

FIRST BANCORP /PR/
Form 10-Q
November 09, 2012
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2012

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

For the transition period from to

COMMISSION FILE NUMBER 001-14793

FIRST BANCORP.

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

Puerto Rico
(State or other jurisdiction of
incorporation or organization)

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

1519 Ponce de León Avenue, Stop 23

Santurce, Puerto Rico
(Address of principal executive offices)

00908
(Zip Code)

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

Not applicable
(Former name, former address and former fiscal year, if changed since last report)

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

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

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

Large accelerated filer Accelerated filer

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

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

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

Common stock: 206,179,368 shares outstanding as of October 31, 2012.

Table of Contents

FIRST BANCORP.

INDEX PAGE

	PAGE
PART I. FINANCIAL INFORMATION	
Item 1. Financial Statements:	
<u>Consolidated Statements of Financial Condition (Unaudited) as of September 30, 2012 and December 31, 2011</u>	5
<u>Consolidated Statements of Income (Loss) (Unaudited) Quarters ended September 30, 2012 and September 30, 2011 and nine-month period ended September 30, 2012 and September 30, 2011</u>	6
<u>Consolidated Statements of Comprehensive Income (Loss) (Unaudited) Quarters ended September 30, 2012 and September 30, 2011 and nine-month period ended September 30, 2012 and September 30, 2011</u>	7
<u>Consolidated Statements of Cash Flows (Unaudited) Nine-month period ended September 30, 2012 and September 30, 2011</u>	8
<u>Consolidated Statements of Changes in Stockholders Equity (Unaudited) Nine-month period ended September 30, 2012 and September 30, 2011</u>	9
<u>Notes to Consolidated Financial Statements (Unaudited)</u>	10
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	56
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	102
<u>Item 4. Controls and Procedures</u>	102
PART II. OTHER INFORMATION	
<u>Item 1. Legal Proceedings</u>	103
<u>Item 1A. Risk Factors</u>	103
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	104
<u>Item 3. Defaults Upon Senior Securities</u>	104
<u>Item 4. Mine Safety Disclosures</u>	104
<u>Item 5. Other Information</u>	104
<u>Item 6. Exhibits</u>	104
<u>SIGNATURES</u>	105

Table of Contents

Forward Looking Statements

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

First BanCorp. wishes to caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made, and to advise readers that various factors, including but not limited to, the following could cause actual results to differ materially from those expressed in, or implied by such forward-looking statements:

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

the risk of being subject to possible additional regulatory actions;

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

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

the risk of not being able to fulfill the Corporation's cash obligations or resume paying dividends to the Corporation's stockholders in the future due to the Corporation's inability to receive approval from the FED to receive dividends from FirstBank or FirstBank's failure to generate sufficient cash flow to make a dividend payment to the Corporation;

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

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

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

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

a decrease in demand for the Corporation's products and services and lower revenues and earnings because of the continued recession in Puerto Rico, the current fiscal problems and budget deficit of the Puerto Rico government and recent credit downgrades of the Puerto Rico government;

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

uncertainty regarding the timing and final substance of any capital or liquidity standards, including the Final Basel III requirements and their implementation through rulemaking by the Federal Reserve, including anticipated requirements to hold higher levels of regulatory capital and liquidity and meet higher regulatory capital ratios as a result of Final Basel III or other capital or liquidity standards;

Table of Contents

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 regulators in Puerto Rico and the USVI and BVI;

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

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

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

the impact on the Corporation's results of operations and financial condition of acquisition and disposition transactions;

a need to recognize additional impairments on financial instruments, goodwill or other intangible assets relating to acquisitions;

risks that downgrades in the credit ratings of the Corporation's long-term senior debt will adversely affect the Corporation's ability to access necessary external funds;

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

general competitive factors and industry consolidation.

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

Investors should refer to the Corporation's Annual Report on Form 10-K for the year ended December 31, 2011, 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.

Table of Contents**FIRST BANCORP.****CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION****(Unaudited)**

(In thousands, except for share information)	September 30, 2012	December 31, 2011
ASSETS		
Cash and due from banks	\$ 786,788	\$ 206,897
Money market investments:		
Federal funds sold		2,603
Time deposits with other financial institutions	605	955
Other short-term investments	216,327	236,111
Total money market investments	216,932	239,669
Investment securities available for sale, at fair value:		
Securities pledged that can be repledged	1,070,375	1,167,265
Other investment securities	527,472	756,003
Total investment securities available for sale	1,597,847	1,923,268
Other equity securities	39,656	37,951
Investment in unconsolidated entities	32,300	43,401
Loans, net of allowance for loan and lease losses of \$445,531 (2011 \$493,917)	9,742,633	10,065,475
Loans held for sale, at lower of cost or market	68,349	15,822
Total loans, net	9,810,982	10,081,297
Premises and equipment, net	182,733	194,942
Other real estate owned	177,001	114,292
Accrued interest receivable on loans and investments	53,216	49,957
Other assets	242,292	235,601
Total assets	\$ 13,139,747	\$ 13,127,275
LIABILITIES		
Non-interest-bearing deposits	\$ 780,717	\$ 705,789
Interest-bearing deposits	9,115,685	9,201,965
Total deposits	9,896,402	9,907,754
Securities sold under agreements to repurchase	900,000	1,000,000
Advances from the Federal Home Loan Bank (FHLB)	518,440	367,440
Notes payable (including \$15,968 measured at fair value as of December 31, 2011)		23,342
Other borrowings	231,959	231,959
Accounts payable and other liabilities	108,829	152,636
Total liabilities	11,655,630	11,683,131

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

Commitments and Contingencies (Note 22)

STOCKHOLDERS EQUITY

Preferred stock, authorized 50,000,000 shares:

Non-cumulative Perpetual Monthly Income Preferred Stock: issued 22,004,000 shares, outstanding 2,521,872 shares, aggregate liquidation value of \$63,047	63,047	63,047
--	--------	--------

Common stock, \$0.10 par value, authorized 2,000,000,000 shares; issued 206,674,221 shares (2011 205,794,024 shares issued)	20,667	20,579
---	--------	--------

Less: Treasury stock (at par value)	(49)	(66)
-------------------------------------	------	------

Common stock outstanding, 206,179,368 shares outstanding (2011 205,134,171 shares outstanding)	20,618	20,513
--	--------	--------

Additional paid-in capital	885,329	884,002
----------------------------	---------	---------

Retained earnings	472,631	457,384
-------------------	---------	---------

Accumulated other comprehensive income, net of tax expense of \$7,843 (2011 \$7,751)	42,492	19,198
--	--------	--------

Total stockholders equity	1,484,117	1,444,144
---------------------------	-----------	-----------

Total liabilities and stockholders equity	\$ 13,139,747	\$ 13,127,275
---	---------------	---------------

The accompanying notes are an integral part of these statements.

Table of Contents**FIRST BANCORP.****CONSOLIDATED STATEMENTS OF INCOME (LOSS)****(Unaudited)**

(In thousands, except per share information)	Quarter Ended		Nine-Month Period Ended	
	September 30, 2012	September 30, 2011	September 30, 2012	September 30, 2011
Interest income:				
Loans	\$ 155,225	\$ 144,934	\$ 437,990	\$ 449,219
Investment securities	11,344	13,283	33,513	52,610
Money market investments	395	325	1,220	1,034
Total interest income	166,964	158,542	472,723	502,863
Interest expense:				
Deposits	29,953	46,140	100,176	149,724
Securities sold under agreements to repurchase	6,707	10,700	21,825	36,858
Advances from FHLB	2,953	3,796	9,222	12,760
Notes payable and other borrowings	1,848	3,651	5,426	8,552
Total interest expense	41,461	64,287	136,649	207,894
Net interest income	125,503	94,255	336,074	294,969
Provision for loan and lease losses	28,952	46,446	90,033	194,362
Net interest income after provision for loan and lease losses	96,551	47,809	246,041	100,607
Non-interest income:				
Service charges on deposit accounts	3,267	3,098	9,754	9,484
Other service charges	1,098	1,485	3,843	4,659
Mortgage banking activities	4,728	3,676	13,260	19,603
Net gain on sale of investments	10	12,506	36	53,796
Other-than-temporary impairment losses on investment securities:				
Total other-than-temporary impairment losses				
Portion of loss previously recognized in other comprehensive income	(557)	(350)	(1,933)	(957)
Net impairment losses on investment securities	(557)	(350)	(1,933)	(957)
Loss on early extinguishment of borrowings		(9,012)		(10,835)
Equity in losses of unconsolidated entities	(2,199)	(4,357)	(10,926)	(5,893)
Other non-interest income	8,779	6,918	23,589	23,454
Total non-interest income	15,126	13,964	37,623	93,311
Non-interest expenses:				
Employees compensation and benefits	31,058	29,375	93,770	89,221
Occupancy and equipment	15,208	15,468	46,065	46,321
Business promotion	4,004	2,509	10,026	8,801
Professional fees	6,295	5,983	16,796	17,192
Taxes, other than income taxes	3,499	3,420	10,350	9,953
Insurance and supervisory fees	13,023	15,041	39,333	44,622
Net loss on real estate owned (REO) and REO operations	8,686	4,952	18,915	16,423

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

Other non-interest expenses	10,070	6,183	28,723	19,695
Total non-interest expenses	91,843	82,931	263,978	252,228
Income (loss) before income taxes	19,834	(21,158)	19,686	(58,310)
Income tax expense	(761)	(2,888)	(4,439)	(9,080)
Net income (loss)	\$ 19,073	\$ (24,046)	\$ 15,247	\$ (67,390)
Net income (loss) attributable to common stockholders	\$ 19,073	\$ (31,143)	\$ 15,247	\$ (88,785)
Net income (loss) per common share:				
Basic	\$ 0.09	\$ (1.46)	\$ 0.07	\$ (4.17)
Diluted	\$ 0.09	\$ (1.46)	\$ 0.07	\$ (4.17)
Dividends declared per common share	\$	\$	\$	\$

The accompanying notes are an integral part of these statements.

Table of Contents**FIRST BANCORP.****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)****(Unaudited)**

(In thousands)	Quarter Ended		Nine-Month Period Ended	
	September 30, 2012	September 30, 2011	September 30, 2012	September 30, 2011
Net income (loss)	\$ 19,073	\$ (24,046)	\$ 15,247	\$ (67,390)
Available-for-sale debt securities on which an other-than-temporary impairment has been recognized:				
Subsequent unrealized gain on debt securities on which an other-than-temporary impairment has been recognized	2,012	1,225	8,309	3,883
Reclassification adjustment for other-than-temporary impairment on debt securities included in net income	(557)	(350)	(1,933)	(957)
All other unrealized gains and losses on available-for-sale securities:				
All other unrealized holding gains arising during the period	14,868	15,285	17,009	26,578
Reclassification adjustments for net gain included in net income		(12,504)		(34,453)
Net unrealized gains on securities reclassified from held to maturity to available for sale				2,789
Income tax expense related to items of other comprehensive income	(442)	(2,364)	(92)	(1,631)
Other comprehensive income (loss) for the period, net of tax	15,881	1,292	23,293	(3,791)
Total comprehensive income (loss)	\$ 34,954	\$ (22,754)	\$ 38,540	\$ (71,181)

The accompanying notes are an integral part of these statements.

Table of Contents**FIRST BANCORP.****CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)**

(In thousands)	Nine-Month Period Ended	
	September 30,	September 30,
	2012	2011
Cash flows from operating activities:		
Net income (loss)	\$ 15,247	\$ (67,390)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation	18,404	18,209
Amortization of core deposit intangible	1,766	1,766
Amortization of purchased credit card relationship intangible	545	
Provision for loan and lease losses	90,033	194,362
Deferred income tax expense	775	2,187
Stock-based compensation	395	69
Gain on sales of investments, net		(53,115)
Loss on early extinguishment of borrowings		10,835
Other-than-temporary impairments on investment securities	1,933	957
Equity in losses of unconsolidated entities	10,926	5,893
Derivative instruments and financial liabilities measured at fair value (gain) loss	(955)	4,179
Loss (gain) on sale of premises and equipment and other assets	259	(2,733)
Net gain on sale of loans held for investment	(451)	(13,347)
Net amortization of premiums, discounts and deferred loan fees and costs	1,126	(1,267)
Originations and purchases of loans held for sale	(295,607)	(67,016)
Sales and repayments of loans held for sale	302,046	74,518
Amortization of broker placement fees	7,607	13,217
Net amortization of premium and discounts on investment securities	10,087	3,600
(Decrease) increase in accrued income tax payable	(1,048)	5,335
(Increase) decrease in accrued interest receivable	(909)	11,560
Decrease in accrued interest payable	(293)	(382)
Decrease (increase) in other assets	20,819	(8,995)
Increase (decrease) in other liabilities	8,059	(3,906)
Net cash provided by operating activities	190,764	128,536
Cash flows from investing activities:		
Principal collected on loans	2,227,673	1,907,704
Loans originated	(1,791,097)	(1,681,084)
Purchases of loans	(493,653)	(118,445)
Proceeds from sale of loans held for investment	22,203	675,450
Proceeds from sale of repossessed assets	59,442	79,974
Proceeds from sale of available-for-sale securities		1,181,065
Proceeds from sale of held-to-maturity securities		348,750
Purchases of securities available for sale	(788,191)	(677,115)
Proceeds from principal repayments and maturities of securities available for sale	1,127,667	619,375
Proceeds from principal repayments and maturities of securities held to maturity		33,726
Additions to premises and equipment	(7,494)	(10,711)
Proceeds from sale of premises and equipment and other assets	1,040	5,107
Proceeds from securities litigation settlement and other proceeds	36	679
(Increase) decrease in other equity securities	(1,705)	15,265
Net cash provided by investing activities	355,921	2,379,740

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

Cash flows from financing activities:

Net decrease in deposits	(19,611)	(1,416,329)
Net repayments and cancellation costs of securities sold under agreements to repurchase	(100,000)	(410,587)
Net FHLB advances proceeds (paid) and cancellation costs	151,000	(244,248)
Repayments of medium-term notes	(21,957)	(7,000)
Proceeds from common stock sold	1,037	
Net cash provided (used in) financing activities	10,469	(2,078,164)
Net increase in cash and cash equivalents	557,154	430,112
Cash and cash equivalents at beginning of period	446,566	370,283
Cash and cash equivalents at end of period	\$ 1,003,720	\$ 800,395
Cash and cash equivalents include:		
Cash and due from banks	\$ 786,788	\$ 612,721
Money market instruments	216,932	187,674
	\$ 1,003,720	\$ 800,395

The accompanying notes are an integral part of these statements.

Table of Contents**FIRST BANCORP.****CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY****(Unaudited)**

(In thousands)	Nine-Month Period Ended	
	September 30, 2012	September 30, 2011
Preferred Stock:		
Balance at beginning of period	\$ 63,047	\$ 425,009
Accretion of preferred stock discount		5,489
Balance at end of period	63,047	430,498
Common Stock outstanding:		
Balance at beginning of period	20,513	2,130
Common stock sold	29	
Restricted stock grants	76	
Balance at end of period	20,618	2,130
Additional Paid-In-Capital:		
Balance at beginning of period	884,002	319,459
Restricted stock grants	(76)	
Common stock sold	1,008	
Stock-based compensation	395	69
Balance at end of period	885,329	319,528
Retained Earnings:		
Balance at beginning of period	457,384	293,643
Net income (loss)	15,247	(67,390)
Accretion of preferred stock discount		(5,489)
Balance at end of period	472,631	220,764
Accumulated Other Comprehensive Income (Loss), net of tax:		
Balance at beginning of period	19,198	17,718
Other comprehensive income (loss), net of tax	23,294	(3,791)
Balance at end of period	42,492	13,927
Total stockholders equity	\$ 1,484,117	\$ 986,847

The accompanying notes are an integral part of these statements.

Table of Contents

FIRST BANCORP.

PART I - 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, 2011. 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, 2011, included in the Corporation s 2011 Annual Report on Form 10-K. On May 30, 2012, the Corporation purchased an approximate \$406 million credit cards portfolio, of which a portion were purchased credit impaired loans. Refer to Note 6 for additional information about this transaction, including the accounting and reporting policies related to this portfolio. All adjustments (consisting only of normal recurring adjustments) that are, in the opinion of management, necessary for a fair presentation of the statement of financial position, results of operations and cash flows for the interim periods have been reflected. All significant intercompany accounts and transactions have been eliminated in consolidation.

The results of operations for the quarter and nine-month period ended September 30, 2012 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 April 2011, the FASB updated the Accounting Standards Codification (Codification) to improve the accounting for repurchase agreements and other agreements that both entitle and obligate a transferor to repurchase or redeem financial assets before their maturity. The amendments in this Update remove from the assessment of effective control the criterion relating to the transferor s ability to repurchase or redeem financial assets on substantially the agreed terms, even in the event of default by the transferee. The Board concluded that this criterion is not a determining factor of effective control. Consequently, the amendments in this Update also eliminate the requirement to demonstrate that the transferor possesses adequate collateral to fund substantially all the cost of purchasing replacement financial assets. Eliminating the transferor s ability criterion and related implementation guidance from an entity s assessment of effective control should improve the accounting for repurchase agreements and other similar transactions. The amendments in this Update are effective for the first interim or annual period beginning on or after December 15, 2011, and should be applied prospectively to transactions or modifications of existing transactions that occur on or after the effective date. Early adoption is not permitted. The Corporation adopted this guidance with no impact on the financial statements.

In May 2011, the FASB updated the Codification to develop common requirements for measuring fair value and for disclosing information about fair value measurements in accordance with GAAP and International Financial Reporting Standards (IFRSs). The amendments in this Update apply to all reporting entities that are required or permitted to measure or disclose the fair value of an asset, a liability, or an instrument classified in a reporting entity s shareholders equity in the financial statements and result in common fair value measurement and disclosure requirements in U.S. GAAP and IFRSs. The amendments in this Update are to be applied prospectively and are effective during interim and annual periods beginning after December 15, 2011. Early application is not permitted. The Corporation adopted this guidance in 2012, refer to note 19 for applicable disclosures. The adoption of this guidance did not have a material impact in the Corporation s consolidated financial position or results of operations.

In June 2011, the FASB updated the Codification to improve the comparability, consistency, and transparency of financial reporting and to increase the prominence of items reported in other comprehensive income. Under the amendments, an entity has the option to present the total comprehensive income either in a single continuous statement or in two separate but consecutive statements and eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders equity. Additionally, this update requires consecutive presentation of the statement of net income and other comprehensive income and requires an entity to present reclassification adjustments on the face of the financial statements from other comprehensive income to net income. The amendments in this Update should be applied retrospectively and are effective for fiscal years beginning after December 15, 2011. Early adoption is permitted, because compliance with the amendments is already permitted. The amendments do not require any transition disclosures. Beginning with the financial statements

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

for the quarter and six-month period ended June 30, 2011, the Corporation is following the guidance of separate but consecutive presentation of the statement of net income and the statement of other comprehensive income.

In September 2011, the FASB updated the Codification to simplify how entities, both public and nonpublic, test goodwill for impairment. The amendments in the Update permit an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. The more-likely-than-not threshold is defined as having a likelihood of more than 50 percent. Under the amendments in this Update, an entity has the option to bypass the qualitative assessment for any reporting unit in any period and proceed

Table of Contents

directly to performing the first step of the two-step goodwill impairment test. An entity may resume performing the qualitative assessment in any subsequent period. The amendments in this Update are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted, including for annual and interim goodwill impairment tests performed as of a date before September 15, 2011, if an entity's financial statements for the most recent annual or interim period have not yet been issued. The Corporation will incorporate this guidance into the annual goodwill impairment evaluation process to be conducted in the fourth quarter of 2012.

In December 2011, the FASB updated the Codification to clarify the guidance on the derecognition of in substance real estate in order to resolve the diversity in practice when a parent ceases to have a controlling financial interest in a subsidiary that is in substance real estate as a result of default on the subsidiary's nonrecourse debt. Under the amendments in this Update, when a parent (reporting entity) ceases to have a controlling financial interest in a subsidiary that is in substance real estate as a result of default on the subsidiary's nonrecourse debt, the reporting entity should apply the guidance in Subtopic 360-20 to determine whether it should derecognize the in substance real estate. That is, even if the reporting entity ceases to have a controlling financial interest, the reporting entity would continue to include the real estate, debt, and the results of the subsidiary's operations in its consolidated financial statements until legal title to the real estate is transferred to legally satisfy the debt. The amendments in this Update are effective for fiscal years, and interim periods within those years, beginning on or after June 15, 2012. The Corporation adopted this guidance with no impact on the consolidated financial statements.

In December 2011, the FASB updated the Codification to enhance and provided converged disclosures about financial and derivative instruments that are either offset on the balance sheet, or are subject to an enforceable master netting arrangement (or other similar arrangement). Entities are required to disclose both gross information and net information about both instruments and transactions eligible for offset in the statement of financial position and instruments and transactions subject to an agreement similar to a master netting arrangement. In November 2012, the FASB decided to amend and clarify the scope of the disclosures to include only derivatives, repurchase agreements and securities lending transactions. The FASB plans to release an exposure draft with the revised scope language during November 2012. The amendments in this Update are effective for interim and annual period beginning on or after January 1, 2013. The Corporation is currently evaluating the impact of the adoption of this guidance, if any, on its consolidated financial statements.

