and FHLMC. More than 90% of the Corporation s residential mortgage loan portfolio consists of fixed-rate, fully amortizing, full documentation loans. The Corporation is not actively engaged in offering negative amortization loans or option adjustable rate mortgage loans.

Consumer (Retail) Banking

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

Treasury and Investments

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

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United States Operations

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

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

Virgin Islands Operations

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

For information regarding First BanCorp s reportable segments, please refer to Note 33, Segment Information, to the Corporation s financial statements for the year ended December 31, 2010 included in Item 8 of this Form 10-K.

Employees

As of December 31, 2010, the Corporation and its subsidiaries employed 2,518 persons. None of its employees are represented by a collective bargaining group. The Corporation considers its employee relations to be good.

SIGNIFICANT EVENTS SINCE THE BEGINNING OF 2010

Implementation of a 1 for 15 reverse stock split

Effective January 7, 2011, the Corporation implemented a one-for-fifteen reverse stock split of all outstanding shares of its common stock. At the Corporation s Special Meeting of Stockholders held on August 24, 2010, shareholders approved an amendment to the Corporation s Restated Articles of Incorporation to implement a reverse stock split at a ratio, to be determined by the Board in its sole discretion, within the range of one new share of common stock for 10 old shares and one new share for 20 old shares. As authorized, the Board elected to effect a reverse stock split at a ratio of one-for-fifteen. The reverse stock split allowed the Corporation to regain compliance with listing standards of the New York Stock Exchange as more fully explained below. The one-for-fifteen reverse stock split reduced the number of outstanding shares of common stock from 319,557,932 shares to 21,303,669 shares of common stock.

All share and per share amounts of common stock included in this Form 10-K, including but not limited to, the amounts of outstanding shares of common stock, options, warrants and other rights convertible into or exercisable for shares of common stock and market prices for the common stock, have been adjusted to retroactively reflect the 1-for-15 reverse stock split effected January 7, 2011.

Regulatory Actions

Effective June 2, 2010, FirstBank, by and through its Board of Directors, entered into the Order with the FDIC and OCIF, a copy of which is attached as Exhibit 10.1 the Form 8-K filed by the Corporation on June 4, 2010. This

Order provides for various things, including (among other things) the following: (1) having and retaining qualified management; (2) increased participation in the affairs of FirstBank by its board of directors; (3) development and implementation by FirstBank of a capital plan to attain a leverage ratio of at least 8%, a Tier 1 risk-based capital ratio of at least 10% and a total risk-based capital ratio of at least 12%; (4) adoption and implementation of strategic, liquidity and fund management and profit and budget plans and related projects within certain timetables set forth in the Order and on an ongoing basis; (5) adoption and implementation of plans for reducing FirstBank s positions in certain classified assets and delinquent and non-accrual loans within timeframes set forth in the Order; (6) refraining from lending to delinquent or classified borrowers already obligated to FirstBank on any extensions of credit so long as such credit remains uncollected, except where FirstBank s failure to extend further credit to a particular borrower would be detrimental to the best interests of FirstBank, and any such additional credit is approved by the FirstBank s board of directors; (7) refraining from accepting, increasing, renewing or rolling over brokered deposits without the prior written approval of the FDIC; (8) establishment of a comprehensive policy and methodology for determining the allowance for loan and lease losses and the review and revision of FirstBank s loan policies, including the non-accrual policy; and (9) adoption and implementation of adequate and effective programs of independent loan review, appraisal compliance and an effective policy for managing FirstBank s sensitivity to interest rate risk. The foregoing summary is not complete and is qualified in all respects by reference to the actual language of the Order.