In July 2012, the FASB updated the Codification to reduce the cost and complexity of performing an impairment test for indefinite-lived intangible assets by simplifying how an entity tests those assets for impairment and to improve consistency in impairment testing guidance among long-lived asset categories. The amendments permit an entity first to assess qualitative factors to determine whether it is more likely than not that an indefinite-lived intangible asset is impaired as a basis for determining whether it is necessary to perform the quantitative impairment test. An entity also has the option to bypass the qualitative assessment for any indefinite-lived intangible asset in any period and proceed directly to performing the quantitative impairment test. An entity will be able to resume performing the qualitative assessment in any subsequent period. The amendments in this Update are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. Early adoption is permitted, including for annual and interim impairment tests performed as of date before July 27, 2012, if an entity's financial statements for the most recent annual or interim period have not yet been issued. The Corporation is currently evaluating the impact of the adoption of this guidance, if any, on its consolidated financial statements.

2 EARNINGS PER COMMON SHARE

The calculations of earnings per common share for the quarters and nine-month period ended on September 30, 2012 and 2011 are as follows:

	Quarter Ended		Nine-Month Period Ended	
	September 30, 2012	September 30, 2011	September 30, 2012	September 30, 2011
	(In thousands, except per share information)			
Net Income (Loss):				
Net income (loss)	\$ 19,073	\$ (24,046)	\$ 15,247	\$ (67,390)
Cumulative convertible preferred stock dividends (Series G)		(5,302)		(15,906)
Preferred stock discount accretion (Series G)		(1,795)		(5,489)
Net income (loss) attributable to common stockholders	\$ 19,073	\$ (31,143)	\$ 15,247	\$ (88,785)
Weighted-Average Shares:				
Basic weighted-average common shares outstanding	205,415	21,303	205,349	21,303
Average potential common shares	508		348	

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

Diluted weighted-average number of common shares outstanding	205,923	21,303	205,697	21,303
Income (loss) per common share:				
Basic	\$ 0.09	\$ (1.46)	\$ 0.07	\$ (4.17)
Diluted	\$ 0.09	\$ (1.46)	\$ 0.07	\$ (4.17)

Table of Contents

Earning (loss) per common share is computed by dividing net income (loss) attributable to common stockholders by the weighted average common shares issued and outstanding. Net income (loss) attributable to common stockholders represents net income (loss) adjusted for preferred stock dividends including dividends declared, and cumulative dividends related to the current dividend period that have not been declared as of the end of the period, and the accretion of discount on preferred stock issuances. Basic weighted average common shares outstanding exclude unvested shares of restricted stock.

Potential common shares consist of common stock issuable under the assumed exercise of stock options, unvested shares of restricted stock, and outstanding warrants using the treasury stock method. This method assumes that the potential common shares are issued and the proceeds from the exercise, in addition to the amount of compensation cost attributable to future services, are used to purchase common stock at the exercise date. The difference between the number of potential shares issued and the shares purchased is added as incremental shares to the actual number of shares outstanding to compute diluted earnings per share. Stock options, unvested shares of restricted stock, and outstanding warrants that result in lower potential shares issued than shares purchased under the treasury stock method are not included in the computation of dilutive earnings per share since their inclusion would have an anti-dilutive effect on earnings per share. Stock options not included in the computation of outstanding shares because they were antidilutive amounted to 114,757 and 129,934 for the quarter and nine-month period ended September 30, 2012 and 2011, respectively. Warrants outstanding to purchase 389,483 shares of common stock for the quarter and nine-month period ended September 30, 2011, and 720 unvested shares of restricted stock for the quarter and nine-month period ended September 30, 2011, were excluded from the computation of diluted earnings per share because the Corporation reported a net loss attributable to common stockholders and their inclusion would have an antidilutive effect.

3 STOCK-BASED COMPENSATION

Between 1997 and January 2007, the Corporation had a stock option plan (the 1997 stock option plan) that authorized the granting of up to 579,740 options on shares of the Corporation s common stock to eligible employees. The options granted under the plan could not exceed 20% of the number of common shares outstanding. Each option provides for the purchase of one share of common stock at a price not less than the fair market value of the stock on the date the option was granted. Stock options were fully vested upon grant. The maximum term to exercise the options is ten years. The stock option plan provides for a proportionate adjustment in the exercise price and the number of shares that can be purchased in the event of a stock dividend, stock split, reclassification of stock, merger or reorganization and certain other issuances and distributions such as stock appreciation rights.

Under the 1997 stock option plan, the Compensation and Benefits Committee (the Compensation Committee) had the authority to grant stock appreciation rights at any time subsequent to the grant of an option. Pursuant to stock appreciation rights, the optionee surrenders the right to exercise an option granted under the plan in consideration for payment by the Corporation of an amount equal to the excess of the fair market value of the shares of common stock subject to such option surrendered over the total option price of such shares. Any option surrendered is cancelled by the Corporation and the shares subject to the option are not eligible for further grants under the option plan. On January 21, 2007, the 1997 stock option plan expired; all outstanding awards granted under this plan continue in full force and effect, subject to their original terms. No awards for shares could be granted under the 1997 stock option plan as of its expiration.

The activity of stock options for the nine-month period ended September 30, 2012 is set forth below:

	Nine-Month Period Ended September 30, 2012			
	Number of Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value (In thousands)
Beginning of period	129,934	\$ 202.99		
Options expired	(9,713)	140.15		
Options cancelled	(5,464)	236.27		
End of period outstanding and exercisable	114,757	\$ 206.72	3.1	\$

On April 29, 2008, the Corporation s stockholders approved the First BanCorp. 2008 Omnibus Incentive Plan (the Omnibus Plan). The Omnibus Plan provides for equity-based compensation incentives (the awards) through the grant of stock options, stock appreciation rights, restricted stock, restricted stock units, performance shares, and other stock-based awards. This plan allows the issuance of up to 8,169,807 shares of common stock, subject to adjustments for stock splits, reorganizations and other similar events. The Corporation s Board of Directors, upon

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

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.

Table of Contents

Under the Omnibus Plan, during the third quarter of 2012, 44,910 shares of restricted stock were awarded to the Corporation's independent directors subject to a one year vesting period. In addition, early in 2012, the Corporation issued 719,500 shares of restricted stock which will vest based on the employees' continued service with the Corporation. Fifty percent (50%) of those shares vest in two years from the grant date and the remaining 50% vest in three years from the grant date. Included in the 719,500 shares of restricted stock are 557,000 shares granted to certain senior executive officers consistent with the requirements of the Troubled Asset Relief Program (TARP) Interim Final Rule. Notwithstanding the vesting period mentioned above, the employees covered by TARP are restricted from transferring the shares. Specifically, the stock that has otherwise vested may not become transferable at any time earlier than as permitted under the schedule set forth by TARP, which is based on the repayment in 25% increments of the aggregate financial assistance received from the U.S. Department of Treasury (the Treasury).

The following table summarizes the restricted stock activity in 2012 under the Omnibus Plan for both executive officers covered by the TARP requirements and other employees as well as for the independent directors:

	Nine-Month Period Ended September 30, 2012	
	Number of shares of restricted stock	Weighted-Average Grant Date Fair Value
Non-vested shares at beginning of period		\$
Granted	764,410	2.50
Non-vested shares at September 30, 2012	764,410	\$ 2.50

For the quarter and nine-month period ended September 30, 2012, the Corporation recognized \$0.2 million and \$0.4 million, respectively, of stock based compensation expense related to the aforementioned restricted stock awards. For the quarter and nine-month period ended September 30, 2011, the Corporation recognized \$23,333 and \$69,999, respectively, of stock based compensation related to 720 shares of restricted stock granted in 2008 to members of the Board of Directors that vested in the fourth quarter of 2011. As of September 30, 2012, there was \$1.4 million of total unrecognized compensation cost related to nonvested shares of restricted stock. That cost is expected to be recognized for 6% of the awards over the next 8 months, for 47% of the awards over the next 1.5 years and the remaining 47% over the next 2.5 years, as if they were multiple awards. No shares of restricted stock were granted or vested during the nine-month period ended September 30, 2011.

The fair value of the shares of restricted stock granted in 2012 was based on the market price of the Corporation's outstanding common stock on the date of the grant, \$3.34 for restricted stocks granted during the third quarter of 2012 and \$4.00 for the restricted stocks granted earlier in 2012. For the 557,000 shares of restricted stock granted under the TARP requirements, the market price was discounted due to post-vesting restrictions. For purposes of computing the discount, the Corporation assumes a common stock appreciation of 25% and a holding period by the Treasury of its outstanding common stock of the Corporation of 3 years, resulting in a fair value of \$2.00 for restricted shares granted under the TARP requirements. Also, the Corporation uses empirical data to estimate employee termination, separate groups of employees that have similar historical exercise behavior are considered separately for valuation purposes.

Stock-based compensation accounting guidance requires the Corporation to develop an estimate of the number of share-based awards that will be forfeited due to employee or director turnover. Quarterly changes in the estimated forfeiture rate may have a significant effect on share-based compensation, as the effect of adjusting the rate for all expense amortization is recognized in the period in which the forfeiture estimate is changed. If the actual forfeiture rate is higher than the estimated forfeiture rate, then an adjustment is made to increase the estimated forfeiture rate, which will result in a decrease to the expense recognized in the financial statements. If the actual forfeiture rate is lower than the estimated forfeiture rate, then an adjustment is made to decrease the estimated forfeiture rate, which will result in an increase to the expense recognized in the financial statements. When unvested options or shares of restricted stock are forfeited, any compensation expense previously recognized on the forfeited awards is reversed in the period of the forfeiture.

Table of Contents**4 INVESTMENT SECURITIES***Investment Securities Available for Sale*

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

(Dollars in thousands)	September 30, 2012					December 31, 2011						
	Amortized cost	Non-Credit Loss Component of OTTI Recorded in OCI	Gross Unrealized		Fair value	Weighted average yield%	Amortized cost	Non-Credit Loss Component of OTTI Recorded in OCI	Gross Unrealized		Fair value	Weighted average yield%
U.S. Treasury securities:												
Due within one year	\$ 7,494	\$	\$ 1	\$	\$ 7,495	0.17	\$ 476,665	\$	\$ 327	\$	\$ 476,992	0.34
Obligations of U.S. Government sponsored agencies:												
Due within one year							300,381		1,204		301,585	1.15
After 1 to 5 years	25,650		11		25,661	0.35						
Puerto Rico Government obligations:												
Due within one year							8,560		110		8,670	4.20
After 1 to 5 years							70,590		171	1	70,760	2.63
After 5 to 10 years	39,744		1,335		41,079	4.49	118,186		76	13	118,249	5.07
After 10 years	21,102		1,190	25	22,267	5.78	24,154		781	1	24,934	5.74
United States and Puerto Rico Government obligations												
	93,990		2,537	25	96,502	3.31	998,536		2,669	15	1,001,190	1.47
Mortgage-backed securities:												
FHLMC certificates:												
Due within one year	206		1		207	3.57						
After 1 to 5 years							928		8		936	3.67
After 10 years	135,512		4,186		139,698	2.28	24,974		238		25,212	2.59
	135,718		4,187		139,905	2.28	25,902		246		26,148	2.62
GNMA certificates:												
After 1 to 5 years	159		8		167	3.59	179		9		188	3.88
After 5 to 10 years	562		45		607	3.60	596		47		643	4.09
After 10 years	604,294		44,793		649,087	4.00	717,237		43,938		761,175	3.98
	605,015		44,846		649,861	4.00	718,012		43,994		762,006	3.98
FNMA certificates:												
Due within one year	282		10		292	3.55						
After 1 to 5 years							1,019		42		1,061	3.82
After 5 to 10 years	14,517		810		15,327	4.04	18,826		1,007		19,833	3.97
After 10 years	624,983		15,872		640,855	2.56	47,485		3,285		50,770	5.46

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

	639,782		16,692		656,474	2.59	67,330		4,334		71,664	5.02
Collateralized Mortgage Obligations issued or guaranteed by FHLMC,												
After 5 to 10 years	377			1	376	3.01						
Other mortgage pass-through trust certificates:												
After 10 years	72,555	31,951	14,085		54,689	2.34	85,014	31,951	8,143		61,206	2.19
Total mortgage-backed securities												
	1,453,447	31,951	79,810	1	1,501,305	3.13	896,258	31,951	56,717		921,024	3.85
Corporate bonds:												
After 10 years							1,447	434			1,013	5.80
Equity securities (without contractual maturity) ⁽¹⁾												
	77			37	40		77			36	41	
Total investment securities available for sale												
	\$ 1,547,514	\$ 31,951	\$ 82,347	\$ 63	\$ 1,597,847	3.15	\$ 1,896,318	\$ 32,385	\$ 59,386	\$ 51	\$ 1,923,268	2.60

(1) Represents common shares of another financial institution in Puerto Rico.

Maturities of mortgage-backed securities are based on contractual terms assuming no prepayments. Expected maturities of investments might differ from contractual maturities because they may be subject to prepayments and/or call options as was the case with approximately \$194.5 million of Puerto Rico Government Obligations called during the first nine months of 2012. 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.

Table of Contents

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 September 30, 2012 and December 31, 2011. It also includes debt securities for which an OTTI was recognized and only the amount related to a credit loss was recognized in earnings. Unrealized losses for which OTTI had been recognized have been reduced by any subsequent recoveries in fair value:

	Less than 12 months		As of September 30, 2012 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	\$ 2,065	\$ 25	\$	\$	\$ 2,065	\$ 25
Mortgage-backed securities:						
Collateralized mortgage obligations issued or guaranteed by FHLMC	376	1			376	1
Other mortgage pass-through trust certificates			54,540	17,867	54,540	17,867
Equity securities			40	37	40	37
	\$ 2,441	\$ 26	\$ 54,580	\$ 17,904	\$ 57,021	\$ 17,930

	Less than 12 months		As of December 31, 2011 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	\$ 15,982	\$ 15	\$	\$	\$ 15,982	\$ 15
Mortgage-backed securities:						
Other mortgage pass-through trust certificates			61,017	23,809	61,017	23,809
Corporate bonds			1,013	434	1,013	434
Equity securities	41	36			41	36
	\$ 16,023	\$ 51	\$ 62,030	\$ 24,243	\$ 78,053	\$ 24,294

Total proceeds from the sale of securities available for sale during the first nine months of 2011 amounted to approximately \$1.2 billion, none in the first nine months of 2012.

Assessment for OTTI

On a quarterly basis, the Corporation performs an assessment to determine whether there have been any events or economic circumstances indicating that a security with an unrealized loss has suffered an OTTI. A debt security is considered impaired if the fair value is less than its amortized cost basis at the reporting date. The accounting literature requires the Corporation to assess whether the unrealized loss is other-than-temporary.

OTTI losses must be recognized in earnings if an investor has the intent to sell the debt security or it is more likely than not that it will be required to sell the debt security before recovery of its amortized cost basis. However, even if an investor does not expect to sell a debt security, it must evaluate expected cash flows to be received and determine if a credit loss has occurred.

An unrealized loss is generally deemed to be other-than-temporary and a credit loss is deemed to exist if the present value of the expected future cash flows is less than the amortized cost basis of the debt security. The credit loss component of an OTTI, if any, is recorded as a component of net impairment losses on investment securities in the accompanying consolidated statements of income (loss), while the remaining portion of the impairment loss is recognized in OCI, provided the Corporation does not intend to sell the underlying debt security and it is more likely than not that the Corporation will not have to sell the debt security prior to recovery.

Table of Contents

Debt securities issued by U.S. government agencies, government-sponsored entities and the U.S. Treasury accounted for more than 92% of the total available-for-sale portfolio as of September 30, 2012 and no credit losses are expected, given the explicit and implicit guarantees provided by the U.S. federal government. The Corporation's assessment was concentrated mainly on private label mortgage-backed securities with an amortized cost of \$72.6 million for which credit losses are evaluated on a quarterly basis. The Corporation considered the following factors in determining whether a credit loss exists and the period over which the debt security is expected to recover:

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

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

The level of cash flows generated from the underlying collateral supporting the principal and interest payments of the debt securities; and

Any adverse change to the credit conditions and liquidity of the issuer, taking into consideration the latest information available about the overall financial condition of the issuer, credit ratings, recent legislation and government actions affecting the issuer's industry and actions taken by the issuer to deal with the present economic climate.

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

(In thousands)	Private label MBS		Private label MBS	
	Quarter ended September 30, 2012	September 30, 2011	Nine-Month Period Ended September 30, 2012	September 30, 2011
Total other-than-temporary impairment losses	\$	\$	\$	\$
Portion of loss previously recognized in other comprehensive income	(557)	(350)	(1,933)	(957)
Net impairment losses recognized in earnings	\$ (557)	\$ (350)	\$ (1,933)	\$ (957)

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

(In thousands)	Quarter ended September 30,		Nine-Month Period Ended	
	2012	2011	September 30, 2012	September 30, 2011
Credit losses at the beginning of the period	\$ 5,199	\$ 2,459	\$ 3,823	\$ 1,852
Additions:				
Credit losses on debt securities for which an OTTI was previously recognized ⁽¹⁾	557	350	1,933	957
Ending balance of credit losses on debt securities held for which a portion of an OTTI was recognized in OCI	\$ 5,756	\$ 2,809	\$ 5,756	\$ 2,809

(1) Related to private label MBS.

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

During the first nine-months of 2012, the \$1.9 million credit related impairment loss is related to Private label MBS, which are collateralized by fixed-rate mortgages on single family residential properties in the United States. The interest rate on these private-label MBS is variable, tied to 3-month LIBOR and limited to the weighted-average coupon of the underlying collateral. The underlying mortgages are fixed-rate single family loans with original high FICO scores (over 700) and moderate original loan-to-value ratios (under 80%), as well as moderate delinquency levels.

Table of Contents

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

	September 30, 2012		December 31, 2011	
	Weighted Average	Range	Weighted Average	Range
Discount rate	14.5%	14.5%	14.5%	14.5%
Prepayment rate	33%	23.81% - 43.58%	27%	21.33% - 37.97%
Projected Cumulative Loss Rate	7%	0.71% - 17.51%	6%	1.94% - 11.89%

No OTTI losses on equity securities held in the available-for-sale investment portfolio were recognized for the first nine-months of 2012 or 2011.

5 OTHER EQUITY SECURITIES

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

As of September 30, 2012 and December 31, 2011, the Corporation had investments in FHLB stock with a book value of \$38.4 million and \$36.7 million, respectively. The net realizable value is a reasonable proxy for the fair value of these instruments. Dividend income from FHLB stock for the quarter and nine-month period ended September 30, 2012 amounted to \$0.3 million and \$1.1 million, respectively, compared to \$0.4 million and \$1.4 million for the comparable periods in 2011.

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

The Corporation has other equity securities that do not have a readily available fair value. The carrying value of such securities as of September 30, 2012 and December 31, 2011 was \$1.3 million.

6 LOAN PORTFOLIO

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

	September 30, 2012	December 31, 2011
	(In thousands)	
Residential mortgage loans, mainly secured by first mortgages	\$ 2,762,418	\$ 2,873,785
Commercial loans:		
Construction loans	352,891	427,863
Commercial mortgage loans	1,459,118	1,565,411
Commercial and Industrial loans	3,369,305	3,856,695
Loans to local financial institutions collateralized by real estate mortgages	258,341	273,821
Commercial loans	5,439,655	6,123,790

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

Finance leases	239,556	247,003
Consumer loans	1,746,535	1,314,814
Loans held for investment	10,188,164	10,559,392
Allowance for loan and lease losses	(445,531)	(493,917)
Loans held for investment, net	\$ 9,742,633	\$ 10,065,475

Table of Contents

Loans held for investment classified as non-performing were as follows:

<i>(In thousands)</i>	September 30, 2012	December 31, 2011
Non-performing loans:		
Residential mortgage	\$ 320,913	\$ 338,208
Commercial mortgage	231,163	240,414
Commercial and Industrial	230,459	270,171
Construction	189,458	250,022
Consumer:		
Auto loans	17,639	19,641
Finance leases	3,061	3,485
Other consumer loans	15,351	16,421
 Total non-performing loans held for investment ⁽¹⁾	 \$ 1,008,044	 \$ 1,138,362

(1) Amount exclude purchased credit-impaired loans with a carrying value of approximately \$12.7 million acquired as part of the credit cards portfolio purchased in the second quarter of 2012 as further discussed below.

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

As of September 30, 2012

<i>(In thousands)</i>	30-59 Days Past Due	60-89 Days Past Due	90 days or more Past Due ⁽¹⁾	Total Past Due ⁽⁴⁾	Purchased Credit- Impaired Loans ⁽⁴⁾	Current	Total loans held for investment	90 days past due and still accruing ⁽⁵⁾
Residential mortgage:								
FHA/VA and other government guaranteed loans ^{(2) (3) (5)}	\$	\$ 12,406	\$ 91,422	\$ 103,828	\$	\$ 112,662	\$ 216,490	\$ 91,422
Other residential mortgage loans ⁽³⁾		109,309	333,903	443,212		2,102,716	2,545,928	12,990
Commercial:								
Commercial & Industrial loans	14,436	11,516	258,354	284,306		3,343,340	3,627,646	27,895
Commercial mortgage loans ⁽³⁾		11,744	235,955	247,699		1,211,419	1,459,118	4,792
Construction loans ⁽³⁾		2,160	189,489	191,649		161,242	352,891	31
Consumer:								
Auto loans	67,561	19,738	17,639	104,938		891,681	996,619	
Finance leases	10,098	3,122	3,061	16,281		223,275	239,556	
Other consumer loans	13,373	7,533	19,249	40,155	12,741	697,020	749,916	3,898
 Total loans held for investment	 \$105,468	 \$ 177,528	 \$ 1,149,072	 \$ 1,432,068	 \$ 12,741	 \$ 8,743,355	 \$ 10,188,164	 \$ 141,028

(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.

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

- (2) As of September 30, 2012, includes \$6.1 million of defaulted loans collateralizing Ginnie Mae (GNMA) securities for which the Corporation has an unconditional option (but not an obligation) to repurchase the defaulted loans.
- (3) According to the Corporation s delinquency policy and consistent with the instructions for the preparation of the Consolidated Financial Statements for Bank Holding Companies (FR Y-9C) required by the Federal Reserve, residential mortgage, commercial mortgage and construction loans are considered past due when the borrower is in arrears 2 or more monthly payments.
- (4) Purchased credit impaired loans are excluded from delinquency and non-performing statistics as further discussed below.
- (5) It is the Corporation s policy to report delinquent residential mortgage loans insured by 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 \$34.6 million of residential mortgage loans insured by FHA or guaranteed by the VA, which are over 18 months delinquent, that are no longer accruing interest as of September 30, 2012.

Table of Contents

As of December 31, 2011

(In thousands)	30-59 Days Past Due	60-89 Days Past Due	90 days or more Past Due ⁽¹⁾	Total Past Due	Current	Total loans held for investment	90 days past due and still accruing
Residential mortgage:							
FHA/VA and other government guaranteed loans ⁽²⁾⁽³⁾	\$	\$ 17,548	\$ 85,188	\$ 102,736	\$ 165,417	\$ 268,153	\$ 85,188
Other residential mortgage loans ⁽³⁾		90,274	350,495	440,769	2,164,863	2,605,632	12,287
Commercial:							
Commercial & Industrial loans	27,674	10,714	294,723	333,111	3,797,405	4,130,516	24,552
Commercial mortgage loans ⁽³⁾		8,891	240,414	249,305	1,316,106	1,565,411	
Construction loans ⁽³⁾		8,211	258,811	267,022	160,841	427,863	8,789
Consumer:							
Auto loans	61,265	18,963	19,641	99,869	837,697	937,566	
Finance leases	11,110	4,172	3,485	18,767	228,236	247,003	
Other consumer loans	10,170	4,699	16,421	31,290	345,958	377,248	
Total loans held for investment	\$ 110,219	\$ 163,472	\$ 1,269,178	\$ 1,542,869	\$ 9,016,523	\$ 10,559,392	\$ 130,816

- (1) Includes non-performing loans and accruing loans which are contractually delinquent 90 days or more (i.e. FHA/VA and other guaranteed loans).
- (2) As of December 31, 2011, includes \$66.4 million of defaulted loans collateralizing Ginnie Mae (GNMA) securities for which the Corporation has an unconditional option (but not an obligation) to repurchase the defaulted loans.
- (3) According to the Corporation's delinquency policy and consistent with the instructions for the preparation of the Consolidated Financial Statements for Bank Holding Companies (FR Y-9C) required by the Federal Reserve, residential mortgage, commercial mortgage and construction loans are considered past due when the borrower is in arrears 2 or more monthly payments.

The Corporation's credit quality indicators by loan type are summarized below:

September 30, 2012	Commercial Credit Exposure-Credit risk Profile based on Creditworthiness category:				
	Substandard	Doubtful	Loss	Total	Total Portfolio
				Adversely Classified	
(In thousands)					
Commercial Mortgage	\$ 388,225	\$ 6,526	\$	\$ 394,751	\$ 1,459,118
Construction	188,051	22,184	605	210,840	352,891
Commercial and Industrial	405,897	23,728	1,240	430,865	3,627,646

December 31, 2011	Commercial Credit Exposure-Credit risk Profile based on Creditworthiness category:				
	Substandard	Doubtful	Loss	Total	Total Portfolio
				Adversely Classified	
(In thousands)					
Commercial Mortgage	\$ 414,355	\$ 8,462	\$	\$ 422,817	\$ 1,565,411
Construction	247,560	32,059	2,916	282,535	427,863
Commercial and Industrial	457,927	31,100	1,373	490,400	4,130,516

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

Substandard- A Substandard Asset is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are

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

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 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.

Table of Contents

September 30, 2012	Consumer Credit Exposure-Credit risk Profile based on payment activity				
	Residential	Real-Estate	Auto	Consumer	
	FHA/VA/ Guaranteed (1)	Other residential loans		Finance Leases	Other Consumer
			(In thousands)		
Performing	\$216,490	\$2,225,015	\$978,980	\$236,495	\$721,824
Purchased Credit-Impaired					12,741
Non-performing		320,913	17,639	3,061	15,351
Total	\$216,490	\$2,545,928	\$996,619	\$239,556	\$749,916

- (1) It is the Corporation's policy to report delinquent residential mortgage loans insured by 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 \$34.6 million of residential mortgage loans insured by FHA or guaranteed by the VA, which are over 18 months delinquent, that are no longer accruing interest as of September 30, 2012.

December 31, 2011	Consumer Credit Exposure-Credit risk Profile based on payment activity				
	Residential	Real-Estate	Auto	Consumer	
	FHA/VA/ Guaranteed	Other residential loans		Finance Leases	Other Consumer
			(In thousands)		
Performing	\$ 268,153	\$ 2,267,424	\$ 917,925	\$ 243,518	\$ 360,827
Non-performing		338,208	19,641	3,485	16,421
Total	\$ 268,153	\$ 2,605,632	\$ 937,566	\$ 247,003	\$ 377,248

Table of Contents

The following tables present information about impaired loans excluding purchased credit-impaired loans, which are reported separately and discussed below:

Impaired Loans

(Dollars in thousands)

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized Quarter to date	Interest Income Recognized Year to date
As of September 30, 2012						
With no related allowance recorded:						
FHA/VA Guaranteed loans	\$	\$	\$	\$	\$	\$
Other residential mortgage loans	106,554	112,039		171,070	1,144	2,733
Commercial:						
Commercial mortgage loans	50,043	62,819		40,939	442	1,003
Commercial & Industrial Loans	31,047	38,017		20,128	51	74
Construction Loans	38,863	64,637		37,314	33	70
Consumer:						
Auto loans						
Finance leases						
Other consumer loans	1,647	2,597		2,729	25	51
	\$ 228,154	\$ 280,109	\$	\$ 272,180	\$ 1,695	\$ 3,931
With an allowance recorded:						
FHA/VA Guaranteed loans	\$	\$	\$	\$	\$	\$
Other residential mortgage loans	488,234	550,123	49,640	428,808	3,857	10,851
Commercial:						
Commercial mortgage loans	313,490	333,339	51,351	324,053	2,369	6,646
Commercial & Industrial Loans	207,465	272,977	57,001	236,896	479	1,503
Construction Loans	139,599	235,137	33,349	171,178	36	289
Consumer:						
Auto loans	11,813	11,813	1,404	10,317	194	616
Finance leases	2,045	2,045	73	1,968	50	134
Other consumer loans	9,338	9,968	1,336	9,028	48	206
	\$ 1,171,984	\$ 1,415,402	\$ 194,154	\$ 1,182,248	\$ 7,033	\$ 20,244
Total:						
FHA/VA Guaranteed loans	\$	\$	\$	\$	\$	\$
Other residential mortgage loans	594,788	662,162	49,640	599,878	5,001	13,584
Commercial:						
Commercial mortgage loans	363,533	396,158	51,351	364,992	2,811	7,649
Commercial & Industrial Loans	238,512	310,994	57,001	257,024	530	1,577
Construction Loans	178,462	299,774	33,349	208,492	69	359
Consumer:						
Auto loans	11,813	11,813	1,404	10,317	194	616
Finance leases	2,045	2,045	73	1,968	50	134
Other consumer loans	10,985	12,565	1,336	11,757	73	257
	\$ 1,400,138	\$ 1,695,511	\$ 194,154	\$ 1,454,428	\$ 8,728	\$ 24,176

Table of Contents

(Dollars in thousands)

	Recorded Investment	Unpaid Principal Balance	Related Allowance
As of December 31, 2011			
With no related allowance recorded:			
FHA/VA Guaranteed loans	\$	\$	\$
Other residential mortgage loans	181,081	192,757	
Commercial:			
Commercial mortgage loans	13,797	15,283	
Commercial & Industrial Loans	40,453	45,948	
Construction Loans	33,759	45,931	
Consumer:			
Auto loans			
Finance leases			
Other consumer loans	2,840	3,846	
	\$ 271,930	\$ 303,765	\$
With an allowance recorded:			
FHA/VA Guaranteed loans	\$	\$	\$
Other residential mortgage loans	423,340	465,495	48,566
Commercial:			
Commercial mortgage loans	354,954	383,890	59,167
Commercial & Industrial Loans	223,572	316,641	58,652
Construction Loans	213,388	344,035	44,768
Consumer:			
Auto loans	8,710	8,710	1,039
Finance leases	1,804	1,804	41
Other consumer loans	9,678	9,678	2,669
	\$ 1,235,446	\$ 1,530,253	\$ 214,902
Total:			
FHA/VA Guaranteed loans	\$	\$	\$
Other residential mortgage loans	604,421	658,252	48,566
Commercial:			
Commercial mortgage loans	368,751	399,173	59,167
Commercial & Industrial Loans	264,025	362,589	58,652
Construction Loans	247,147	389,966	44,768
Consumer:			
Auto loans	8,710	8,710	1,039
Finance leases	1,804	1,804	41
Other consumer loans	12,518	13,524	2,669
	\$ 1,507,376	\$ 1,834,018	\$ 214,902

Interest income of approximately \$10.2 million and \$25.1 million was recognized on impaired loans for the third quarter and first nine months of 2011, respectively.

The following tables show the activity for impaired loans and the related specific reserve:

Quarter ended	Nine-Month Period Ended
September 30, 2012	

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

	(In thousands)	
Impaired Loans:		
Balance at beginning of period	\$ 1,432,469	\$ 1,507,376
Loans determined impaired during the period	55,292	222,841
Net charge-offs	(30,971)	(107,458)
Increases to impaired loans (disbursements)	11,039	30,160
Foreclosures	(26,353)	(113,737)
Loans no longer considered impaired	(5,351)	(42,269)
Paid in full or partial payments	(35,987)	(96,775)
Balance at end of period	\$ 1,400,138	\$ 1,400,138

Table of Contents

	Quarter Ended	Nine-Month Period Ended September 30, 2012 (In thousands)
Specific Reserve:		
Balance at beginning of period	\$ 209,860	\$ 214,902
Provision for loan losses	15,265	87,070
Net charge-offs	(30,971)	(107,818)
Balance at end of period	\$ 194,154	\$ 194,154

Acquired loans including Purchased Credit-Impaired Loans

On May 30, 2012, the Corporation re-entered the credit card business with the acquisition of an approximate \$406 million portfolio of FirstBank-branded credit card portfolio from FIA Card Services (FIA). These loans were recorded on the Consolidated Statement of Financial Condition at estimated fair value on acquisition date of \$368.9 million. The Corporation concluded that a portion of these loans acquired were purchased credit-impaired (PCI) loans. PCI loans are acquired loans with evidence of credit quality deterioration since origination for which it is probable at the date of purchase that the Corporation will be unable to collect all contractually required payments. The loans for which the Corporation concluded were credit impaired had a contractual outstanding unpaid principal and interest balance of \$34.6 million and an estimated fair value of \$15.7 million. Given the initial fair value of these loans included an estimate of credit losses expected to be realized over the remaining lives of the loans, the Corporation's subsequent accounting for PCI loans differs from the accounting for non-PCI loans, therefore, the Corporation separately tracks and report PCI loans and exclude these loans from delinquency and nonperforming loan statistics. Credit card loans continue to accrue finance charges and fees until charged-off at 180 days delinquent and the methodology employed to calculate the allowance for loan losses for non-PCI loans is similar to the methodology used for other consumer loans, except for that the loss rates are determined evaluating 12 months of historical performance, instead of 24 months.

Initial Fair value and Accretable Yield of Acquired loans

At acquisition, the Corporation estimated the cash flows the Corporation expected to collect on credit card loans acquired with a deteriorated credit quality. Under the accounting guidance for PCI loans, the difference between the contractually required payments and the cash flows expected to be collected at acquisition is referred to as the nonaccretable difference. This difference is neither accreted into income nor recorded on the Corporation's consolidated Statement of Financial Condition. The excess of cash flows expected to be collected over the estimated fair value is referred to as the accretable yield and is recognized in interest income over the remaining life of the loans, using the effective yield method. The table below displays the contractually required principal and interest, cash flows expected to be collected and fair value at acquisition related to the loans the Corporation acquired. The table also displays the nonaccretable difference and the accretable yield at acquisition.

(In thousands)	At acquisition Purchased Credit- Impaired Loans
Contractually outstanding principal and interest at acquisition	\$ 34,577
Less: Nonaccretable difference	(15,408)
Cash flows expected to be collected at acquisition	19,169
Less: Accretable yield	(3,451)
Fair value of loans acquired	\$ 15,718

Outstanding balance and Carrying value of PCI loans

The table below presents the outstanding contractual principal balance and carrying value of the PCI loans as of September 30, 2012:

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

(In thousands)	Purchased Credit- Impaired Loans
Contractual balance	\$ 31,364
Carrying value	12,741

Table of Contents*Changes in accretable yield of acquired loans*

Subsequent to acquisition, the Corporation is required to periodically evaluate its estimate of cash flows expected to be collected. These evaluations, performed quarterly, require the continued use of key assumptions and estimates, similar to the initial estimate of fair value. Subsequent changes in the estimated cash flows expected to be collected may result in changes in the accretable yield and nonaccretable difference or reclassifications from nonaccretable yield to accretable. Increases in the cash flows expected to be collected will generally result in an increase in interest income over the remaining life of the loan or pool of loans. Decreases in expected cash flows due to further credit deterioration will generally result in an impairment charge recognized in the Corporation's provision for loan and lease losses, resulting in an increase to the allowance for loan losses. During the third quarter and first nine-months of 2012, the Corporation did not record record charges to the provision for loan losses related to PCI loans.

The following table presents changes in the accretable yield related to the PCI loans acquired from FIA:

(Dollars in thousands)	PCI Loans
Accretable yield at acquisition	\$ 3,451
Accretion recognized in earnings	(740)
Accretable yield as of September 30, 2012	\$ 2,711

In addition to the credit card portfolio acquired from FIA, the Corporation purchased during the first nine-months of 2012 \$149.5 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 whether the Corporation wants to retain high yielding loans and improve net interest margins or generate profits by selling loans. When the Corporation sells such loans, it generally keeps the servicing of the loans. The Corporation sold approximately \$156.3 million of performing residential mortgage loans in the secondary market to FNMA and FHLMC during the first nine months of 2012. Also, the Corporation securitized approximately \$165.3 million of FHA/VA mortgage loans into GNMA mortgage-backed securities during the first nine-months of 2012.

The Corporation's primary lending area is Puerto Rico. The Corporation's Puerto Rico banking subsidiary, FirstBank, also lends in the U.S. and British Virgin Islands markets and in the United States (principally in the state of Florida). Of the total gross loans held for investment portfolio of \$10.2 billion as of September 30, 2012, approximately 85% have credit risk concentration in Puerto Rico, 7% in the United States and 8% in the Virgin Islands.

As of September 30, 2012, the Corporation had \$148.7 million outstanding in credit facilities granted to the Puerto Rico Government and/or its political subdivisions, down from \$360.1 million as of December 31, 2011, and \$117.7 million granted to the Government of the Virgin Islands, down from \$139.4 million as of December 31, 2011. A substantial portion of these credit facilities consist of loans to municipalities in Puerto Rico for which the good faith, credit and unlimited taxing power of the applicable municipality have been pledged to their repayment. Another portion of these obligations consists of loans to public corporations that obtain revenues from rates charged for services or products, such as electric power and water utilities. Public corporations have varying degrees of independence from the central Government and many receive appropriations or other payments from it.

In addition to loans extended to government entities, the largest loan to one borrower as of September 30, 2012 in the amount of \$258.3 million is with one mortgage originator in Puerto Rico, Doral Financial Corporation. This commercial loan is secured by individual real-estate loans, mostly 1-4 residential mortgage loans.

Troubled Debt Restructurings

The Corporation provides homeownership preservation assistance to its customers through a loss mitigation program in Puerto Rico and in accordance with the 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 Troubled

Table of Contents

debt restructurings (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 September 30, 2012, the Corporation's total TDR loans of \$925.1 million consisted of \$410.2 million of residential mortgage loans, \$107.5 million of commercial and industrial loans, \$298.1 million of commercial mortgage loans, \$86.6 million of construction loans and \$22.7 million of consumer loans. Outstanding unfunded commitments on TDR loans amounted to \$4.4 million as of September 30, 2012.

The Corporation's loss mitigation programs for residential mortgage and consumer loans can provide for one or a combination of the following: movement of interest past due to the end of the loan, extension of the loan term, deferral of principal payments for a significant period of time, and reduction of interest rates either permanently, offered up to 2010, or for a period of up to two years (step-up rates). Additionally, in remote 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 foreclosure action absent some lender concession. Notwithstanding, 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 three month period whereby 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 enters into a permanent modification. As a result of new accounting guidance on TDRs, 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 TDR regardless of whether the borrower enters into a permanent modification. At September 30, 2012, we classified an additional \$5.7 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 the construction portfolios, at the time of the 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; waiving of borrower covenants; forgiveness of principal or interest; or other contract changes that would be considered a concession. The Corporation mitigates loan defaults for its commercial loan portfolios through its collections function. The function's objective is to minimize both early stage delinquencies and losses upon default of commercial loans. In the case of C&I, commercial mortgage and construction loan portfolios, the Special Asset Group (SAG) focuses on strategies for the accelerated reduction of non-performing assets through note sales, short sales, loss mitigation programs, and sales of REO. In addition to the management of the resolution process for problem loans, the SAG oversees collection efforts for all loans to prevent migration to the non-performing and/or adversely classified status. The SAG utilizes relationship officers, collection specialists and attorneys. In the case of residential construction projects, the workout function monitors project specifics, such as project management and marketing, as deemed necessary. The SAG utilizes its collections infrastructure of workout collection officers, credit work-out specialists, in-house legal counsel, and third party consultants. In the case of residential construction projects and large commercial loans, the function also utilizes third-party specialized consultants to monitor the residential and commercial construction projects in terms of construction, marketing and sales, and 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 not considered concessions, and the loans continue to be recorded as performing.

Table of Contents

Selected information on TDRs that includes the recorded investment by loan class and modification type is summarized in the following table. This information reflects all TDRs at September 30, 2012:

(In Thousands)	September 30, 2012						
	Interest rate below market	Maturity or term extension	Combination of reduction in interest rate and extension of maturity	Forgiveness of principal and/or interest	Forbearance agreement (1)	Other (2)	Total
Troubled Debt Restructurings:							
Non- FHA/VA Residential Mortgage loans	\$ 17,437	\$ 4,196	\$ 346,314	\$	\$	\$ 42,300	\$ 410,247
Commercial Mortgage Loans	102,643	16,251	117,014	46,903		15,235	298,046
Commercial & Industrial Loans	16,878	12,394	21,708	7,333	9,521	39,723	107,557
Construction Loans	6,349	2,027	9,094		63,477	5,634	86,581
Consumer Loans - Auto		1,067	7,851			2,895	11,813
Finance Leases		1,669	375				2,044
Consumer Loans - Other	353	497	5,808			2,198	8,856
Total Troubled Debt Restructurings	\$ 143,660	\$ 38,101	\$ 508,164	\$ 54,236	\$ 72,998	\$ 107,985	\$ 925,144

(1) Mainly related to one construction relationship amounting to \$53.4 million.

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

The following table presents the Corporation's TDR activity:

(In Thousands)	Quarter ended	Nine-Month Period
	Ended September 30, 2012	
Beginning Balance of TDRs	\$ 861,932	\$ 820,499
New TDRs	90,674	216,202
Increases to existing TDRs (disbursements)	5,690	21,825
Charge-offs post modification	(15,636)	(41,198)
Foreclosures	(2,513)	(30,768)
Removed from TDR classification		(7,051)
Paid-off and partial payments	(15,003)	(54,365)
Ending balance of TDRs	\$ 925,144	\$ 925,144

TDRs are classified as either accrual or nonaccrual loans. A loan on nonaccrual and restructured as a TDR will remain on nonaccrual status until the borrower has proven the ability to perform under the modified structure for a minimum of six months and there is evidence that such payments can and are likely to continue as agreed. Performance prior to the restructuring, or significant events that coincide with the restructuring, are included in assessing whether the borrower can meet the new terms and may result in the loans being returned to accrual at the time of the restructuring or after a shorter performance period. If the borrower's ability to meet the revised payment schedule is uncertain, the loan remains classified as a nonaccrual loan. Loan modifications increase the Corporation interest income by returning a non-performing loan to performing status, if applicable, and increase cash flows by providing for payments to be made by the borrower, and avoid increases in foreclosure and real estate owned (REO) 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 nine-month period ended

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

September 30, 2012, \$7.1 million were removed from the TDR classification, as reflected in the table above.