Effective June 3, 2010, First BanCorp entered into the Written Agreement with the FED, a copy of which is attached as Exhibit 10.2 to the Form 8-K filed by the Corporation on June 4, 2010. The Agreement provides, among other things, that the holding company must serve as a source of strength to FirstBank, and that, except upon consent of the FED, (1) the holding company may not pay dividends to stockholders or receive dividends from FirstBank, (2) the holding company and its nonbank subsidiaries may not make payments on trust preferred securities or subordinated debt, and (3) the holding company cannot incur, increase or guarantee debt or repurchase any capital securities. The Agreement also requires that the holding company submit a capital plan that is acceptable to the FED and that reflects sufficient capital at First BanCorp on a consolidated basis, and follow certain guidelines with respect to the appointment or change in responsibilities of senior officers. The foregoing summary is not complete and is qualified in all respects by reference to the actual language of the Agreement.

In July 2010, the Corporation and FirstBank jointly submitted a capital plan setting forth how they plan to improve their capital positions to comply with the above mentioned Agreements over time. The primary objective of the Capital Plan is to improve the Corporation s capital structure in order to (1) enhance its ability to operate in the current economic environment, (2) be in a position to continue executing business strategies to return to profitability, and (3) achieve certain minimum capital ratios over time. Specifically, the capital plan details how the Bank will attempt to achieve a total capital to risk-weighted assets ratio of at least 12%, a Tier 1 capital to risk-weighted assets ratio of at least 10% and a leverage ratio of at least 8%. The Capital Plan set forth the following capital restructuring initiatives as well as various deleveraging strategies: (1) the issuance of shares of common stock in exchange for shares of the Corporation s preferred stock held by the U.S. Treasury; (2) the issuance of shares of common stock for any and all of the Corporation s outstanding Series A through E preferred stock; and (3) a $500 million capital raise through the issuance of new common shares for cash.

As discussed below, the Corporation has completed the transactions designed to accomplish the first two initiatives, including the exchange of 89% of the outstanding Series A through E preferred stock and the issuance of Series G Preferred Stock, which is mandatorily convertible into shares of common stock, in exchange for the Fixed Rate Cumulative Perpetual Preferred Stock, Series F, $1,000 liquidation preference per share (Series F Preferred Stock), held by the U.S. Treasury. In addition, in December 2010, the U.S. Treasury agreed to amendments to the terms of the Series G Preferred Stock that revise the terms under which the Corporation can compel the conversion of the Series G Preferred Stock into shares of common stock. The revised terms require that the Corporation sell shares of common stock for gross proceeds of $350 million, rather than $500 million, and provide for the issuance of approximately 29.2 million shares of common stock upon the mandatory conversion based on an initial conversion rate of 68.9459 shares of common stock for each share of Series G Preferred Stock (calculated by dividing $750, or a discount of 25% from the $1,000 liquidation preference per share of Series G Preferred Stock, by the initial conversion price of $10.8781 per share, which is subject to adjustment). Previously, the discount was 35% from the

$1,000 liquidation value.

The deleveraging strategies described in the Capital Plan included, among others, the sale of assets. In this regard, the Corporation announced in December 2010 the signing of a non-binding letter of intent for the sale of a

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portfolio of loans, of which approximately 93% were classified assets. The sale of loans was completed in February 2011.

In March 2011, the Corporation revised its Capital Plan to reflect initiatives implemented during the second half of 2010 and the financial forecast for 2011. The updated Capital Plan delineates the capital goals and the actions to be taken to secure compliance with the provisions of the Agreements. The updated Capital Plan, which was submitted to the regulators, includes a reduced $350 million capital raise to be achieved through the issuance of new shares of common stock for cash and other alternative capital preservation strategies, including among others, additional deleverage.

In addition to the Capital Plan, the Corporation has submitted to its regulators a liquidity and brokered deposit plan, including a contingency funding plan, a non-performing asset reduction plan, a plan for the reduction of classified and special mention assets, a budget and profit plan and a strategic plan. Further, the Corporation has reviewed and enhanced the Corporation s loan review and appraisal programs, the credit policies, the treasury and investments policy, the asset classification and allowance for loan and lease losses and nonaccrual policies, and the charge-off policy. The Agreements also require the submission to the regulators of quarterly progress reports, which, to date, have been timely filed.

The Agreements impose no other restrictions on FirstBank s products or services offered to customers, nor do they impose any type of penalties or fines upon FirstBank or the Corporation. Concurrent with the issuance of the Order and since then, the FDIC has granted FirstBank temporary waivers to enable it to continue accessing the brokered deposit market. The most recent waiver enables it to continue to issued brokered CDs through June 30, 2011. FirstBank will continue to request approvals for future periods.

Completion of Exchange of Series F Preferred Stock into Convertible Preferred Stock and subsequent amendment

On July 20, 2010, the U.S. Treasury accepted in exchange for our Fixed Rate Cumulative Perpetual Preferred Stock, Series F, $1,000 liquidation preference per share (Series F Preferred Stock), that it had acquired in January 2009, and accrued dividends on the Series F Preferred Stock, 424,174 shares of a new series of mandatorily convertible preferred stock (the Series G Preferred Stock), that, except for being convertible into shares of the Corporation s common stock, has terms similar (including the same liquidation preference) to those of the Series F Preferred Stock. The U.S. Treasury, and any subsequent holder of the Series G Preferred Stock, will have the right to convert the Series G Preferred Stock into the Corporation s common stock at any time. In addition, the Corporation will have the right to compel the conversion of the Series G Preferred Stock into shares of common stock under certain conditions including the exchange for common stock of at least 70%of the aggregate liquidation preference of the then outstanding Series A through E preferred stock and the raise of at least $350 million from the sale of common stock. Unless earlier converted, the Series G Preferred Stock is automatically convertible into common stock on the seventh anniversary of its issuance. On August 24, 2010, the Corporation obtained stockholder approval to increase the number of authorized shares of common stock from 750 million to 2 billion and decrease the par value of its common stock from $1.00 to $0.10 per share. These approvals and the issuance of common stock in exchange for Series A through E preferred stock, discussed below, satisfy all but one of the substantive conditions to the Corporation s ability to compel the conversion of the 424,174 shares of Series G Preferred Stock issued to the U.S. Treasury. The other substantive condition to the Corporation s ability to compel the conversion of the Series G Preferred Stock is the issuance of a minimum amount of additional capital, subject to terms, other than the price per share, reasonably acceptable to the U.S. Treasury in its sole discretion. On September 16, 2010, the Corporation filed a registration statement for a proposed underwritten offering of $500 million of its common stock with the SEC, which was subsequently amended to, among other things, lower the size of the offering to $350 million as discussed below.

As discussed above, during the fourth quarter of 2010, the Corporation executed an amendment to the exchange agreement with the U.S. Treasury pursuant to which the U.S. Treasury agreed to a reduction in the size of the capital raise, from $500 million to $350 million, required to satisfy the remaining substantive condition to compel the conversion of the Series G Preferred Stock owned by the U.S. Treasury into shares of common stock. The amendment to the exchange agreement with the U.S. Treasury also provided for a reduction in the previously

agreed-upon discount of the liquidation preference of the Series G Preferred Stock from 35% to 25%, thus, increasing the number of shares of common stock into which the Series G Preferred Stock is convertible from 25.3 million to 29.2 million shares of common stock upon the mandatory conversion based on an initial conversion rate of 68.9459 shares of common stock for each share of Series G Preferred Stock (calculated by dividing $750, or a discount of 25% from the $1,000 liquidation preference per share of Series G Preferred Stock, by the initial conversion price of $10.878 per share, which is subject to adjustment).

Like the Series F Preferred Stock, the Series G Preferred Stock qualifies as Tier 1 regulatory capital. Cumulative dividends on the Series G Preferred Stock accrue on the liquidation preference amount on a quarterly basis at a rate of 5% per annum through January 16, 2014, and 9% per annum thereafter, but will only be paid when, as and if declared by the Corporation s Board of Directors out of assets legally available therefore. The Series G Preferred Stock ranks pari passu with the Corporation s existing Series A through E preferred stock in terms of dividend payments and distributions upon liquidation, dissolution and winding up of the Corporation. The exchange agreement relating to this issuance contains limitations on the payment of dividends on common stock, including limiting regular quarterly cash dividends to an amount not exceeding the last quarterly cash dividend paid per share, or the amount publicly announced (if lower), of common stock prior to October 14, 2008, which was $1.05 per share on a post reverse split basis.