Table of Contents

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

(In Thousands)	September 30, 2012		Total TDRs
	Accrual	Nonaccrual (1)	
Non- FHA/VA Residential Mortgage loans	\$ 294,184	\$ 116,063	\$ 410,247
Commercial Mortgage Loans	157,445	140,601	298,046
Commercial & Industrial Loans	24,749	82,808	107,557
Construction Loans	2,490	84,091	86,581
Consumer Loans - Auto	7,114	4,699	11,813
Finance Leases	1,985	59	2,044
Consumer Loans - Other	7,037	1,819	8,856
Total Troubled Debt Restructurings	\$ 495,004	\$ 430,140	\$ 925,144

- (1) Included in non-accrual loans are \$203.6 million in loans that are performing under the terms of the restructuring agreement but are reported in non-accrual until the restructured loans meet the criteria of sustained payment performance under the revised terms for reinstatement to accrual status and there is no doubt about full collectability.

TDRs exclude restructured mortgage loans that are government guaranteed (i.e. FHA/VA loans) totaling \$94.3 million. The Corporation excludes government guaranteed loans from TDRs given that in the event that the borrower defaults on the loan, the principal and interest are guaranteed by the U.S. Government, therefore, the risk of loss on these types of loans is very low. The Corporation does not consider loans with government guarantees to be impaired loans for the purpose of calculating the allowance for loan and lease losses.

Loan modifications that are considered TDRs completed during the quarter and nine-month period ended September 30, 2012 and 2011 were as follows:

(Dollars in thousands)	Number of contracts	Quarter ended September 30, 2012	
		Pre-modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings:			
Non- FHA/VA Residential Mortgage loans	147	\$ 23,421	\$ 23,431
Commercial Mortgage Loans	14	57,100	57,100
Commercial & Industrial Loans	11	1,278	1,271
Construction Loans	3	4,380	4,380
Consumer Loans - Auto	156	2,044	2,044
Finance Leases	24	462	462
Consumer Loans - Other	304	1,986	1,986
Total Troubled Debt Restructurings	659	\$ 90,671	\$ 90,674

(Dollars in thousands)	Number of contracts	Nine-Month Period Ended September 30, 2012	
		Pre-modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings:			
Non- FHA/VA Residential Mortgage loans	403	\$ 64,412	\$ 64,773
Commercial Mortgage Loans	35	100,036	100,072
Commercial & Industrial Loans	47	33,162	29,593

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

Construction Loans	8	9,671	9,661
Consumer Loans - Auto	445	5,473	5,430
Finance Leases	76	1,384	1,384
Consumer Loans - Other	827	5,289	5,289
Total Troubled Debt Restructurings	1,841	\$ 219,427	\$ 216,202

Table of Contents

(Dollars in thousands)

	Number of contracts	Quarter ended September 30, 2011	
		Pre-modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings:			
Non- FHA/VA Residential Mortgage loans	190	\$ 30,724	\$ 31,395
Commercial Mortgage Loans	21	37,686	39,998
Commercial & Industrial Loans	19	24,355	24,085
Construction Loans	7	14,532	14,423
Consumer Loans - Auto	188	2,359	2,359
Finance Leases	32	409	409
Consumer Loans - Other	234	2,730	2,820
Total Troubled Debt Restructurings	691	\$ 112,795	\$ 115,489

(Dollars in thousands)

	Number of contracts	Nine-Month Period Ended September 30, 2011	
		Pre-modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings:			
Non- FHA/VA Residential Mortgage loans	607	\$ 98,168	\$ 101,367
Commercial Mortgage Loans	61	149,340	121,078
Commercial & Industrial Loans	43	44,561	43,702
Construction Loans	14	106,204	106,278
Consumer Loans - Auto	600	7,423	7,423
Finance Leases	87	1,501	1,501
Consumer Loans - Other	910	8,758	8,892
Total Troubled Debt Restructurings	2,322	\$ 415,955	\$ 390,241

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.

Table of Contents

Loan modifications considered troubled debt restructurings that defaulted during the quarter and nine-month period ended September 30, 2012 and 2011 and had been modified in a TDR during the 12-months preceding the default date were as follows:

(Dollars in Thousands)	Quarter ended September 30,			
	2012		2011	
	Number of contracts	Recorded Investment	Number of contracts	Recorded Investment
Non- FHA/VA Residential Mortgage loans	49	\$ 8,031	31	\$ 4,108
Commercial Mortgage Loans	1	338	5	2,783
Commercial & Industrial Loans	1	1,910	1	128
Construction Loans				
Consumer Loans - Auto	3	38		
Consumer Loans - Other	6	37	2	49
Finance Leases			52	250
Total	60	\$ 10,354	91	\$ 7,318

(Dollars in Thousands)	Nine-Month Period Ended September 30,			
	2012		2011	
	Number of contracts	Recorded Investment	Number of contracts	Recorded Investment
Non- FHA/VA Residential Mortgage loans	137	\$ 20,841	120	\$ 31,141
Commercial Mortgage Loans	9	5,549	21	6,211
Commercial & Industrial Loans	5	8,189	2	1,567
Construction Loans	2	8,382	1	70
Consumer Loans - Auto	39	431		
Consumer Loans - Other	12	155	2	49
Finance Leases	1	27	54	373
Total	205	\$ 43,574	200	\$ 39,411

For certain TDRs, the Corporation splits the loans into two new notes, A and B notes. The A note is restructured to comply with the Corporation's lending standards at current market rates, and is tailored to suit the customer's ability to make timely interest and principal payments. The B note includes the granting of the concession to the borrower and varies by situation. The B note is charged-off but the obligation is not forgiven to the borrower, and any payments collected are accounted for as recoveries. At the time of restructuring, the A note is identified and classified as a TDR. If the loan performs for at least six months according to the modified terms, the A note may be returned to accrual status. The borrower's payment performance prior to the restructuring are included in assessing whether the borrower can meet the new terms and may result in that the loans be returned to accrual status at the time of 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 if it is on accrual, is in compliance with its modified terms, and yields a market rate (as determined and documented at the time of the restructure).

The recorded investment in loans restructured using the A/B note restructure workout strategy was approximately \$128.7 million at September 30, 2012. 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 nine-months of 2012 and 2011:

(In thousands)	September 30, 2012	September 30, 2011
Principal balance deemed collectible at end of period	\$ 128,651	\$ 77,799
Amount charged-off	\$ 2,735	\$ 29,576

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

Charges to the provision for loan losses	\$	1,939	\$	6,349
Allowance for loan losses as of September 30, 2012	\$	5,951	\$	1,394

Of the loans comprising the \$128.7 million that have been deemed collectible, approximately \$118.0 million were placed in accruing status as the borrowers have exhibited a period of sustained performance. These loans continue to be individually evaluated for impairment purposes.

Table of Contents**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 September 30, 2012						
Allowance for loan and lease losses:						
Beginning balance	\$ 67,440	\$ 100,846	\$ 166,021	\$ 67,858	\$ 54,988	\$ 457,153
Charge-offs	(7,586)	(5,681)	(12,795)	(9,012)	(9,444)	(44,518)
Recoveries	228	679	534	686	1,817	3,944
Provision (release)	9,083	(6,617)	8,117	6,379	11,990	28,952
Ending balance	\$ 69,165	\$ 89,227	\$ 161,877	\$ 65,911	\$ 59,351	\$ 445,531
Ending balance: specific reserve for impaired loans	\$ 49,640	\$ 51,351	\$ 57,001	\$ 33,349	\$ 2,813	\$ 194,154
Ending balance: purchased credit-impaired loans	\$	\$	\$	\$	\$	\$
Ending balance: general allowance	\$ 19,525	\$ 37,876	\$ 104,876	\$ 32,562	\$ 56,538	\$ 251,377
Loans held for investment:						
Ending balance	\$ 2,762,418	\$ 1,459,118	\$ 3,627,646	\$ 352,891	\$ 1,986,091	\$ 10,188,164
Ending balance: impaired loans	\$ 594,788	\$ 363,533	\$ 238,512	\$ 178,462	\$ 24,843	\$ 1,400,138
Ending balance: purchased credit-impaired loans	\$	\$	\$	\$	\$ 12,741	\$ 12,741
Ending balance: loans with general allowance	\$ 2,167,630	\$ 1,095,585	\$ 3,389,134	\$ 174,429	\$ 1,948,507	\$ 8,775,285

(In thousands)	Residential Mortgage Loans	Commercial Mortgage Loans	Commercial & Industrial Loans	Construction Loans	Consumer Loans	Total
Nine-Month Period Ended September 30, 2012						
Allowance for loan and lease losses:						
Beginning balance	\$ 68,678	\$ 108,991	\$ 164,490	\$ 91,386	\$ 60,372	\$ 493,917
Charge-offs	(27,976)	(15,588)	(35,494)	(42,908)	(29,327)	(151,293)
Recoveries	676	721	2,179	4,004	5,294	12,874
Provision (release)	27,787	(4,897)	30,702	13,429	23,012	90,033
Ending balance	\$ 69,165	\$ 89,227	\$ 161,877	\$ 65,911	\$ 59,351	\$ 445,531
Ending balance: specific reserve for impaired loans	\$ 49,640	\$ 51,351	\$ 57,001	\$ 33,349	\$ 2,813	\$ 194,154
Ending balance: purchased credit-impaired loans	\$	\$	\$	\$	\$	\$

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

Ending balance: general allowance	\$ 19,525	\$ 37,876	\$ 104,876	\$ 32,562	\$ 56,538	\$ 251,377
-----------------------------------	-----------	-----------	------------	-----------	-----------	------------

Loans held for investment:

Ending balance	\$ 2,762,418	\$ 1,459,118	\$ 3,627,646	\$ 352,891	\$ 1,986,091	\$ 10,188,164
----------------	--------------	--------------	--------------	------------	--------------	---------------

Ending balance: impaired loans	\$ 594,788	\$ 363,533	\$ 238,512	\$ 178,462	\$ 24,843	\$ 1,400,138
--------------------------------	------------	------------	------------	------------	-----------	--------------

Ending balance: purchased credit-impaired loans	\$	\$	\$	\$	\$ 12,741	\$ 12,741
---	----	----	----	----	-----------	-----------

Ending balance: loans with general allowance	\$ 2,167,630	\$ 1,095,585	\$ 3,389,134	\$ 174,429	\$ 1,948,507	\$ 8,775,285
--	--------------	--------------	--------------	------------	--------------	--------------

(In thousands)	Residential Mortgage Loans	Commercial Mortgage Loans	Commercial & Industrial Loans	Construction Loans	Consumer Loans	Total
Quarter ended September 30, 2011						
Allowance for loan and lease losses:						
Beginning balance	\$ 67,404	\$ 90,785	\$ 188,562	\$ 131,344	\$ 62,783	\$ 540,878
Charge-offs	(16,076)	(3,316)	(22,703)	(17,008)	(11,086)	(70,189)
Recoveries	260	7	177	185	1,923	2,552
Provision (release)	17,744	13,324	10,437	(2,547)	7,488	46,446
Ending balance	\$ 69,332	\$ 100,800	\$ 176,473	\$ 111,974	\$ 61,108	\$ 519,687

Ending balance: specific reserve for impaired loans	\$ 49,350	\$ 35,928	\$ 77,932	\$ 48,209	\$ 2,878	\$ 214,297
---	-----------	-----------	-----------	-----------	----------	------------

Ending balance: general allowance	\$ 19,982	\$ 64,872	\$ 98,541	\$ 63,765	\$ 58,230	\$ 305,390
-----------------------------------	-----------	-----------	-----------	-----------	-----------	------------

Loans held for investment:

Ending balance	\$ 2,873,966	\$ 1,584,787	\$ 4,123,174	\$ 473,812	\$ 1,577,403	\$ 10,633,142
----------------	--------------	--------------	--------------	------------	--------------	---------------

Ending balance: impaired loans	\$ 548,677	\$ 245,439	\$ 384,640	\$ 237,701	\$ 15,325	\$ 1,431,782
--------------------------------	------------	------------	------------	------------	-----------	--------------

Ending balance: loans with general allowance	\$ 2,325,289	\$ 1,339,348	\$ 3,738,534	\$ 236,111	\$ 1,562,078	\$ 9,201,360
--	--------------	--------------	--------------	------------	--------------	--------------

(In thousands)	Residential Mortgage Loans	Commercial Mortgage Loans	Commercial & Industrial Loans	Construction Loans	Consumer Loans	Total
Nine-Month Period Ended September 30, 2011						
Allowance for loan and lease losses:						
Beginning balance	\$ 62,330	\$ 105,596	\$ 152,641	\$ 151,972	\$ 80,486	\$ 553,025
Charge-offs	(30,571)	(37,647)	(50,858)	(83,483)	(35,168)	(237,727)
Recoveries	657	84	1,281	2,215	5,790	10,027
Provision	36,916	32,767	73,409	41,270	10,000	194,362
Ending balance	\$ 69,332	\$ 100,800	\$ 176,473	\$ 111,974	\$ 61,108	\$ 519,687

Ending balance: specific reserve for impaired loans	\$ 49,350	\$ 35,928	\$ 77,932	\$ 48,209	\$ 2,878	\$ 214,297
---	-----------	-----------	-----------	-----------	----------	------------

Ending balance: general allowance	\$ 19,982	\$ 64,872	\$ 98,541	\$ 63,765	\$ 58,230	\$ 305,390
-----------------------------------	-----------	-----------	-----------	-----------	-----------	------------

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

Loans held for investment:

Ending balance	\$ 2,873,966	\$ 1,584,787	\$ 4,123,174	\$ 473,812	\$ 1,577,403	\$ 10,633,142
Ending balance: impaired loans	\$ 548,677	\$ 245,439	\$ 384,640	\$ 237,701	\$ 15,325	\$ 1,431,782
Ending balance: loans with general allowance	\$ 2,325,289	\$ 1,339,348	\$ 3,738,534	\$ 236,111	\$ 1,562,078	\$ 9,201,360

Table of Contents

As of September 30, 2012, the Corporation maintains a \$1.6 million reserve for unfunded loan commitments mainly related to outstanding construction and C&I loans commitments. The reserve for unfunded loan commitments is an estimate of the losses inherent in off-balance sheet loan commitments at the balance sheet date. It is calculated by multiplying an estimated loss factor by an estimated probability of funding, and then by the period-end amounts for unfunded commitments. The reserve for unfunded loan commitments is included as part of accounts payable and other liabilities in the consolidated statement of financial condition.

8 LOANS HELD FOR SALE

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

	September 30, 2012	December 31, 2011
	(In thousands)	
Residential mortgage loans	\$ 68,349	\$ 11,058
Construction loans		4,764
Total	\$ 68,349	\$ 15,822

9 DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

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

The Corporation designates a derivative as a fair value hedge, cash flow hedge or as an economic undesignated hedge when it enters into the derivative contract. As of September 30, 2012 and December 31, 2011, 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. Specifically, the interest rate on certain of the Corporation's commercial loans to other financial institutions is generally a variable rate limited to the weighted-average coupon of the referenced residential mortgage collateral, less a contractual servicing fee.

Interest rate swaps - Interest rate swap agreements generally involve the exchange of fixed and floating-rate interest payment obligations without the exchange of the underlying notional principal amount. As of September 30, 2012 and December 31, 2011, most of the interest rate swaps outstanding are used for protection against rising interest rates. Similar to unrealized gains and losses arising from changes in fair value, net interest settlements on interest rate swaps are recorded as an adjustment to interest income or interest expense depending on whether an asset or liability is being economically hedged.

Indexed options - Indexed options are generally over-the-counter (OTC) contracts that the Corporation enters into in order to receive the appreciation of a specified Stock Index (e.g., Dow Jones Industrial Composite Stock Index) over a specified period in exchange for a premium paid at the contract's inception. The option period is determined by the contractual maturity of the notes payable tied to the performance of the Stock Index. The credit risk inherent in these options is the risk that the exchange party may not fulfill its obligation.

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

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

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

Table of Contents

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.

Table of Contents

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

	Notional Amounts	
	As of September 30, 2012	As of December 31, 2011
(In thousands)		
Economic undesignated hedges:		
Interest rate contracts:		
Interest rate swap agreements used to hedge loans	\$ 38,597	\$ 39,786
Written interest rate cap agreements		67,894
Purchased interest rate cap agreements		67,894
Equity contracts:		
Embedded written options on stock index deposits and notes payable		46,515
Purchased options used to manage exposure to the stock market on embedded stock index options		46,515
Forward Contracts:		
Sale of TBA GNMA MBS pools	26,000	19,000
	\$ 64,597	\$ 287,604

The following table summarizes the fair value of derivative instruments and the location in the Statement of Financial Condition:

(In thousands)	Statement of Financial Condition Location	Asset Derivatives		Statement of Financial Condition Location	Liability Derivatives	
		September 30, 2012 Fair Value	December 31, 2011 Fair Value		September 30, 2012 Fair Value	December 31, 2011 Fair Value
Economic undesignated hedges:						
Interest rate contracts:						
Interest rate swap agreements used to hedge loans	Other assets	\$ 318	\$ 378	Accounts payable and other liabilities	\$ 6,238	\$ 6,767
Equity contracts:						
Embedded written options on stock index notes payable	Other assets			Notes payable		899
Purchased options used to manage exposure to the stock market on embedded stock index options	Other assets		899	Accounts payable and other liabilities		
Forward Contracts:						
Sales of TBA GNMA MBS pools	Other assets	18		Accounts payable and other liabilities	190	168
		\$ 336	\$ 1,277		\$ 6,428	\$ 7,834

The following table summarizes the effect of derivative instruments on the Statement of Income (Loss):

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

(In thousands)	Location of Gain or (loss) Recognized in Income on Derivatives	Unrealized (Loss) or Gain		Unrealized Gain or (Loss) Nine-Month Period Ended	
		Quarter Ended September 30, 2012	2011	September 30, 2012	2011
ECONOMIC UNDESIGNATED HEDGES:					
Interest rate contracts:					
Interest rate swap agreements used to hedge fixed-rate:					
Loans	Interest income - Loans	\$ 170	\$ (954)	\$ 469	\$ (1,794)
Equity contracts:					
Embedded written and purchased options on stock index notes payable	Interest expense - Notes payable and other borrowings		40		(7)
Forward contracts:					
Sales of TBA GNMA MBS pools	Mortgage Banking Activities	(47)	(176)	(4)	(209)
Total gain (loss) on derivatives		\$ 123	\$ (1,090)	\$ 465	\$ (2,010)

Derivative instruments, such as interest rate swaps, are subject to market risk. As is the case with investment securities, the market value of derivative instruments is largely a function of the financial market's expectations regarding the future direction of interest rates. Accordingly, current market values are not necessarily indicative of the future impact of derivative instruments on earnings.

Table of Contents

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.

A summary of interest rate swaps follows:

	As of September 30, 2012	As of December 31, 2011
	(Dollars in thousands)	
Pay fixed/receive floating :		
Notional amount	\$ 38,597	\$ 39,786
Weighted-average receive rate at period end	2.08 %	2.13 %
Weighted-average pay rate at period end	6.82 %	6.82 %
Floating rates range from 167 to 252 basis points over 3-month LIBOR		

As of September 30, 2012, the Corporation has not entered into any derivative instrument containing credit-risk-related contingent features.

10 GOODWILL AND OTHER INTANGIBLES

Goodwill as of September 30, 2012 and December 31, 2011 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 2011. The evaluation was a two step process. The Step 1 evaluation of goodwill allocated to the Florida reporting unit indicated potential impairment of goodwill. The Step 1 fair value for the unit was below the carrying amount of its equity book value as of the October 1, 2011 valuation date, requiring the completion of Step 2. The Step 2 required a valuation of all assets and liabilities of the Florida unit, including any recognized and unrecognized intangible assets, to determine the fair value of net assets. To complete Step 2, the Corporation subtracted from the unit's Step 1 fair value the determined fair value of the net assets to arrive at the implied fair value of goodwill. The results of the Step 2 analysis indicated that the implied fair value of goodwill exceeded the goodwill carrying value by \$13.7 million, resulting in no goodwill impairment. Goodwill was not impaired as of December 31, 2011, nor was any goodwill written-off due to impairment during 2011. 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 nine-months of 2012. 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 next 9.3 years on an accelerated basis proportionate to the projected run-off of the acquired credit cards accounts, which is based on historical performance of the portfolio.