Additionally, as part of the terms of the Exchange Agreement, the Corporation also agreed to amend and restate the terms of a warrant dated January 16, 2009 that entitles the U. S. Treasury to purchase 389,483 shares of the Corporation s common stock to extend its term and adjust the initial exercise price to be consistent with the conversion price applicable to the Series G Preferred Stock. The amended and restated warrant (the Warrant), issued to the U.S. Treasury entitles the U.S. Treasury to purchase 389,483 shares of the Corporation s common stock at an initial exercise price of $10.878 per share instead of the exercise price on the original warrant of $154.05 per share. The Warrant has a 10-year term and is exercisable at any time. The exercise price and the number of shares issuable upon exercise of the Warrant are subject to certain anti-dilution adjustments.

Completion of Exchange of Series A through E Preferred Stock into Common Stock.

On August 30, 2010, we completed our offer to issue shares of common stock in exchange for our issued and outstanding shares of Series A through E Noncumulative Perpetual Monthly Income Preferred Stock (the Series A through E Preferred Stock). Our issuance of 15,134,347 shares of common stock in the exchange offer improves our capital structure and improved our Tier 1 common equity to risk-weighted assets ratio and tangible common equity to tangible assets ratio. Our ratio of Tier 1 common equity to risk-weighted assets, which was 2.86% as of June 30, 2010, increased to 5.01% as of December 31, 2010, and our ratio of tangible common equity to tangible assets, which was 2.57% as of June 30, 2010, increased to 3.80% as of December 31, 2010. In addition, the issuance of shares of common stock in the exchange offer satisfied a substantive condition to our ability to mandatorily convert the Series G Preferred Stock into common stock and improved our ability to meet any new capital requirements.

Approval of our stockholders to the issuance of shares in the exchange offer, which was required by NYSE listing requirements, and to the decrease in the par value of our common stock from $1 to $0.10 were conditions to the completion of the exchange offer. The exchange offer resulted in the tender of $487.1 million, or 88.54%, of the aggregate liquidation preference of the Series A through E Preferred Stock. The tender of over $385 million of the liquidation preference of the Series A through E Preferred Stock and our stockholders approval of the amendments to our Restated Articles of Incorporation to increase the number of authorized shares of common stock and decrease the par value of our common stock satisfy all but one of the substantive conditions to our ability to compel the conversion into common stock of the aforementioned 424,174 shares of new Series G Preferred Stock that we issued to the U.S. Treasury on July 20, 2010.

Other capital restructuring events

On August 24, 2010, the Corporation s stockholder s approved an additional increase in the Corporation s common stock to 2 billion, up from 750 million. During the second quarter of 2010, the Corporation s stockholders had already increased the authorized shares of common stock from 250 million to 750 million. The Corporation s stockholders approval at the same meeting of the decrease in the par value of the common stock from $1 per share to $0.10 per share had no effect on the total dollar value of the Corporation s stockholders equity.

Deleverage and De-risking of the Balance Sheet

We have deleveraged our balance sheet in order to preserve capital, principally by selling investments and reducing the size of the loan portfolio. Significant decreases in assets have been achieved mainly through the non-renewal of matured commercial loans, such as temporary loan facilities to the Puerto Rico government, and through the charge-off of portions of loans deemed uncollectible. In addition, a reduced volume of loan originations, mainly in construction loans, has contributed to this deleveraging strategy.

During 2010, we reduced our investment portfolio by approximately $1.6 billion, while our loan portfolio decreased by $2.0 billion. The net reduction in securities and loans was the main driver of the reduction of our total assets to $15.6 billion as of December 31, 2010, a decrease of $3.9 billion from December 31, 2009. This decrease in securities and loans allowed a reduction of $4.2 billion in wholesale funding as of December 31, 2010, including repurchase agreements, advances, and brokered CDs.