Table of Contents

The following tables 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 September 30, 2012	As of December 31, 2011
Core deposit intangible:		
Gross amount	\$ 45,844	\$ 45,844
Accumulated amortization	(35,921)	(34,155)
Net carrying amount	\$ 9,923	\$ 11,689
Remaining amortization period	10.7 years	11.5 years
Purchased credit card relationship intangible:		
Gross amount	\$ 24,465	\$
Accumulated amortization	(545)	
Net carrying amount	\$ 23,920	\$

Remaining amortization period 9.3 years

For the quarter and nine-month period ended September 30, 2012, the amortization expense of core deposit intangibles amounted to \$0.6 million and \$1.8 million (2011 \$0.6 million and \$1.8 million). For the quarter and nine-month period ended September 30, 2012, the amortization expense of the purchased credit card relationship intangible amounted to \$0.4 million and \$0.5 million, respectively.

11 NON-CONSOLIDATED VARIABLE INTEREST ENTITIES AND SERVICING ASSETS

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

When evaluating transfers and other transactions with Variable Interest Entities (VIEs) for consolidation, the Corporation first determines if the counterparty is an entity for which a variable interest exists. If no scope exception is applicable and a variable interest exists, the Corporation then evaluates if it is the primary beneficiary of the VIE and whether the entity should be consolidated or not.

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

Ginnie Mae

The Corporation typically transfers first lien residential mortgage loans in conjunction with Ginnie Mae securitization transactions whereby the loans are exchanged for cash or securities that are readily redeemed for cash proceeds and servicing rights. The securities issued through these transactions are guaranteed by the issuer and, as such, under seller/servicer agreements the Corporation is required to service the loans in accordance with the issuers' servicing guidelines and standards. As of September 30, 2012, the Corporation serviced loans securitized through GNMA with principal balance of \$734.2 million.

Trust Preferred Securities

In 2004, FBP Statutory Trust I, a financing subsidiary of the Corporation, sold to institutional investors \$100 million of its variable rate trust preferred securities. The proceeds of the issuance, together with the proceeds of the purchase by the Corporation of \$3.1 million of FBP Statutory Trust I variable rate common securities, were used by FBP Statutory Trust I to purchase \$103.1 million aggregate principal amount of the Corporation's Junior Subordinated Deferrable Debentures. Also in 2004, FBP Statutory Trust II, a statutory trust that is wholly-owned by the Corporation, sold to institutional investors \$125 million of its variable rate trust preferred securities. The proceeds of the issuance, together with the proceeds of the purchase by the Corporation of \$3.9 million of FBP Statutory Trust II variable rate common securities, were used by FBP Statutory Trust II to purchase \$128.9 million aggregate principal amount of the Corporation's Junior Subordinated Deferrable Debentures. The

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

trust preferred debentures are presented in the Corporation's Consolidated Statement of Financial Condition as Other Borrowings, net of related issuance costs. The variable rate trust preferred securities are fully and unconditionally guaranteed by the Corporation. The \$100 million Junior Subordinated

Table of Contents

Deferrable Debentures issued by the Corporation in April 2004 and the \$125 million issued in September 2004 mature on September 17, 2034 and September 20, 2034, respectively; however, under certain circumstances, the maturity of Junior Subordinated Debentures may be shortened (such shortening would result in a mandatory redemption of the variable rate trust preferred securities). The trust preferred securities, subject to certain limitations, qualify as Tier I regulatory capital under current Federal Reserve rules and regulations. The Collins Amendment to the Dodd-Frank Wall Street Reform and Consumer Protection Act eliminates certain trust preferred securities from Tier 1 Capital. These regulatory capital deductions for trust preferred securities are to be phased in incrementally over a period of 3 years beginning on January 1, 2013.

Grantor Trusts

During 2004 and 2005, a third party to the Corporation, from now on identified as the seller, established a series of statutory trusts to effect the securitization of mortgage loans and the sale of trust certificates. The seller initially provided the servicing for a fee, which is senior to the obligations to pay trust certificate holders. The seller then entered into a sales agreement through which it sold and issued the trust certificates in favor of the Corporation's banking subsidiary. Currently, the Bank is the sole owner of the trust certificates; the servicing of the underlying residential mortgages that generate the principal and interest cash flows, is performed by another third party, which receives a fee compensation for services provided, the servicing fee. The securities are variable rate securities indexed to 90 day LIBOR plus a spread. The principal payments from the underlying loans are remitted to a paying agent (servicer) who then remits interest to the Bank; interest income is shared to a certain extent with the FDIC, that has an interest only strip (IO) tied to the cash flows of the underlying loans, whereas it is entitled to receive the excess of the interest income less a servicing fee over the variable rate income that the Bank earns on the securities. This IO is limited to the weighted average coupon of the securities. The FDIC became the owner of the IO upon the intervention of the seller, a failed financial institution. No recourse agreement exists and the risk from losses on non accruing loans and repossessed collateral are absorbed by the Bank as the sole holder of the certificates. As of September 30, 2012, the amortized balance and carrying value of Grantor Trusts amounted to \$72.5 million and \$54.5 million, respectively, with a weighted average yield of 2.34%.

Investment in unconsolidated entities

On February 16, 2011, FirstBank sold an asset portfolio consisting of performing and non-performing construction, commercial mortgage and C&I loans with an aggregate book value of \$269.3 million to CPG/GS PR NPL, LLC (CPG/GS or the Joint Venture) organized under the Laws of the Commonwealth of Puerto Rico and majority owned by PRLP Ventures LLC (PRLP), a company created by Goldman, Sachs & Co. and Caribbean Property Group. In connection with the sale, the Corporation received \$88.5 million in cash and a 35% interest in CPG/GS, and made a loan in the amount of \$136.1 million representing seller financing provided by FirstBank. The loan has a 7-year maturity and bears variable interest at 30-day LIBOR plus 300 basis points and is secured by a pledge of all of the acquiring entity's assets as well as the PRLP's 65% ownership interest in CPG/GS. As of September 30, 2012, the carrying amount of the loan is \$75.5 million and is included in the Corporation's C&I loan receivable portfolio; the carrying value of FirstBank's equity interest in CPG/GS is \$32.3 million as of September 30, 2012, accounted under the equity method and included as part of Investment in unconsolidated entities in the Consolidated Statements of Financial Condition. When applying the equity method, the Bank follows the Hypothetical Liquidation Book Value method (HLBV) to determine its share in CPG/GS earnings or losses. Under HLBV, the Bank determines its share in CPG/GS earnings or losses by determining the difference between its claim on CPG/GS's book value at the end of the period as compared to the beginning of the period. This claim is calculated as the amount the Bank would receive if CPG/GS were to liquidate all of its assets at recorded amounts determined in accordance with GAAP and distribute the resulting cash to the investors, PRLP and FirstBank, according to their respective priorities as provided in the contractual agreement. The Bank reports its share of CPG/GS operating results on a one-quarter lag basis. In addition, as a result of using HLBV, the difference between the Bank's investment in CPG/GS and its claim in the book value of CPG/GS at the date of the investment, known as the basis difference, is amortized over the estimated life of the investment, or five years as of September 30, 2012. CPG/GS records its loans receivable under the fair value option. Equity in losses of unconsolidated entities for the quarter and nine-month period ended September 30, 2012 of \$2.2 million and \$10.9 million, includes \$1.1 million and \$4.2 million, respectively, related to the amortization of the basis differential compared to equity in losses of unconsolidated entities of \$4.4 million and \$5.9 million for the same periods in 2011.

FirstBank also provided an \$80 million advance facility to CPG/GS to fund unfunded commitments and costs to complete projects under construction which was fully disbursed in 2011, and a \$20 million working capital line of credit to fund certain expenses of CPG/GS. During the second quarter of 2012, CPG repaid the outstanding balance of the advance facility to fund unfunded commitments and the funds became available to re-draw under a one-time revolver agreement. These loans bear variable interest at 30-day LIBOR plus 300 basis points. As of September 30, 2012, the carrying value of the revolver agreement and working capital line were \$8.6 million and \$0, respectively, and are included in the Corporation's C&I loan receivable portfolio.

Cash proceeds received by CPG/GS are first used to cover operating expenses and debt service payments, including the note receivable, the advanced facility and the working capital line, described above, which must be fully repaid before proceeds can be used for other purposes, including the return of capital to both PRLP and FirstBank. FirstBank will not receive any return on its equity interest until PRLP receives an aggregate amount equivalent to its initial investment and a priority return of at least 12%, resulting in FirstBank's interest in CPG/GS being

subordinate to PRLP's interest. CPG/GS will then begin to make payments pro rata to PRLP

Table of Contents

and FirstBank, 35% and 65%, respectively, until FirstBank has achieved a 12% return on its invested capital and the aggregate amount of distributions is equal to FirstBank's capital contributions to CPG/GS. FirstBank may experience further losses associated with this transaction due to this subordination in an amount equal to up to the value of its interest in CPG/GS. Factors that could impact FirstBank's recoverability of its equity interest include lower than expected sale prices of units underlying CPG/GS assets and/or lower than projected liquidation value of the underlying collateral and changes in the expected timing of cash flows, among others.

The Bank has determined that CPG/GS is a VIE in which the Bank is not the primary beneficiary. In determining the primary beneficiary of CPG/GS, the Bank considered applicable guidance that requires the Bank to qualitatively assess the determination of the primary beneficiary (or consolidator) of CPG/GS based on whether it has both the power to direct the activities of CPG/GS that most significantly impact the entity's economic performance and the obligation to absorb losses of CPG/GS that could potentially be significant to the VIE or the right to receive benefits from the entity that could potentially be significant to the VIE. The Bank determined that it does not have the power to direct the activities that most significantly impact the economic performance of CPG/GS as it does not have the right to manage the loan portfolio, impact foreclosure proceedings, or manage the construction and sale of the property; therefore, the Bank concluded that it is not the primary beneficiary of CPG/GS. As a creditor to CPG/GS, the Bank has certain rights related to CPG/GS, however, these are intended to be protective in nature and do not provide the Bank with the ability to manage the operations of CPG/GS. Since CPG/GS is not a consolidated subsidiary of the Bank and given that the transaction met the criteria for sale accounting under authoritative guidance, the Bank accounted for this transaction as a true sale, recognizing the cash received, the notes receivable and the interest in CPG/GS and derecognizing the loan portfolio sold.

The initial fair value of the investment in CPG/GS was determined using techniques with significant unobservable (Level 3) inputs. The valuation inputs included an estimate of future cash flows, expectations about possible variations in the amount and timing of cash flows, and a discount factor based on a rate of return. The Corporation researched available market data and internal information (i.e. proposals received for the servicing of distressed assets and public disclosures and information of similar structures and/or of distressed asset sales) and determined reasonable ranges of expected returns for FirstBank's equity interest.

The rate of return of 17.57% was used as the discount factor used to estimate the value of the FirstBank's equity interest and represents the Bank's estimate of the yield a market participant would require. A reasonable range of equity returns was assessed considering the range of company specific risk premiums. The valuation of this type of equity interest is highly subjective and somewhat dependent on non-observable market assumptions, which may result in variations from market participant to market participant.

Servicing Assets

The Corporation is actively involved in the securitization of pools of FHA-insured and VA-guaranteed mortgages for issuance of GNMA mortgage-backed securities. Also, certain conventional conforming-loans are sold to FNMA or FHLMC with servicing retained. The Corporation recognizes as separate assets the rights to service loans for others, whether those servicing assets are originated or purchased.

The changes in servicing assets are shown below:

	Quarter ended		Nine-Month Period Ended	
	September 30, 2012	September 30, 2011	September 30, 2012	September 30, 2011
	(In thousands)			
Balance at beginning of period	\$ 16,592	\$ 14,638	\$ 15,226	\$ 15,163
Capitalization of servicing assets	1,389	1,271	4,486	3,793
Amortization	(834)	(726)	(2,220)	(1,823)
Adjustment to servicing assets for loans repurchased ⁽¹⁾	(124)	(93)	(629)	(238)
Adjustment to fair value	(363)	(166)	(203)	(1,971)
Balance at end of period	\$ 16,660	\$ 14,924	\$ 16,660	\$ 14,924

(1) Amount represents the adjustment to fair value related to the repurchase of \$9.9 million and \$54.5 million for the quarter and nine-month period ended September 30, 2012, respectively, and, \$8.5 million and \$29.3 million for the quarter and nine-month period ended September 30, 2011, respectively, in principal balance of loans serviced for others.

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

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.

Table of Contents

Changes in the impairment allowance were as follows:

	Quarter ended		Nine-Month Period Ended	
	September 30, 2012	September 30, 2011	September 30, 2012	September 30, 2011
	(In thousands)			
Balance at beginning of period	\$ 118	\$ 2,239	\$ 2,725	\$ 434
Temporary impairment charges	378	232	565	2,355
OTTI of servicing assets			(2,447)	
Recoveries	(15)	(66)	(362)	(384)
Balance at end of period	\$ 481	\$ 2,405	\$ 481	\$ 2,405

The components of net servicing income are shown below:

	Quarter ended		Nine-Month Period Ended	
	September 30, 2012	September 30, 2011	September 30, 2012	September 30, 2011
	(In thousands)			
Servicing fees	\$ 1,399	\$ 1,293	\$ 4,161	\$ 3,955
Late charges and prepayment penalties	463	184	925	551
Adjustment for loans repurchased	(124)	(93)	(629)	(238)
Servicing income, gross	1,738	1,384	4,457	4,268
Amortization and impairment of servicing assets	(1,197)	(892)	(2,423)	(3,794)
Servicing income, net	\$ 541	\$ 492	\$ 2,034	\$ 474

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

	Maximum	Minimum
Nine-Month Period Ended September 30, 2012:		
Constant prepayment rate:		
Government guaranteed mortgage loans	12.4 %	11.6 %
Conventional conforming mortgage loans	12.8 %	12.6 %
Conventional non-conforming mortgage loans	13.8 %	13.3 %
Discount rate:		
Government guaranteed mortgage loans	12.0 %	12.0 %
Conventional conforming mortgage loans	10.0 %	10.0 %
Conventional non-conforming mortgage loans	14.3 %	14.3 %
Nine-Month Period Ended September 30, 2011:		
Constant prepayment rate:		
Government guaranteed mortgage loans	12.9 %	10.6 %
Conventional conforming mortgage loans	14.3 %	12.7 %
Conventional non-conforming mortgage loans	13.9 %	11.7 %
Discount rate:		
Government guaranteed mortgage loans	11.5 %	11.3 %
Conventional conforming mortgage loans	9.5 %	9.3 %
Conventional non-conforming mortgage loans	15.0 %	13.8 %

Table of Contents

At September 30, 2012, fair values of the Corporation's servicing assets were based on a valuation model that incorporates market driven assumptions, adjusted by the particular characteristics of the Corporation's servicing portfolio, regarding discount rates and mortgage prepayment rates. The weighted-averages of the key economic assumptions used by the Corporation in its valuation model and the sensitivity of the current fair value to immediate 10 percent and 20 percent adverse changes in those assumptions for mortgage loans at September 30, 2012, were as follows:

	(Dollars in thousands)
Carrying amount of servicing assets	\$ 16,660
Fair value	\$ 18,007
Weighted-average expected life (in years)	7.60
Constant prepayment rate (weighted-average annual rate)	12.66 %
Decrease in fair value due to 10% adverse change	\$ 857
Decrease in fair value due to 20% adverse change	\$ 1,650
Discount rate (weighted-average annual rate)	11.09 %
Decrease in fair value due to 10% adverse change	\$ 663
Decrease in fair value due to 20% adverse change	\$ 1,281

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

12 DEPOSITS

The following table summarizes deposit balances:

	September 30, 2012	December 31, 2011
	(In thousands)	
Type of account and interest rate:		
Non-interest bearing checking accounts	\$ 780,717	\$ 705,789
Savings accounts	2,287,511	2,145,625
Interest-bearing checking accounts	1,117,189	1,066,753
Certificates of deposit	2,302,723	2,258,216
Brokered certificates of deposit	3,408,262	3,731,371
	\$ 9,896,402	\$ 9,907,754

Brokered certificates of deposit mature as follows:

	September 30, 2012
	(In thousands)
One to ninety days	\$ 654,931
Over ninety days to one year	1,761,624
One to three years	889,003
Three to five years	98,446
Over five years	4,258

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

Total \$ 3,408,262

The following are the components of interest expense on deposits:

	Quarter Ended		Nine-Month Period Ended	
	September 30, 2012	September 30, 2011	September 30, 2012	September 30, 2011
	(In thousands)		(In thousands)	
Interest expense on deposits	\$ 27,653	\$ 42,465	\$ 92,569	\$ 136,507
Amortization of broker placement fees	2,300	3,675	7,607	13,217
Interest expense on deposits	\$ 29,953	\$ 46,140	\$ 100,176	\$ 149,724

Table of Contents**13 SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE**

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

	September 30, 2012	December 31, 2011
	(In thousands)	
Repurchase agreements, interest ranging from 2.45% to 3.52% (December 31, 2011 - 2.50% to 4.40%)	\$ 900,000	\$ 1,000,000

Repurchase agreements mature as follows:

	September 30, 2012 (In thousands)
Three to five years	\$ 600,000
Over five years	300,000
Total	\$ 900,000

As of September 30, 2012 and December 31, 2011, the securities underlying such agreements were delivered to the dealers with whom the repurchase agreements were transacted.

Repurchase agreements as of September 30, 2012, grouped by counterparty, were as follows:

(Dollars in thousands)	Amount	Weighted-Average Maturity (In Months)
Counterparty		
Citigroup Global Markets	\$ 300,000	49
JP Morgan Chase	200,000	52
Dean Witter / Morgan Stanley	100,000	60
Credit Suisse First Boston	300,000	62
	\$ 900,000	

14 ADVANCES FROM THE FEDERAL HOME LOAN BANK (FHLB)

Following is a summary of the advances from the FHLB:

(In thousands)	September 30, 2012	December 31, 2011
Fixed-rate advances from FHLB, with a weighted-average interest rate of 2.31% (December 31, 2011 - 3.59%)	\$ 518,440	\$ 367,440

Advances from FHLB mature as follows:

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

	September 30, 2012
	(In thousands)
One to thirty days	\$ 10,000
Over ninety days to one year	155,000
One to three years	53,440
Three to five years	300,000
Total	\$ 518,440

Table of Contents

As of September 30, 2012, the Corporation had additional capacity of approximately \$300.4 million on this credit facility based on collateral pledged at the FHLB, including haircuts reflecting the perceived risk associated with holding the collateral.

15 NOTES PAYABLE

Notes payable consist of:

(In thousands)	September 30, 2012	December 31, 2011
Callable step-rate notes, bearing step increasing interest from 5.00% to 7.00% (6.00 % as of December 31, 2011) maturing on October 18, 2019, measured at fair value ⁽¹⁾	\$	\$ 15,968
Dow Jones Industrial Average (DJIA) linked principal protected notes:		
Series A maturing on February 28, 2012		7,374
	\$	\$ 23,342

- (1) During the second quarter of 2012, the Corporation prepaid medium term notes with a principal balance of 15.4 million that carried a rate of 6.00%. These notes were carried at fair value and changes in value were recorded as part of interest expense. As a result of the prepayment of the notes, a marked-to-market loss of \$0.5 million was reversed resulting in a reduction in interest expense for the first nine months of 2012.

16 OTHER BORROWINGS

Other borrowings consist of:

(In thousands)	September 30, 2012	December 31, 2011
Junior subordinated debentures due in 2034, interest-bearing at a floating-rate of 2.75% over 3-month LIBOR (3.14% as of September 30, 2012 and 3.31% as of December 31, 2011)	\$ 103,093	\$ 103,093
Junior subordinated debentures due in 2034, interest-bearing at a floating-rate of 2.50% over 3-month LIBOR (2.89% as of September 30, 2012 and 3.06% as of December 31, 2011)	128,866	128,866
	\$ 231,959	\$ 231,959

17 STOCKHOLDERS EQUITY**Common Stock**

As of September 30, 2012 and December 31, 2011, the Corporation had 2,000,000,000 authorized shares of common stock with a par value of \$0.10 per share. As of September 30, 2012 and December 31, 2011, there were 206,674,221 and 205,794,024 shares issued, respectively, and 206,179,368 and 205,134,171 shares outstanding, respectively. On July 30, 2009, the Corporation announced the suspension of common and preferred stock dividends effective with the preferred dividend for the month of August 2009.

In August of 2012 the Corporation granted 44,910 shares of restricted stock under the Omnibus Plan, as amended, to the independent directors subject to a one year vesting period. Also in March of 2012 the Corporation granted 719,500 shares of restricted stock, to certain senior executive officers and certain other employees. The restrictions on such restricted stock will lapse 50% over a two year period and 50% over a three year period. Included in the shares of restricted stock granted in 2012 are 557,000 shares granted to certain senior executive officers consistent with the requirements of the TARP Interim Final Rule, refer to Note 3 for additional details. The shares of restricted stock may vest more quickly in the event of death, disability, retirement, or a change in control. Based on particular circumstances evaluated by the Compensation Committee as they may relate to the termination of a restricted stock holder, the Corporation's Board of Directors may, with the

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

recommendation of the Compensation Committee, grant the full vesting of the restricted stock held upon termination of employment. Holders of restricted stock have the right to dividends or dividend equivalents, as applicable, during the restriction period. Such dividends or dividend equivalents will accrue during the restriction period, but will not be paid until restrictions lapse. The holder of restricted stock has the right to vote the shares.

Table of Contents

Preferred Stock

The Corporation has 50,000,000 authorized shares of preferred stock with a par value of \$1, redeemable at the Corporation's option subject to certain terms. This stock may be issued in series and the shares of each series shall have such rights and preferences as shall be fixed by the Board of Directors when authorizing the issuance of that particular series. As of September 30, 2012, 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 the 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 preferred stock in a quotation medium.

As mentioned above, the Corporation stopped paying dividends for common and all its outstanding series of preferred stock. This suspension was effective with the dividends for the month of August 2009 on the Corporation's five outstanding series of non-cumulative preferred stock.

Stock repurchase plan and treasury stock

The Corporation has a stock repurchase program under which, from time to time, it repurchases shares of common stock in the open market and holds them as treasury stock. No shares of common stock were repurchased during the first nine-months of 2012 or in 2011 by the Corporation. On February 17, 2012, the Corporation sold 165,000 shares of treasury stock at a purchase price of \$3.79 per share to a director. As of September 30, 2012 and December 31, 2011 the Corporation had 494,853 and 659,853 shares held as treasury stock, respectively, that were available for general corporate purposes.

FirstBank Statutory Reserve

The Banking Act of the Commonwealth of Puerto Rico requires that a minimum of 10% of FirstBank's net income for the year be transferred to legal surplus until such surplus equals the total of paid-in-capital on common and preferred stock. Amounts transferred to the legal surplus account from the retained earnings account are not available for distribution to the stockholders without the prior consent of the Puerto Rico Commissioner of Financial Institutions. The net loss experienced in 2011 exhausted FirstBank's statutory reserve fund. The Bank cannot pay dividends until it can replenish the reserve fund to an amount of at least 20% of the original capital contributed.

18 INCOME TAXES

Income tax expense includes Puerto Rico and Virgin Islands income taxes as well as applicable U.S. federal and state taxes. The Corporation is subject to Puerto Rico income tax on its income from all sources. As a Puerto Rico corporation, First BanCorp is treated as a foreign corporation for U.S. income tax purposes and is generally subject to United States income tax only on its income from sources within the United States or income effectively connected with the conduct of a trade or business within the United States. Any such tax paid is also creditable against the Corporation's Puerto Rico tax liability, subject to certain conditions and limitations.

On January 31, 2011, the Puerto Rico Government approved Act No. 1, which repealed the 1994 Code (1994 PR Code) and replaces it with the Puerto Rico Internal Revenue Code of 2011 (2011 PR Code). The provisions of the 2011 PR Code are generally applicable to taxable years commencing after December 31, 2010. Under 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, a particular subsidiary must be able to demonstrate sufficient taxable income within the applicable carry forward period (7 years under the 2011 PR Code, except for losses incurred during tax years commenced after December 31, 2004 and before December 31, 2012, that the carry forward period is extended to 10 years). The 2011 PR Code provides a dividend received deduction of 100% on dividends received from controlled subsidiaries subject to taxation in Puerto Rico and 85% on dividends received from other taxable domestic corporations. Dividend payments from a U.S. subsidiary to the Corporation are subject to a 10% withholding tax based on the provisions of the U.S. Internal Revenue Code.

Under the 2011 PR Code, First BanCorp is subject to a maximum statutory tax rate of 30% (25% for taxable years commencing after December 31, 2013 if certain economic conditions are met by the Puerto Rico economy). The 2011 PR Code also includes an alternative minimum tax of 20% that applies if the Corporation's regular income tax liability is less than the alternative minimum tax requirements.

Table of Contents

The Corporation has maintained an effective tax rate lower than the maximum statutory rate mainly by investing in government obligations and mortgage-backed securities exempt from U.S. and Puerto Rico income taxes and by doing business through International Banking Entity (IBE) of the Bank and through the Bank's subsidiary, FirstBank Overseas Corporation, in which the interest income and gain on sales is exempt from Puerto Rico and U.S. income taxation except for tax years that commenced after December 31, 2008 and before January 1, 2012, for which a special 5% tax was imposed to all IBEs. The IBEs and FirstBank Overseas Corporation were created under the International Banking Entity Act of Puerto Rico, which provides for total Puerto Rico tax exemption on net income derived from eligible activities by IBEs operating in Puerto Rico. IBEs that operate as a unit of a bank pay income taxes at normal rates to the extent that the IBEs' net income exceeds 20% of the bank's total net taxable income.

For the quarter and nine-month period ended September 30, 2012, the Corporation recorded an income tax expense of \$0.7 million and \$4.4 million, respectively, compared to an income tax expense of \$2.9 million and \$9.1 million for the same periods in 2011. The decrease is primarily due to lower taxable income from profitable subsidiaries and for the nine-months period was also driven by a reduction in deferred tax assets of profitable subsidiaries due to a reduction in statutory tax rates in 2011. The income tax in the interim financial statements is calculated based on the income of the individual subsidiaries and the currently valid tax rates as a best possible estimate. As of September 30, 2012, the deferred tax asset, net of a valuation allowance of \$360.0 million, amounted to \$4.6 million compared to \$5.4 million as of December 31, 2011.

Accounting for income taxes requires that companies assess whether a valuation allowance should be recorded against their deferred tax asset based on the consideration of all available evidence, using a more likely than not realization standard. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount that is more likely than not to be realized. In making such assessment, significant weight is to be given to evidence that can be objectively verified, including both positive and negative evidence. Consideration must be given to all sources of taxable income available to realize the deferred tax asset, including the future reversal of existing temporary differences, future taxable income exclusive of the reversal of temporary differences and carryforwards, taxable income in carryback years and tax planning strategies. In estimating taxes, management assesses the relative merits and risks of the appropriate tax treatment of transactions taking into account statutory, judicial and regulatory guidance, and recognizes tax benefits only when deemed probable of realization.

In assessing the weight of positive and negative evidence, a significant negative factor that resulted in the maintenance of the valuation allowance was that the Corporation's banking subsidiary, FirstBank Puerto Rico, continues in a three-year historical cumulative loss position as of September 30, 2012, mainly due to significant charges to the provision for loan and lease losses in prior years as a result of the economic downturn. As of September 30, 2012, management concluded that \$4.6 million of the deferred tax asset will be realized as it relate to profitable subsidiaries and to amounts that can be realized through future reversals of existing taxable temporary differences. To the extent the realization of a portion, or all, of the tax asset becomes more likely than not based on changes in circumstances (such as, improved earnings, changes in tax laws or other relevant changes), a reversal of that portion of the deferred tax asset valuation allowance will then be recorded.

The authoritative accounting guidance prescribes a comprehensive model for the financial statement recognition, measurement, presentation and disclosure of income tax uncertainties with respect to positions taken or expected to be taken on income tax returns. Under this guidance, income tax benefits are recognized and measured based upon a two-step model: 1) a tax position must be more likely than not to be sustained based solely on its technical merits in order to be recognized, and 2) the benefit is measured as the largest dollar amount of that position that is more likely than not to be sustained upon settlement. The difference between the benefit recognized in accordance with this model and the tax benefit claimed on a tax return is referred to as an unrecognized tax benefit (UTB).

During the third quarter of 2011, the Corporation recorded new UTBs of \$2.4 million, all of which would, if recognized, affect the Corporation's effective tax rate. The Corporation classified all interest and penalties, if any, related to tax uncertainties as income tax expense. As of September 30, 2012, the Corporation's accrued interest that relates to tax uncertainties amounted to \$1.1 million and there is no need to accrue for the payment of penalties. For the nine-month period ended September 30, 2012, the total amount of interest recognized by the Corporation as part of income tax expense related to tax uncertainties was \$0.2 million. During the first nine months of 2012 there was no change to the UTB of \$2.4 million. The amount of UTBs may increase or decrease for various reasons, including changes in the amounts for current tax year positions, the expiration of open income tax returns due to the expiration of statutes of limitations, changes in management's judgment about the level of uncertainty, the status of examinations, litigation and legislative activity and the addition or elimination of uncertain tax positions. The years 2007 through 2009 have been examined by the United States Internal Revenue Service (IRS) and disputed issues have been taken to administrative appeals. Although the timing of the resolution and/or closure of audits is highly uncertain, the Corporation believes it is reasonably possible that the IRS will conclude this audit within the next twelve months. If any issues addressed in the IRS audit are resolved in a manner not consistent with the Corporation's expectations, the Corporation could be required to adjust its provision for income taxes in the period such resolution occurs. The Corporation currently cannot reasonably estimate a range of possible changes to existing reserves.

Table of Contents

The Corporation's liability for income taxes includes the liability for UTBs, and interest which relates to tax years still subject to review by taxing authorities. Audit periods remain open for review until the statute of limitations has passed. The statute of limitations under the PR Code is 4 years; and for Virgin Islands and U.S. income tax purposes is 3 years after a tax return is due or filed, whichever is later. The completion of an audit by the taxing authorities or the expiration of the statute of limitations for a given audit period could result in an adjustment to the Corporation's liability for income taxes. Any such adjustment could be material to results of operations for any given quarterly or annual period based, in part, upon the results of operations for the given period. For Puerto Rico and Virgin Islands income tax purposes, all tax years subsequent to 2009 remain open to examination. Taxable years from 2007 remain open to examination for U.S. income tax purpose.

19 FAIR VALUE

Fair Value Option

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

Medium-Term Notes

The Corporation elected the fair value option for certain medium term notes that were hedged with interest rate swaps that were previously designated for fair value hedge accounting. These medium-term notes were repaid during the second quarter of 2012. As of December 31, 2011, these medium-term notes with a principal balance of \$15.4 million, had a fair value of \$16.0 million, recorded in notes payable. Interest paid/accrued on these instruments was recorded as part of interest expense and the accrued interest was part of the fair value of the notes. Electing the fair value option allows the Corporation to eliminate the burden of complying with the requirements for hedge accounting (e.g., documentation and effectiveness assessment) without introducing earnings volatility.

Medium-term notes for which the Corporation elected the fair value option were priced using observable market data in the institutional markets.

Fair Value Measurement

The FASB authoritative guidance for fair value measurement defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. This guidance also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Three levels of inputs may be used to measure fair value:

- 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 are traded in an active exchange market, as well as certain U.S. Treasury and other U.S. government and agency securities and corporate debt securities that are traded by dealers or brokers in active markets.
- Level 2** Valuations of Level 2 assets and liabilities are based on observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include (i) mortgage-backed securities for which the fair value is estimated based on the value of identical or comparable assets, (ii) debt securities with quoted prices that are traded less frequently than exchange-traded instruments and (iii) derivative contracts and financial liabilities (e.g., medium-term notes elected to be measured at fair value) whose value is determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data.
- Level 3** Valuations of Level 3 assets and liabilities are based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models for which the determination of fair value requires significant management judgment or estimation. For 2012, there have been no transfers into or out of Level 1, Level 2 or Level 3 measurement of the fair value hierarchy.

Table of Contents***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, U.S. Treasury notes and non-callable U.S. Agency debt securities), when available (Level 1), or market prices for identical or comparable assets (as is the case with MBS and callable U.S. agency debt) that are based on observable market parameters including benchmark yields, reported trades, quotes from brokers or dealers, issuer spreads, bids, offers and reference data including market research operations, (Level 2). Observable prices in the market already consider the risk of nonperformance. If listed prices or quotes are not available, fair value is based upon models that use unobservable inputs due to the limited market activity of the instrument, as is the case with certain private label mortgage-backed securities held by the Corporation, (Level 3).

Private label MBS are collateralized by fixed-rate mortgages on single-family residential properties in the United States; the interest rate on the securities is variable, tied to 3-month LIBOR and limited to the weighted-average coupon of the underlying collateral. The market valuation represents the estimated net cash flows over the projected life of the pool of underlying assets applying a discount rate that reflects market observed floating spreads over LIBOR, with a widening spread bias on a nonrated security. The market valuation is derived from a model that utilizes relevant assumptions such as prepayment rate, default rate, and loss severity on a loan level basis. The Corporation modeled the cash flow from the fixed-rate mortgage collateral using a static cash flow analysis according to collateral attributes of the underlying mortgage pool (i.e. loan term, current balance, note rate, rate adjustment type, rate adjustment frequency, rate caps, others) in combination with prepayment forecasts obtained from a commercially available prepayment model (ADCO). The variable cash flow of the security is modeled using the 3-month LIBOR forward curve. Loss assumptions were driven by the combination of default and loss severity estimates, taking into account loan credit characteristics (loan-to-value, state, origination date, property type, occupancy loan purpose, documentation type, debt-to-income ratio, other) to provide an estimate of default and loss severity.

Corporate bonds are collateralized by an agency zero-coupon bond and a synthetic Collateralized Debt Obligation of 125 corporate bonds rated investment grade at the time of structuring. The value of the bonds is tied to the level of credit default swap spreads.

Refer to table below for further information regarding qualitative information for all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3).

Derivative instruments

The fair value of most of the derivative instruments is based on observable market parameters and takes into consideration the credit risk component of paying counterparties when appropriate, except when collateral is pledged. That is, on interest rate swaps, the credit risk of both counterparties is included in the valuation; and, on options and caps, only the seller's credit risk is considered. The derivative instruments, namely swaps and caps, were valued using a discounted cash flow approach using the related US LIBOR and swap rate for each cash flow. Derivatives include interest rate swaps used for protection against rising interest rates. For these interest rate swaps, a credit component was not considered in the valuation since the Corporation has fully collateralized with investment securities any mark to market loss with the counterparty and, if there were market gains, the counterparty had to deliver collateral to the Corporation.

Although most of the derivative instruments are fully collateralized, a credit spread is considered for those that are not secured in full. The cumulative mark-to-market effect of credit risk in the valuation of derivative instruments for the quarter and nine-month period ended September 30, 2012 was immaterial.

Term notes payable

The fair value of term notes was determined using a discounted cash flow analysis over the full term of the borrowings. The model assumes that the embedded options are exercised economically. The discount rates used in the valuations consider 3-month LIBOR forward curves and the credit spread at every cash flow. During the second quarter of 2012, the Corporation prepaid medium term notes with a principal balance of \$15.4 million that carried a rate of 6.00%. These notes were carried at fair value and changes in value were recorded as part of interest expense. As a result of the prepayment of the notes, a marked-to-market loss of \$0.5 million was reversed resulting in a reduction in interest expense for the nine-month period ended on September 30, 2012.

Table of Contents

Assets and liabilities measured at fair value on a recurring basis, including financial liabilities for which the Corporation has elected the fair value option, are summarized below:

(In thousands)	As of September 30, 2012				As of December 31, 2011			
	Fair Value Measurements Using				Fair Value Measurements Using			
	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	\$ 40	\$	\$	\$ 40	\$ 41	\$	\$	\$ 41
U.S. Treasury Securities	7,495			7,495	476,992			476,992
Non-callable U.S. agency debt					301,585			301,585
Callable U.S. agency debt and MBS		1,472,277		1,472,277		859,818		859,818
Puerto Rico Government Obligations		59,603	3,743	63,346		219,369	3,244	222,613
Private label MBS			54,689	54,689			61,206	61,206
Corporate bonds							1,013	1,013
Derivatives, included in assets:								
Interest rate swap agreements		318		318		378		378
Purchased options used to manage exposure to the stock market on embedded stock indexed options						899		899
Forward contracts		18		18				
Liabilities:								
Medium-term notes						15,968		15,968
Derivatives, included in liabilities:								
Interest rate swap agreements		6,238		6,238		6,767		6,767
Embedded written options on stock index deposits and notes payable						899		899
Forward Contracts		190		190		168		168
Total	\$ 7,535	\$ 1,538,644	\$ 58,432	\$ 1,604,611	\$ 778,618	\$ 1,104,266	\$ 65,463	\$ 1,948,347

Changes in Fair Value for items Measured at Fair Value Pursuant to Election of the Fair Value Option For the Quarter ended September 30, 2012

Decrease

(increase) in Interest Expense included in Current-Period Earnings ⁽¹⁾

(In thousands)	
Medium-term notes	\$ (1,871)

Table of Contents

The table below presents a reconciliation for all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the quarter and nine-month period ended September 30, 2012 and 2011.

Level 3 Instruments Only	Total Fair Value Measurements Quarter ended September 30,	
	2012	2011
	Securities Available For Sale ⁽¹⁾	Securities Available For Sale ⁽¹⁾
(In thousands)		
Beginning balance	\$ 61,838	71,412
Total gains or (losses) (realized/unrealized):		
Included in earnings	(557)	(350)
Included in other comprehensive income	1,666	897
Sales	(1,450)	
Principal repayments and amortization	(3,065)	(3,851)
Ending balance	\$ 58,432	\$ 68,108

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

Level 3 Instruments Only	Total Fair Value Measurements Nine-Month Period Ended September 30,	
	2012	2011
	Securities Available For Sale ⁽¹⁾	Securities Available For Sale ⁽¹⁾
(In thousands)		
Beginning balance	\$ 65,463	74,993
Total gains or (losses) (realized/unrealized):		
Included in earnings	(1,933)	(957)
Included in other comprehensive income	6,722	2,768
Held-to-Maturity investment securities reclassified to Available-for-Sale		2,000
Sales	(1,450)	
Principal repayments and amortization	(10,370)	(10,696)
Ending balance	\$ 58,432	\$ 68,108

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

The table below presents qualitative information for all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) at September 30, 2012.

(In thousands)	Fair Value	Valuation Technique	September 30, 2012 Unobservable Input	Range
Investment securities available-for-sale:				
Private label MBS	\$ 54,689	Discounted cash flow	Discount rate	14.5%

			Prepayment rate	23.81% - 43.58% (Weighted Average 33%)
			Projected Cumulative Loss Rate	0.71% - 17.51% (Weighted Average 7%)
Puerto Rico Government Obligations	3,743	Discounted cash flow	Prepayment Speed	5.95%

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 the prepayment rates. Shifts in those inputs would result in different fair value measurements. Increases in the probability of default, loss severity assumptions and pre-payments rates in isolation would generally result in an adverse effect in 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 speed. A significant increase (decrease) in the assumed speed would lead to a higher (lower) fair value estimate. Loss severity and probability of default are not included as significant unobservable variables because the note is guaranteed by the Puerto Rico Housing Finance Authority (PRHFA). The PRHFA credit risk is modeled by discounting the cash flows using a curve appropriate to the PRHFA credit rating.

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

Table of Contents

As of September 30, 2012, 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 September 30, 2012			Losses recorded for the Quarter Ended September 30, 2012	Losses recorded for the Nine-Month Period Ended September 30, 2012
	Level 1	Level 2	Level 3		
	(In thousands)				
Loans receivable ⁽¹⁾	\$	\$	\$ 702,308	\$ 19,676	\$ 80,172
Other Real Estate Owned ⁽²⁾			177,001	3,264	7,860
Mortgage servicing rights ⁽³⁾			16,660	363	203

- (1) Mainly impaired commercial and construction loans. The impairment was generally measured based on the fair value of the collateral. The fair values are derived from 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 is derived from appraisals that take into consideration prices in observed transactions involving similar assets in similar locations but adjusted for specific characteristics and assumptions of the properties (e.g. absorption rates), which are not market observable. Losses are related to market valuation adjustments after the transfer from the loan to the Other Real Estate Owned (OREO) portfolio.
- (3) Fair value adjustments to mortgage servicing rights were mainly due to assumptions associated with mortgage prepayment rates. The Corporation carries its mortgage servicing rights at lower of cost or market, and they are accordingly measured at fair value on a non-recurring basis. Assumptions for the value of mortgage servicing rights include: Prepayment rate 12.66%, Discount Rate 11.09%.

As of September 30, 2011, 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 September 30, 2011			Losses recorded for the Quarter Ended September 30, 2011	Losses recorded for the Nine-Month Period Ended September 30, 2011
	Level 1	Level 2	Level 3		
	(In thousands)				
Loans receivable ⁽¹⁾	\$	\$	\$ 842,773	\$ 45,312	\$ 187,269
Other Real Estate Owned ⁽²⁾			109,514	2,325	6,294

- (1) Mainly impaired commercial and construction loans. The impairment was generally measured based on the fair value of the collateral. The fair values are derived from 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 is derived from appraisals that take into consideration prices in observed transactions involving similar assets in similar locations but adjusted for specific characteristics and assumptions of the properties (e.g. absorption rates), which are not market observable. Losses are related to market valuation adjustments after the transfer from the loan to the Other Real Estate Owned (OREO) portfolio.

Qualitative information regarding the fair value measurements for Level 3 financial instruments are as follows:

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

September 30, 2012

	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 speed 12.66%; weighted average discount rate 11.09%

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

Table of Contents

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 U.S. Government obligations, which have a contractual maturity of three months or less. The fair value of these securities is based on quoted market prices in active markets that incorporate the risk of nonperformance.

Other equity securities

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

Loans receivable, including loans held for sale

The fair value of loans held for investment and for mortgage loans held for sale was estimated using discounted cash flow analyses, based on interest rates currently being offered for loans with similar terms and credit quality and with adjustments that the Corporation's management believes a market participant would consider in determining fair value. Loans were classified by type such as commercial, residential mortgage, and automobile. These asset categories were further segmented into fixed- and adjustable-rate categories. The fair values of performing fixed-rate and adjustable-rate loans were calculated by discounting expected cash flows through the estimated maturity date. 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 customer account relationship. Loans with no stated maturity, like credit lines, were valued at book value. Prepayment assumptions were considered for non-residential loans. For residential mortgage loans, prepayment estimates were based on recent historical prepayment experience of the Corporation's residential mortgage portfolio. Discount rates were based on the Treasury and LIBOR/Swap Yield Curves at the date of the analysis, and included appropriate adjustments for expected credit losses and liquidity.