During the third quarter of 2010, we achieved a significant reduction in investment securities mostly as a result of a balance sheet repositioning strategy that resulted in the sale of $1.2 billion in investment securities combined with the early termination of $1.0 billion in repurchase agreements, which, given the yield and cost combination of the instruments, eliminated assets that were providing no positive marginal contribution to earnings. A nominal loss of $0.3 million was recorded as a result of these transactions as the realized gain of $47.1 million on the sale of investment securities was offset by the $47.4 million cost on the early extinguishment of repurchase agreements.

On December 7, 2010, the Corporation announced that it had signed a non-binding letter of intent relating to a possible sale of a loan portfolio with an unpaid principal balance of approximately $701.9 million (book value of $602.8 million), to a new joint venture. Accordingly, during the fourth quarter of 2010, the Corporation transferred loans with an unpaid principal balance of $527 million and a book value of $447 million ($335 million of construction loans, $83 million of commercial mortgage loans and $29 million of commercial and industrial loans) to loans held for sale. The recorded investment in the loans was written down to a value of $281.6 million, which resulted in 2010 fourth quarter charge-offs of $165.1 million (a $127.0 million charge to construction loans, a $29.5 million charge to commercial mortgage loans and an $8.6 million charge to commercial and industrial loans). Further, the provision for loan and lease losses was increased by $102.9 million.

On February 8, 2011, the Corporation entered into a definitive agreement to sell substantially all of the loans transferred to held for sale and, on February 16, 2011, completed the sale of loans with an unpaid principal balance of $510.2 million (book value of $269.3 million), at a purchase price of $272.2 million to a joint venture, majority owned by PRLP Ventures LLC, a company created by Goldman, Sachs & Co. and Caribbean Property Group. The purchase price of $272.2 million was funded with an initial cash contribution by PRLP Ventures LLC of $88.4 million received by FirstBank, a promissory note of approximately $136 million representing seller financing provided by FirstBank, and a $47.6 million or 35% equity interest in the joint venture to be retained by FirstBank. The size of the loan pool sold is approximately $185 million lower than the amount originally stated in the letter of intent due to loan payments and exclusions from the pool. The loan portfolio sold was composed of 73% construction loans, 19% commercial real estate loans and 8% commercial loans. Approximately 93% of the loans are adversely classified loans and 55% were in non-performing status as of December 31, 2010.

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

NYSE Listing

On July 10, 2010, the NYSE notified us that the average closing price of our common stock over the consecutive 30 trading-day period ended July 6, 2010 was less than $1.00. Under NYSE rules, a listed company is considered to be below compliance standards if the average closing price of its common stock is less than $1.00 over a

consecutive 30 trading-day period. Pursuant to listing standards, the Corporation had a six-month period to bring both the share price and the average closing price over a consecutive 30 trading-day period above $1.00. On January 7, 2011, the Corporation implemented a one-for-fifteen reverse stock split of all outstanding shares of its common stock to, among other matters, allow the Corporation to regain compliance with listing standards of the NYSE. Following the reverse stock split, on February 18, 2011, the Corporation received a notice from the NYSE confirming that the Corporation s average stock price for the 30 trading days ended February 18, 2011 indicated that the Corporation s stock price was above the NYSE s minimum requirement of $1.00 based on a 30 trading-day average. Accordingly, the Corporation is no longer considered below the $1.00 continued listing criterion.

Business Developments

Effective July 1, 2010, the operations conducted by First Leasing and Grupo Empresas de Servicios Financieros as separate subsidiaries were merged with and into FirstBank. On March 2, 2011, the Bank sold substantially all the assets of its Virgin Islands insurance subsidiary, First Insurance Agency VI, to Marshall and Sterling Insurance.

Floating Rate Junior Subordinated Deferrable

The Agreement also provides that we cannot make any distributions of interest, principal or other sums on subordinated debentures or trust preferred securities without prior written approval of the Federal Reserve. With respect to our $231.9 million of outstanding subordinated debentures, we have provided, within the time frame prescribed by the indentures governing the subordinated debentures, a notice to the trustees of the subordinated debentures of our election to extend the interest payments on the debentures. Under the indentures, we have the right, from time to time, and without causing an event of default, to defer payments of interest on the subordinated debentures by extending the interest payment period at any time and from time to time during the term of the subordinated debentures for up to twenty consecutive quarterly periods. We have elected to defer the interest payments that were due in September and December 2010 and in March 2011 because the Federal Reserve advised it would not approve a request to make interest payments on the subordinated debentures.