Deposits

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

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

The fair value of brokered CDs, which are included within deposits, is determined using discounted cash flow analyses over the full term of the CDs. The fair value of the CDs is computed using the outstanding principal amount. The discount rates used are based on brokered CD market rates as of September 30, 2012. The fair value does not incorporate the risk of nonperformance, since interests in brokered CDs are generally sold by brokers in amounts of less than \$250,000 and, therefore, insured by the FDIC.

Securities sold under agreements to repurchase

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

Advances from FHLB

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

Table of Contents*Other borrowings*

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

The following table presents the estimated fair value and carrying value of financial instruments as of September 30, 2012 and December 31, 2011

	Total Carrying Amount in Statement of Financial Condition		Fair Value Estimated		
	September 30, 2012	September 30, 2012	Level 1 (In thousands)	Level 2	Level 3
Assets:					
Cash and due from banks and money market investments	\$ 1,003,720	\$ 1,003,720	\$ 1,003,720	\$	\$
Investment securities available for sale	1,597,847	1,597,847	7,535	1,531,880	58,432
Other equity securities	39,656	39,656		39,656	
Loans held for sale	68,349	70,976		70,976	
Loans, held for investment	10,188,164				
Less: allowance for loan and lease losses	(445,531)				
Loans held for investment, net of allowance	\$ 9,742,633	9,466,460			9,466,460
Derivatives, included in assets	336	336		336	
Liabilities:					
Deposits	9,896,402	9,937,355		9,937,355	
Securities sold under agreements to repurchase	900,000	997,179		997,179	
Advances from FHLB	518,440	524,176		524,176	
Other borrowings	231,959	132,599			132,599
Derivatives, included in liabilities	6,428	6,428		6,428	

	Total Carrying Amount in Statement of Financial Condition		Fair Value Estimated	
	December 31, 2011	December 31, 2011	December 31, 2011	
(In thousands)				
Assets:				
Cash and due from banks and money market investments	\$ 446,566	\$	446,566	
Investment securities available for sale	1,923,268		1,923,268	
Other equity securities	37,951		37,951	
Loans held for sale	15,822		16,038	
Loans, held for investment	10,559,392			
Less: allowance for loan and lease losses	(493,917)			
Loans held for investment, net of allowance	\$ 10,065,475		9,618,267	
Derivatives, included in assets	1,277		1,277	
Liabilities:				

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

Deposits	9,907,754	9,974,119
Securities sold under agreements to repurchase	1,000,000	1,102,263
Advances from FHLB	367,440	379,730
Notes Payable	23,342	22,476
Other borrowings	231,959	160,603
Derivatives, included in liabilities	7,834	7,834

Table of Contents**20 SUPPLEMENTAL CASH FLOW INFORMATION**

Supplemental cash flow information follows:

	Nine-Month Period Ended	
	September 30, 2012	
	2012	2011
	(In thousands)	
Cash paid for:		
Interest on borrowings	\$ 128,193	\$ 191,570
Income tax	5,139	2,120
Non-cash investing and financing activities:		
Additions to other real estate owned	133,124	125,420
Additions to auto repossessions	39,383	50,380
Capitalization of servicing assets	4,486	3,793
Loan securitizations	165,318	151,972
Loans sold to a joint venture in exchange for an acquisition loan and an equity interest in the joint venture		183,709
Reclassification of Held-to-Maturity investment securities to Available-for-Sale		88,751

21 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 September 30, 2012, the Corporation had six reportable segments: Commercial and Corporate Banking; Mortgage Banking; Consumer (Retail) Banking; Treasury and Investments; United States operations and Virgin Islands operations. Management determined the reportable segments based on the internal reporting used to evaluate performance and to assess where to allocate resources. Other factors such as the Corporation's organizational chart, nature of the products, distribution channels and the economic characteristics of the product were also considered in the determination of the reportable segments.

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

The accounting policies of the segments are the same as those referred to in Note 1 to the Corporation's financial statements for the year ended December 31, 2011 contained in the Corporation's Annual Report on Form 10-K.

The Corporation evaluates the performance of the segments based on net interest income, the estimated provision for loan and lease losses, non-interest income and direct non-interest expenses. The segments are also evaluated based on the average volume of their interest-earning assets less the allowance for loan and lease losses.

Table of Contents

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

(In thousands)	Mortgage Banking	Consumer (Retail) Banking	Commercial and Corporate	Treasury and Investments	United States Operations	Virgin Islands Operations	Total
For the quarter ended September 30, 2012:							
Interest income	\$ 27,792	\$ 60,306	\$ 46,104	\$ 11,563	\$ 9,031	\$ 12,168	\$ 166,964
Net (charge) credit for transfer of funds	(12,357)	(756)	(5,933)	15,991	3,055		
Interest expense		(7,289)		(26,191)	(6,903)	(1,078)	(41,461)
Net interest income	15,435	52,261	40,171	1,363	5,183	11,090	125,503
Provision for loan and lease losses	(8,453)	(12,000)	(5,892)		6,860	(9,467)	(28,952)
Non-interest income	4,312	9,487	1,993	(538)	491	1,580	17,325
Direct non-interest expenses	(10,330)	(26,865)	(12,607)	(1,795)	(7,735)	(9,053)	(68,385)
Segment income (loss)	\$ 964	\$ 22,883	\$ 23,665	\$ (970)	\$ 4,799	\$ (5,850)	\$ 45,491
Average earnings assets	\$ 2,084,719	\$ 1,784,630	\$ 4,478,267	\$ 2,259,288	\$ 704,780	\$ 797,332	\$ 12,109,016

(In thousands)	Mortgage Banking	Consumer (Retail) Banking	Commercial and Corporate	Treasury and Investments	United States Operations	Virgin Islands Operations	Total
For the quarter ended September 30, 2011:							
Interest income	\$ 27,505	\$ 41,611	\$ 51,101	\$ 13,328	\$ 11,101	\$ 13,896	\$ 158,542
Net (charge) credit for transfer of funds	(14,030)	3,528	(3,658)	10,203	3,957		
Interest expense		(10,220)		(42,657)	(9,694)	(1,716)	(64,287)
Net interest income (loss)	13,475	34,919	47,443	(19,126)	5,364	12,180	94,255
Provision for loan and lease losses	(16,153)	(7,719)	(8,261)		(5,417)	(8,896)	(46,446)
Non-interest income	3,180	7,354	1,702	3,834	590	1,661	18,321
Direct non-interest expenses	(6,918)	(22,332)	(9,682)	(2,060)	(9,341)	(8,505)	(58,838)
Segment (loss) income	\$ (6,416)	\$ 12,222	\$ 31,202	\$ (17,352)	\$ (8,804)	\$ (3,560)	\$ 7,292
Average earnings assets	\$ 2,047,220	\$ 1,435,818	\$ 5,107,637	\$ 2,765,749	\$ 834,848	\$ 888,393	\$ 13,079,665

	Mortgage Banking	Consumer (Retail) Banking	Commercial & Corporate	Treasury & Investments	United States Operations	Virgin Islands Operations	Total
For the Nine-Month Period Ended September 30, 2012:							
Interest income	\$ 82,550	\$ 147,641	\$ 142,375	\$ 34,077	\$ 28,566	\$ 37,514	\$ 472,723
Net (charge) credit for transfer of funds	(37,848)	1,827	(18,964)	45,559	9,426		
Interest expense		(23,818)		(86,551)	(22,702)	(3,578)	(136,649)

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

Net interest income (loss)	44,702	125,650	123,411	(6,915)	15,290	33,936	336,074
Provision for loan and lease losses	(29,541)	(21,576)	(37,449)		12,216	(13,683)	(90,033)
Non-interest income	12,070	23,827	8,215	(1,779)	1,264	4,952	48,549
Direct non-interest expenses	(31,142)	(73,964)	(37,356)	(5,107)	(20,912)	(28,506)	(196,987)
Segment (loss) income	\$ (3,911)	\$ 53,937	\$ 56,821	\$ (13,801)	\$ 7,858	\$ (3,301)	\$ 97,603
Average earnings assets	\$ 2,061,036	\$ 1,572,342	\$ 4,635,264	\$ 2,368,164	\$ 735,889	\$ 820,510	\$ 12,193,205

	Mortgage Banking	Consumer (Retail) Banking	Commercial and Corporate	Treasury and Investments	United States Operations	Virgin Islands Operations	Total
For the Nine-Month Period Ended September 30, 2011:							
Interest income	\$ 90,779	\$ 127,401	\$ 154,098	\$ 52,770	\$ 34,547	\$ 43,268	\$ 502,863
Net (charge) credit for transfer of funds	(48,007)	7,920	(9,672)	37,078	12,681		
Interest expense		(32,334)		(139,998)	(30,543)	(5,019)	(207,894)
Net interest income (loss)	42,772	102,987	144,426	(50,150)	16,685	38,249	294,969
Provision for loan and lease losses	(27,892)	(10,622)	(108,902)		(15,546)	(31,400)	(194,362)
Non-interest income	18,968	21,342	6,531	42,548	903	8,912	99,204
Direct non-interest expenses	(23,140)	(67,944)	(30,559)	(4,744)	(26,159)	(27,921)	(180,467)
Segment income (loss)	\$ 10,708	\$ 45,763	\$ 11,496	\$ (12,346)	\$ (24,117)	\$ (12,160)	\$ 19,344
Average earnings assets	\$ 2,192,271	\$ 1,460,871	\$ 5,219,856	\$ 3,280,009	\$ 866,778	\$ 893,256	\$ 13,913,041

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

	Quarter Ended September 30,		Nine-Month Period Ended September 30,	
	2012	2011	2012	2011
Net Income (loss):				
Total income for segments and other	\$ 45,491	\$ 7,292	\$ 97,603	\$ 19,344
Other non-interest income (loss) ⁽¹⁾	(2,199)	(4,357)	(10,926)	(5,893)
Other operating expenses	(23,458)	(24,093)	(66,991)	(71,761)
Income (loss) before income taxes	19,834	(21,158)	19,686	(58,310)
Income tax expense	(761)	(2,888)	(4,439)	(9,080)
Total consolidated net income (loss)	\$ 19,073	\$ (24,046)	\$ 15,247	\$ (67,390)

Table of Contents

	Quarter Ended September 30,		Nine-Month Period Ended September 30,	
	2012	2011	2012	2011
Average assets:				
Total average earning assets for segments	\$ 12,109,016	\$ 13,079,665	\$ 12,193,205	\$ 13,913,041
Other average earning assets ⁽¹⁾	34,403	46,046	38,215	39,064
Average non-earning assets	707,816	662,192	692,083	670,758
Total consolidated average assets	\$ 12,851,235	\$ 13,787,903	\$ 12,923,503	\$ 14,622,863

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

22 REGULATORY MATTERS, COMMITMENTS AND CONTINGENCIES

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

Capital standards established by regulations require the Corporation to maintain minimum amounts and ratios for Leverage (Tier 1 capital to average total assets) and ratios of Tier 1 Capital to Risk-Weighted Assets and Total Capital to Risk-Weighted Assets as defined in the regulations. The total amount of risk-weighted assets is computed by applying risk-weighting factors to the Corporation's assets and certain off-balance sheet items, which generally vary from 0% to 100% depending on the nature of the asset.

Effective June 2, 2010, FirstBank, by and through its Board of Directors, entered into the FDIC Order with the FDIC and OCIF. This Order provides for various things, including (among other things) the following: (1) having and retaining qualified management; (2) increased participation in the affairs of FirstBank by its board of directors; (3) development and implementation by FirstBank of a capital plan to attain a leverage ratio of at least 8%, a Tier 1 risk-based capital ratio of at least 10% and a total risk-based capital ratio of at least 12%; (4) adoption and implementation of strategic, liquidity and fund management and profit and budget plans and related projects within certain timetables set forth in the FDIC Order and on an ongoing basis; (5) adoption and implementation of plans for reducing FirstBank's positions in certain classified assets and delinquent and non-accrual loans within timeframes set forth in the FDIC Order; (6) refraining from lending to delinquent or classified borrowers already obligated to FirstBank on any extensions of credit so long as such credit remains uncollected, except where FirstBank's failure to extend further credit to a particular borrower would be detrimental to the best interests of FirstBank, and any such additional credit is approved by the FirstBank's Board of Directors; (7) refraining from accepting, increasing, renewing or rolling over brokered CDs without the prior written approval of the FDIC; (8) establishment of a comprehensive policy and methodology for determining the allowance for loan and lease losses and the review and revision of FirstBank's loan policies, including the non-accrual policy; and (9) adoption and implementation of adequate and effective programs of independent loan review, appraisal compliance and an effective policy for managing FirstBank's sensitivity to interest rate risk. The foregoing summary is not complete and is qualified in all respects by reference to the actual language of the FDIC Order. Although all the regulatory capital ratios exceeded the established well capitalized levels and the minimum capital ratio requirements of the FDIC Order at September 30, 2012, because of the FDIC Order with the FDIC, FirstBank cannot be treated as a well capitalized institution under regulatory guidance.

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

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

The Corporation submitted its capital plan setting forth how it plans to improve capital positions to comply with the FDIC Order and the Written Agreement over time. In addition to the Capital Plan, the Corporation has submitted to its regulators a liquidity and brokered CD plan, including a contingency funding plan, a non-performing asset reduction plan, a budget and profit plan, a strategic plan and a plan for the reduction of classified and special mention assets. As of September 30, 2012 the Corporation had completed all of the items included in the capital plan and is working on to continue the reduction of non-performing loans. Further, the Corporation has reviewed and enhanced the Corporation's loan review program, various credit policies, the Corporation's treasury and investment policy, the Corporation's asset classification and allowance for loan and lease losses and non-accrual policies, the Corporation's charge-off policy and the Corporation's appraisal program. The Agreements also require the submission to the regulators of quarterly progress reports.

Table of Contents

The FDIC Order imposes no other restrictions on FirstBank's products or services offered to customers, nor does it or the Written Agreement impose any type of penalties or fines upon FirstBank or the Corporation. Concurrent with the FDIC Order, the FDIC has granted FirstBank temporary waivers to enable it to continue accessing the brokered CD market through December 31, 2012. FirstBank will request approvals for future periods.

In June 2012, the U.S. banking regulators jointly published three notices of proposed rulemaking that are essentially intended to implement the Basel III for U.S. banks. Together these notices of proposed rulemaking would, among other things: (i) Implement in the United States the Basel III regulatory capital reforms including those that revise the definition of capital, increase minimum capital ratios, and introduce a minimum Tier 1 common equity ratio of 4.5% and a capital conservation buffer of 2.5% (for a total minimum Tier 1 common equity ratio of 7.0%); (ii) Revise Basel I rules for calculating risk-weighted assets to enhance risk sensitivity; and (iii) Comply with the Dodd-Frank Act provision prohibiting the reliance on external credit ratings.

Although uncertainty exists regarding final capital rules, based on our current interpretation of the proposed Basel III capital rules we anticipate to exceed the fully phased-in minimum capital ratios as established in the current proposal. The proposed Basel III capital rules and interpretations used in estimating our Basel III calculations are subject to change depending on final Basel III capital rules.

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 September 30, 2012, commitments to extend credit amounted to approximately \$1.5 billion, of which \$1.0 billion relate to credit card loans. Commercial and Financial standby letters of credit amounted to approximately \$83.4 million. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any conditions established in the contract. Commitments generally have fixed expiration dates or other termination clauses. For most of the commercial lines of credit, the Corporation has the option to reevaluate the agreement prior to additional disbursements. In the case of credit cards and personal lines of credit, the Corporation can at any time and without cause, cancel the unused credit facility. Generally, the Corporation's mortgage banking activities do not enter into interest rate lock agreements with prospective borrowers.

Lehman Brothers Special Financing, Inc. (Lehman) was the counterparty to the Corporation on certain interest rate swap agreements. During the third quarter of 2008, Lehman failed to pay the scheduled net cash settlement due to the Corporation, which constituted an event of default under those interest rate swap agreements. The Corporation terminated all interest rate swaps with Lehman and replaced them with other counterparties under similar terms and conditions. In connection with the unpaid net cash settlement under the swap agreements, the Corporation has an unsecured counterparty exposure with Lehman, which filed for bankruptcy on October 3, 2008, of approximately \$1.4 million. This exposure was reserved in the third quarter of 2008. The Corporation had securities pledged as collateral with a \$63.6 million face value to guarantee its performance under the swap agreements in the event payment there under was required.

Since the second quarter of 2009, the Corporation has maintained a non-performing asset with a book value of \$64.5 million in addition to accrued interest of \$2.1 million related to the collateral pledged with Lehman. The Corporation believes that the securities pledged as collateral should not be part of the Lehman bankruptcy estate given the facts that the posted collateral constituted a performance guarantee under the swap agreements and was not part of a financing agreement, and that ownership of the securities was never transferred to Lehman. Upon termination of the interest rate swap agreements, Lehman's obligation was to return the collateral to the Corporation. During the fourth quarter of 2009, the Corporation discovered that Lehman Brothers, Inc., acting as agent of Lehman, had deposited the securities in a custodial account at JP Morgan Chase, and that, shortly before the filing of the Lehman bankruptcy proceedings, it had provided instructions to have most of the securities transferred to Barclays Capital (Barclays) in New York. After Barclays' refusal to turn over the securities, the Corporation filed a lawsuit against Barclays in federal court in New York demanding the return of the securities in December 2009. During February 2010, Barclays filed a motion with the court requesting that the Corporation's claim be dismissed on the grounds that the allegations of the complaint are not sufficient to justify the granting of the remedies therein sought. Shortly thereafter, the Corporation filed its opposition motion. A hearing on the motions was held in court on April 28, 2010. The court, on that date, after hearing the arguments by both sides, concluded that the Corporation's equitable-based causes of action, upon which the return of the investment securities is being demanded, contain allegations that sufficiently plead facts warranting the denial of Barclays' motion to dismiss the Corporation's claim. Accordingly, the judge ordered the case to proceed to trial.

Subsequent to the court decision, the district court judge transferred the case to the Lehman bankruptcy court for trial. Discovery pursuant to that case management plan has been completed. The parties filed dispositive motions on September 13, 2012. Oppositions to such motions and replies thereto must be filed by October 15, 2012 and November 14, 2012, respectively, but this timing is subject to adjustment. The Corporation may not succeed in its litigation against Barclays to recover all or a substantial portion of the securities.

Table of Contents

Additionally, the Corporation continues to pursue its claim filed in January 2009 in the proceedings under the Securities Protection Act with regard to Lehman Brothers Inc. in the United States Bankruptcy Court for the Southern District of New York.

An estimated loss has not been accrued as the Corporation is unable to determine the timing of the claim resolution or whether it will succeed in recovering all or a substantial portion of the collateral or its equivalent value.

Because the Corporation has not had the benefit of the use of the investment securities pledged to Lehman (i.e., ability to sell, pledge or transfer), and because the Corporation has not received principal or interest payments since 2008 (after the collapse of Lehman), the appropriate carrying value of these securities has been under review with our regulators, with recent heightened concern due to the complex and lengthy litigation regarding this matter. If, as a result of these discussions, developments in the litigation, or for other reasons, the Corporation should determine that it is probable that the asset has been impaired and that the Corporation needs to recognize a partial or full loss for the investment securities pledged to Lehman, such an action would adversely affect the Corporation's results of operations in the period in which such action is taken. The Corporation expects to reassess the recoverability of the asset upon the resolution of the dispositive motions filed with the court, which motions could be resolved in the fourth quarter of 2012.

As of September 30, 2012, First BanCorp and its subsidiaries were defendants in various legal proceedings arising in the ordinary course of business. Management believes that the final disposition of these matters will not have a material adverse effect on the Corporation's financial position or results of operations.

23 FIRST BANCORP. (Holding Company Only) Financial Information

The following condensed financial information presents the financial position of the Holding Company only as of September 30, 2012 and December 31, 2011 and the results of its operations for the quarter and nine-month period ended September 30, 2012 and 2011.