Impact of Credit Ratings on Liquidity

The Corporation s ability to access new non-deposit sources of funding could be adversely affected by these credit ratings and any additional downgrades. The Corporation s credit as a long-term issuer is currently rated CCC+, or seven notches below investment grade, with negative outlook by Standard & Poor s (S&P) and is rated CC, or eight notches below investment grade, by Fitch Ratings Limited (Fitch). FirstBank s credit as a long-term is currently rated B3, or six notches below investment grade, by Moody s Investor Service (Moody s), CCC+, or seven notches below investment grade, with negative outlook by S&P, and CC, or eight notches below investment grade by Fitch. These rating reflect downgrades in 2010 by S&P, Fitch and Moody s. Although these downgrades did not affect any of the Corporation s outstanding debt and have not affected the Corporation s liquidity, the ratings may adversely affect the Corporation s ability to obtain new external sources of funding to finance its operations, and/or cause external funding to be more expensive, which could in turn adversely affect results of operations. Also, changes in credit ratings may further affect the fair value of certain liabilities and unsecured derivatives that consider the Corporation s own credit risk as part of the valuation.

WEBSITE ACCESS TO REPORT

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

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

Code of Ethics for Senior Financial Officers

Code of Ethics applicable to all employees

Independence Principles for Directors

Luxury Expenditure Policy

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

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

MARKET AREA AND COMPETITION

Puerto Rico, where the banking market is highly competitive, is the main geographic service area of the Corporation. As of December 31, 2010, the Corporation also had a presence in the state of Florida and in the United States and British Virgin Islands. Puerto Rico banks are subject to the same federal laws, regulations and supervision that apply to similar institutions in the United States mainland.

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

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

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

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SUPERVISION AND REGULATION

Recent Events affecting the Corporation

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

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

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

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

The Collins Amendment to the Dodd-Frank Act, among other things, eliminates certain trust preferred securities from Tier I capital. Preferred securities issued under the U.S. Treasury s Troubled Asset Relief Program (TARP) are exempted from this treatment. In the case of certain trust preferred securities issued prior to May 19, 2010 by bank holding companies with total consolidated assets of $15 billion or more as of December 31, 2009, these regulatory capital deductions are to be phased in incrementally over a period of three years beginning on January 1, 2013. This provision also requires the federal banking agencies to establish minimum leverage and risk-based capital requirements that will apply to both insured banks and their holding companies. Regulations implementing the Collins Amendment must be issued within 18 months of July 21, 2010.

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

The U.S. Congress has also recently adopted additional consumer protection laws such as the Credit Card Accountability Responsibility and Disclosure Act of 2009, and the Federal Reserve has adopted numerous new

regulations addressing banks credit card, overdraft and mortgage lending practices. Additional consumer protection legislation and regulatory activity is anticipated in the near future.

Internationally, both the Basel Committee on Banking Supervision and the Financial Stability Board (established in April 2009 by the Group of Twenty (G-20) Finance Ministers and Central Bank Governors to take action to strengthen regulation and supervision of the financial system with greater international consistency, cooperation and transparency) have committed to raise capital standards and liquidity buffers within the banking system (Basel III). On September 12, 2010, the Group of Governors and Heads of Supervision agreed to the calibration and phase-in of the Basel III minimum capital requirements (raising the minimum Tier 1 equity ratio to 6.0%, with full implementation by January 2015) and introducing a capital conservation buffer of common equity of an additional 2.5% with implementation by January 2019. The U.S. federal banking agencies generally support Basel III. The G-20 endorsed Basel III on November 12, 2010.

Bank Holding Company Activities and Other Limitations

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

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

Under the Federal Reserve Board policy, a bank holding company such as the Corporation is expected to act as a source of financial strength to its banking subsidiaries and to commit support to them. This support may be required at times when, absent such policy, the bank holding company might not otherwise provide such support. In the event of a bank holding company s bankruptcy, any commitment by the bank holding company to a federal bank regulatory agency to maintain capital of a subsidiary bank will be assumed by the bankruptcy trustee and be entitled to a priority of payment. In addition, any capital loans by a bank holding company to any of its subsidiary banks must be subordinated in right of payment to deposits and to certain other indebtedness of such subsidiary bank. As of December 31, 2010, FirstBank was the only depository institution subsidiary of the Corporation.

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

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

The potential restrictions are different if the lapse pertains to the Community Reinvestment Act requirement. In that case, until all the subsidiary institutions are restored to at least satisfactory Community Reinvestment Act

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rating status, the financial holding company may not engage, directly or through a subsidiary, in any of the additional activities permissible under the GLB Act or make additional acquisitions of companies engaged in the additional activities. However, completed acquisitions and additional activities and affiliations previously begun are left undisturbed, as the GLB Act does not require divestiture for this type of situation.

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

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

Sarbanes-Oxley Act

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

Since the 2004 Annual Report on Form 10-K, the Corporation has included in its annual report on Form 10-K its management assessment regarding the effectiveness of the Corporation s internal control over financial reporting. The internal control report includes a statement of management s responsibility for establishing and maintaining adequate internal control over financial reporting for the Corporation; management s assessment as to the effectiveness of the Corporation s internal control over financial reporting based on management s evaluation, as of year-end; and the framework used by management as criteria for evaluating the effectiveness of the Corporation s internal control over financial reporting. As of December 31, 2010, First BanCorp s management concluded that its internal control over financial reporting was effective. The Corporation s independent registered public accounting firm reached the same conclusion.

Emergency Economic Stabilization Act of 2008

On October 3, 2008, the Emergency Economic Stabilization Act of 2008 (the EESA) was signed into law. The EESA authorized the Treasury to access up to $700 billion to protect the U.S. economy and restore confidence and stability to the financial markets. One such program under TARP was action by Treasury to make significant investments in U.S. financial institutions through the Capital Purchase Program (CPP). The Treasury s stated purpose in implementing the CPP was to improve the capitalization of healthy institutions, which would improve the

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flow of credit to businesses and consumers, and boost the confidence of depositors, investors, and counterparties alike. All federal banking and thrift regulatory agencies encouraged eligible institutions to participate in the CPP.

The Corporation applied for, and the Treasury approved, a capital purchase in the amount of $400,000,000. The Corporation entered into a Letter Agreement with the Treasury, pursuant to which the Corporation issued and sold to the Treasury for an aggregate purchase price of $400,000,000 in cash (i) 400,000 shares of Series F Preferred Stock, and (2) a warrant to purchase 389,483 shares of the Corporation s common stock at an exercise price of $154.05 per share, subject to certain anti-dilution and other adjustments. The TARP transaction closed on January 16, 2009. As previously described above, on July 20, 2010, we exchanged the Series F Preferred Stock, plus accrued dividends on the Series F Preferred Stock, for 424,174 shares of a new Series G Preferred Stock and amended the warrant issued on January 16, 2009 and on December 2, 2010 the Agreement and the certificate of designation of the Series G preferred stock were amended to, among other provisions, reduce the required capital amount to compel the conversion of the Series G preferred stock from $500 million to $350 million.

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

American Recovery and Reinvestment Act of 2009

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

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

Homeowner Affordability and Stability Plan

On February 18, 2009, President Obama announced a comprehensive plan to help responsible homeowners avoid foreclosure by providing affordable and sustainable mortgage loans. The Homeowner Affordability and Stability Plan, a $75 billion federal program, provides for a sweeping loan modification program targeted at borrowers who

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

USA Patriot Act

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

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

Privacy Policies

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

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

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

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

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

Dividend Restrictions

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

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

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

In prior years, the principal source of funds for the Corporation s par