	As of September 30, 2012	As of December 31, 2011
	(In thousands)	
Assets		
Cash and due from banks	\$ 36,631	\$ 41,681
Money market investments	6,111	3,111
Investment securities available for sale, at market:		
Equity investments	40	41
Other investment securities	1,300	1,300
Investment in First Bank Puerto Rico, at equity	1,660,373	1,615,304
Investment in First Bank Insurance Agency, at equity	7,163	5,338
Investment in FBP Statutory Trust I	3,093	3,093
Investment in FBP Statutory Trust II	3,866	3,866
Other assets	3,669	3,488
 Total assets	 \$ 1,722,246	 \$ 1,677,222
Liabilities & Stockholders' Equity		
Liabilities:		
Other borrowings	\$ 231,959	\$ 231,959
Accounts payable and other liabilities	6,170	1,119
 Total liabilities	 238,129	 233,078
 Stockholders' equity	 1,484,117	 1,444,144
 Total liabilities and stockholders' equity	 \$ 1,722,246	 \$ 1,677,222

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

	Quarter Ended		Nine-Month Period Ended			
	September 30, 2012	September 30, 2011	September 30, 2012	September 30, 2011		
(In thousands)						
Income:						
Interest income on investment securities	\$	\$	1	\$	\$	1
Dividends from other subsidiaries						3,000
Interest income on other investments	6		12			
Other income	55	53	165			157
	61	54	177			3,158
Expense:						
Notes payable and other borrowings	1,849	1,755	5,529			5,221
Other operating expenses	783	745	2,618			1,792
	2,632	2,500	8,147			7,013
Investment related proceeds and impairments on equity securities						679
Loss before income taxes and equity in undistributed earnings (losses) of subsidiaries	(2,571)	(2,446)	(7,970)			(3,176)
Income tax provision						
Equity in undistributed earnings (losses) of subsidiaries	21,644	(21,600)	23,217			(64,214)
Net income (loss)	\$ 19,073	\$ (24,046)	\$ 15,247			\$ (67,390)

24 SUBSEQUENT EVENTS

The Corporation has performed an evaluation of events occurring subsequent to September 30, 2012; management has determined that there are no additional events occurring in this period that required disclosure in or adjustment to the accompanying financial statements.

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

(In thousands, except for per share and financial ratios)	Quarter ended September 30,		Nine-Month Period Ended September 30,	
	2012	2011	2012	2011
Condensed Income Statements:				
Total interest income	\$ 166,964	\$ 158,542	\$ 472,723	\$ 502,863
Total interest expense	41,461	64,287	136,649	207,894
Net interest income	125,503	94,255	336,074	294,969
Provision for loan and lease losses	28,952	46,446	90,033	194,362
Non-interest income	15,126	13,964	37,623	93,311
Non-interest expenses	91,843	82,931	263,978	252,228
Income (loss) before income taxes	19,834	(21,158)	19,686	(58,310)
Income tax expense	(761)	(2,888)	(4,439)	(9,080)
Net income (loss)	19,073	(24,046)	15,247	(67,390)
Net income (loss) attributable to common stockholders	19,073	(31,143)	15,247	(88,785)
Per Common Share Results:				
Net earnings (loss) per share basic	\$ 0.09	\$ (1.46)	\$ 0.07	\$ (4.17)
Net earnings (loss) per share diluted	\$ 0.09	\$ (1.46)	\$ 0.07	\$ (4.17)
Cash dividends declared	\$	\$	\$	\$
Average shares outstanding	205,415	21,303	205,349	21,303
Average shares outstanding diluted	205,923	21,303	205,697	21,303
Book value per common share	\$ 6.89	\$ 26.12	\$ 6.89	\$ 26.12
Tangible book value per common share ⁽¹⁾	\$ 6.59	\$ 24.22	\$ 6.59	\$ 24.22
Selected Financial Ratios (In Percent):				
Profitability:				
Return on Average Assets	0.59	(0.69)	0.16	(0.62)
Interest Rate Spread ⁽²⁾	3.77	2.61	3.31	2.55
Net Interest Margin ⁽²⁾	4.02	2.86	3.59	2.81
Return on Average Total Equity	5.19	(9.46)	1.41	(8.78)
Return on Average Common Equity	5.43	(21.33)	1.47	(19.83)
Average Total Equity to Average Total Assets	11.37	7.31	11.20	7.02
Tangible common equity ratio ⁽¹⁾	10.39	3.84	10.39	3.84
Dividend payout ratio				
Efficiency ratio ⁽³⁾	65.31	76.63	70.64	64.96
Asset Quality:				
Allowance for loan and lease losses to loans held for investment	4.37	4.89	4.37	4.89
Net charge-offs (annualized) to average loans ⁽⁴⁾	1.58	2.50	1.79	2.72
Provision for loan and lease losses to net charge-offs	71.36	68.67	65.04	85.36
Non-performing assets to total assets ⁽⁴⁾	9.58	10.22	9.58	10.22
Non-performing loans held for investment to total loans held for investment ⁽⁴⁾	9.89	11.13	9.89	11.13
Allowance to total non-performing loans held for investment ⁽⁴⁾	44.20	43.90	44.20	43.90
Allowance to total non-performing loans held for investment excluding residential real estate loans ⁽⁴⁾	64.84	63.44	64.84	63.44
Other Information:				
Common Stock Price: End of period	\$ 4.42	\$ 2.80	\$ 4.42	\$ 2.80

	As of September 30, 2012	As of December 31, 2011
Balance Sheet Data:		
Loans, including loans held for sale	\$ 10,256,513	\$ 10,575,214

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

Allowance for loan and lease losses	445,531	493,917
Money market and investment securities	1,854,435	2,200,888
Intangible assets	61,941	39,787
Deferred tax asset, net	4,577	5,442
Total assets	13,139,747	13,127,275
Deposits	9,896,402	9,907,754
Borrowings	1,650,399	1,622,741
Total preferred equity	63,047	63,047
Total common equity	1,378,578	1,361,899
Accumulated other comprehensive income, net of tax	42,492	19,198
Total equity	1,484,117	1,444,144

- (1) Non-GAAP measure. Refer to Capital discussion below for additional information of the components and reconciliation of these measures.
- (2) On a tax-equivalent basis and excluding the changes in fair value of derivative instruments and financial liabilities measured at fair value (see Net Interest Income discussion below for a reconciliation of this non-GAAP measure).
- (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 and financial instruments measured at fair value.
- (4) Loans used in the denominator in calculating net charge-off, non-performing loan and non-performing asset rates include purchased credit-impaired (PCI) loans. However, the Corporation separately tracks and reports PCI loans and exclude these from delinquency, non-performing loan and non-performing asset statistics.

Table of Contents

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

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 and British Virgin Islands and the State of Florida (USA) concentrating in commercial banking, residential mortgage loan originations, finance leases, personal loans, small loans, auto loans, insurance agency and broker-dealer activities.

As described in Note 22, Regulatory Matters, Commitment and Contingencies, FirstBank is currently operating under a Consent Order (the Order) with the Federal Deposit Insurance Corporation (FDIC) and First BanCorp has entered into a Written Agreement (the Written Agreement and collectively with the Order the Agreements) with the Board of Governors of the Federal Reserve System (the FED or Federal Reserve).

OVERVIEW OF RESULTS OF OPERATIONS

First BanCorp.'s results of operations generally depend primarily upon its net interest income, which is the difference between the interest income earned on its interest-earning assets, including investment securities and loans, and the interest expense incurred on its interest-bearing liabilities, including deposits and borrowings. Net interest income is affected by various factors, including: the interest rate scenario; the volumes, mix and composition of interest-earning assets and interest-bearing liabilities; and the re-pricing characteristics of these assets and liabilities. The Corporation's results of operations also depend on the provision for loan and lease losses, which significantly affected the results for the past three years, non-interest expenses (such as personnel, occupancy, deposit insurance premiums and other costs), non-interest income (mainly service charges and fees on loans and deposits, insurance income and revenues from broker-dealer operations), gains (losses) on sales of investments, gains (losses) on mortgage banking activities, and income taxes.

Net income for the quarter ended September 30, 2012 amounted to \$19.1 million or \$0.09 per diluted common share, compared to a net loss of \$24.0 million or (\$1.46) per diluted common share for the quarter ended September 30, 2011. The Corporation's financial results for the third quarter of 2012, as compared to the third quarter of 2011, were principally impacted by: (i) a \$31.2 million increase in net interest income mainly achieved through reductions in the overall cost of funding and the impact of the \$406 million credit cards portfolio acquired in late May 2012, (ii) a decrease of \$17.5 million in the provision for loan and lease losses which reflected primarily a lower provision for commercial mortgage loans due to improvements in the cumulative charge-off history used for the general reserve determination, the decrease in the amount of adversely classified loans and the overall decrease in the size of the portfolio. These variances were partially offset by an \$8.9 million increase in non-interest expenses driven by higher losses on real estate owned (REO) operations and expenses related to the recently acquired credit cards portfolio.

The key drivers of the Corporation's financial results for the quarter ended September 30, 2012 include the following:

Net interest income for the quarter ended September 30, 2012 was \$125.5 million, compared to \$94.3 million for the same period in 2011 driven by an improvement of 116 basis points in the net interest margin, excluding fair value adjustments (for definition and reconciliation of this non-GAAP measure, refer to Net Interest Income discussion below) to 3.98%. The improvement in the net interest margin was primarily due to: (i) a decrease of 51 basis points in the average cost of funding achieved through lower deposit pricing and the maturity of high-cost borrowings, and (ii) the purchase in late May of a \$406 million credit cards portfolio from FIA Card Services (FIA). This acquisition increased the average balance of consumer loans by approximately \$366.9 million and contributed \$18.6 million to interest income, including \$3.1 million related to the discount accretion recorded as an adjustment to the yield of the purchased portfolio, and was the main driver for the 64 basis points increase in the yield on total earning assets. Refer to the Net Interest Income discussion below for additional information.

For the third quarter of 2012, the Corporation's provision for loan and lease losses amounted to \$29.0 million, compared to \$46.4 million for the same period in 2011. The decrease in the provision for 2012 was primarily driven by a lower provision for commercial mortgage loans due to improvements in the cumulative charge-off history used for the general reserve determination, the reduction in adversely classified loans and the overall decrease in the size of the portfolio. Refer to the discussions under Provision

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

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.

Table of Contents

For the quarter ended September 30, 2012, the Corporation's non-interest income amounted to \$15.1 million, compared to \$14.0 million for the quarter ended September 30, 2011. The increase in non-interest income was mainly due to \$3.1 million of interchange and other fees related to the credit cards portfolio acquired and a decrease of \$2.2 million in equity in losses of unconsolidated entities. Revenues from mortgage banking activities also showed an increase of \$1.1 million. These variances were partially offset by the impact in the prior year of a \$3.5 million gain recorded in connection with certain Puerto Rico Housing Finance Authority bonds held by the corporation that were exchanged for cash as part of a tender offer.

Non-interest expenses for the third quarter of 2012 amounted to \$91.8 million, compared to \$82.9 million for the same period in 2011. The increase of \$8.9 million was mainly related to a \$3.7 million increase in losses on real estate owned operations, a \$3.0 million increase in servicing and processing fees, mainly related to the servicing of the credit cards portfolio, a \$1.7 million increase in employee compensation and benefits, and higher marketing expenses including accrued expenses related to the credit cards portfolio rewards program. Partially offsetting this increase was a \$1.9 million decrease in the deposit insurance premium expense. Refer to the Non Interest Expenses discussion below for additional information.

For the third quarter of 2012, the Corporation recorded an income tax expense of \$0.8 million, compared to \$2.9 million for the same period in 2011. The variance is mainly due to lower taxable income from profitable subsidiaries. Refer to the Income Taxes discussion below for additional information.

Total assets as of September 30, 2012 amounted to \$13.1 billion, an increase of \$12.5 million compared to total assets as of December 31, 2011. The increase is attributable to a higher liquidity obtained, in part, through Federal Home Loan Bank (FHLB) advances and increases in non-brokered deposits. Cash and cash equivalents increased by \$557.2 million, offset by a reduction in loans and investment securities. The available for sale investment securities decreased by \$325.4 million driven by matured U.S. Treasury and agency debt securities and Puerto Rico Government Obligations called prior to their contractual maturity, partially offset by purchases of U.S. agency mortgage-backed securities (MBS). Additionally, the loan portfolio decreased by \$270.3 million, led by pay-offs and repayments of commercial and industrial (C&I) loans, as well as foreclosures and charge-offs. The REO portfolio increased by \$62.7 million. Refer to the Financial Condition and Operating Data discussion below for additional information.

As of September 30, 2012, total liabilities amounted to \$11.66 billion, a decrease of approximately \$27.5 million, as compared to \$11.68 billion as of December 31, 2011. The decline in total liabilities is mainly attributable to a decrease of \$323.1 million in brokered CDs. In addition, the Corporation repaid \$100 million of maturing repurchase agreements, and all of its \$21 million of medium-term notes. These variances were partially offset by a \$311.8 million increase in non-brokered deposits and a \$151 million increase in FHLB advances. Refer to the Risk Management Liquidity and Capital Adequacy discussion below for additional information about the Corporation's funding sources.

The Corporation's stockholders' equity amounted to \$1.5 billion as of September 30, 2012, an increase of \$40.0 million from December 31, 2011, driven by a \$23.3 million increase in other comprehensive income due to higher unrealized gains on available for sale securities, net income of \$15.2 million for the first nine months of 2012, and net proceeds of \$1.0 million related to 280,787 shares of common stock sold. Refer to the Risk Management Capital section below for additional information.

Total loan production, including purchases, refinancing and draws from existing revolving and non-revolving commitments, for the quarter ended September 30, 2012 was \$660.2 million, excluding the utilization activity on outstanding credit cards, compared to \$763 million for the comparable period in 2011. The decrease in loan production is mainly related to government loan originations that decreased \$218 million, partially offset by an increased volume of auto and residential mortgage loan originations.

Total non-performing loans as of September 30, 2012 were \$1.0 billion, a decrease of \$135.1 million compared to December 31, 2011. The decrease was primarily related to foreclosures of construction projects, charge-offs, and a decrease in the inflows of non-performing loans. Total non-performing assets decreased by \$78.0 million during the nine-month period ended September 30,

2012. Refer to the Risk Management Non-accruing and Non-performing Assets section below for additional information.

CRITICAL ACCOUNTING POLICIES AND PRACTICES

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

Table of Contents

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 2011 Annual Report on Form 10-K. There have not been any material changes in the Corporation's critical accounting policies since December 31, 2011. On May 30, 2012, the Corporation purchased an approximate \$406 million credit cards portfolio, of which a portion were purchased credit impaired loans. Refer to Financial Condition and Operating Data Analysis-Loan Portfolio-Consumer Loans and Finance Leases below, and Note 6 to the accompanying unaudited consolidated financial statements for additional information about this transaction, including the accounting and reporting policies related to this portfolio.

RESULTS OF OPERATIONS**Net Interest Income**

Net interest income is the excess of interest earned by First BanCorp. on its interest-earning assets over the interest incurred on its interest-bearing liabilities. First BanCorp.'s net interest income is subject to interest rate risk due to the re-pricing and maturity mismatch of the Corporation's assets and liabilities. Net interest income for the quarter and nine-month period ended September 30, 2012 was \$125.5 million and \$336.1 million, respectively, compared to \$94.3 million and \$295.0 million for the comparable periods in 2011. On a tax-equivalent basis and excluding the changes in the fair value of derivative instruments and unrealized gains and losses on liabilities measured at fair value, net interest income for the quarter and nine-month period ended September 30, 2012 was \$126.8 million and \$340.0 million, respectively, compared to \$98.3 million and \$304.3 million for the comparable periods of 2011.

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

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

Part I

Quarter ended September 30, (Dollars in thousands)	Average Volume		Interest income (⁽¹⁾ / expense		Average Rate (⁽¹⁾)	
	2012	2011	2012	2011	2012	2011
(Dollars in thousands)						
Interest-earning assets:						
Money market & other short-term investments	\$ 553,283	\$ 482,057	\$ 395	\$ 325	0.28%	0.27%
Government obligations ⁽²⁾	336,598	1,273,109	1,069	4,646	1.26%	1.45%
Mortgage-backed securities	1,313,353	988,900	10,705	8,771	3.24%	3.52%
Corporate bonds	959	2,000	16	29	6.64%	5.75%
FHLB stock	33,131	40,265	318	396	3.82%	3.90%
Equity securities	1,377	1,377			0.00%	0.00%
Total investments ⁽³⁾	2,238,701	2,787,708	12,503	14,167	2.22%	2.02%
Residential mortgage loans	2,815,261	2,825,394	37,897	38,822	5.36%	5.45%
Construction loans	365,656	526,383	2,480	3,418	2.70%	2.58%
C&I and commercial mortgage loans	5,151,641	5,887,610	52,514	60,332	4.06%	4.07%
Finance leases	237,986	258,139	5,222	5,385	8.73%	8.28%
Consumer loans	1,727,291	1,334,900	57,641	38,893	13.28%	11.56%
Total loans ^{(4) (5)}	10,297,835	10,832,426	155,754	146,850	6.02%	5.38%

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

Total interest-earning assets	\$ 12,536,536	\$ 13,620,134	\$ 168,257	\$ 161,017	5.34%	4.69%
Interest-bearing liabilities:						
Brokered CDs	\$ 3,400,984	\$ 4,887,851	\$ 15,435	\$ 26,286	1.81%	2.13%
Other interest-bearing deposits	5,589,449	5,308,927	14,516	19,855	1.03%	1.48%
Other borrowed funds	1,131,959	1,336,508	8,557	12,750	3.01%	3.78%
FHLB advances	395,777	411,168	2,953	3,795	2.97%	3.66%
Total interest-bearing liabilities ⁽⁶⁾	\$ 10,518,169	\$ 11,944,454	\$ 41,461	\$ 62,686	1.57%	2.08%
Net interest income			\$ 126,796	\$ 98,331		
Interest rate spread					3.77%	2.61%
Net interest margin					4.02%	2.86%

Table of Contents

Nine-Month Period Ended September 30, (Dollars in thousands)	Average Volume		Interest income (⁽¹⁾) / expense		Average Rate (⁽¹⁾)	
	2012	2011	2012	2011	2012	2011
Interest-earning assets:						
Money market & other short-term investments	\$ 570,639	\$ 509,488	\$ 1,220	\$ 1,034	0.29%	0.27%
Government obligations ⁽²⁾	655,056	1,482,025	8,238	17,049	1.68%	1.54%
Mortgage-backed securities	1,099,082	1,265,491	26,506	36,336	3.22%	3.84%
Corporate bonds	1,609	2,000	76	87	6.31%	5.82%
FHLB stock	34,057	45,512	1,072	1,561	4.20%	4.59%
Equity securities	1,377	1,377		1	0.00%	0.10%
Total investments ⁽³⁾	2,361,820	3,305,893	37,112	56,068	2.10%	2.27%
Residential mortgage loans	2,796,850	2,991,200	113,459	126,837	5.42%	5.67%
Construction loans	399,078	664,889	7,695	14,063	2.58%	2.83%
C&I and commercial mortgage loans	5,358,916	5,869,011	163,478	177,444	4.07%	4.04%
Finance leases	240,415	268,124	15,760	16,649	8.76%	8.30%
Consumer loans	1,494,873	1,371,146	139,588	118,935	12.47%	11.60%
Total loans ^{(4) (5)}	10,290,132	11,164,370	439,980	453,928	5.71%	5.44%
Total interest-earning assets	\$ 12,651,952	\$ 14,470,263	\$ 477,092	\$ 509,996	5.04%	4.71%
Interest-bearing liabilities:						
Brokered CDs	\$ 3,503,304	\$ 5,481,742	\$ 52,971	\$ 88,751	2.02%	2.16%
Other interest-bearing deposits	5,550,100	5,240,236	47,203	60,973	1.14%	1.56%
Other borrowed funds	1,184,930	1,528,747	27,743	43,234	3.13%	3.78%
FHLB advances	368,137	493,107	9,222	12,760	3.35%	3.46%
Total interest-bearing liabilities ⁽⁶⁾	\$ 10,606,471	\$ 12,743,832	\$ 137,139	\$ 205,718	1.73%	2.16%
Net interest income			\$ 339,953	\$ 304,278		
Interest rate spread					3.31%	2.55%
Net interest margin					3.59%	2.81%

(1) On an adjusted tax-equivalent basis. The adjusted tax-equivalent yield was estimated by dividing the interest rate spread on exempt assets by 1 less Puerto Rico statutory tax rate (30.0% for 2012; 30% for the Corporation's subsidiaries other than IBEs and 25% for the Corporation's IBEs in 2011) and adding to it the cost of interest-bearing liabilities. The tax-equivalent adjustment recognizes the income tax savings when comparing taxable and tax-exempt assets. Management believes that it is a standard practice in the banking industry to present net interest income, interest rate spread and net interest margin on a fully tax-equivalent basis. Therefore, management believes these measures provide useful information to investors by allowing them to make peer comparisons. Changes in the fair value of derivative and unrealized gains or losses on liabilities measured at fair value are excluded from interest income and interest expense because the changes in valuation do not affect interest paid or received.

(2) Government obligations include debt issued by government sponsored agencies.

(3) Unrealized gains and losses in available-for-sale securities are excluded from the average volumes.

(4) Average loan balances include the average of non-performing loans.

(5) Interest income on loans includes \$3.7 million and \$2.5 million for the quarters ended September 30, 2012 and 2011, respectively, and \$9.0 million and \$7.2 million for the nine-month periods ended September 30, 2012 and 2011, respectively, of income from prepayment penalties and late fees related to the Corporation's loan portfolio.

- (6) Unrealized gains and losses on liabilities measured at fair value are excluded from the average volumes.

Table of Contents**Part II**

(In thousands)	Quarter ended September 30, 2012 compared to 2011			Nine-Month Period Ended September 30, 2012 compared to 2011		
	Increase (decrease)			Increase (decrease)		
	Volume	Due to:		Volume	Due to:	
		Rate	Total		Rate	Total
	(In thousands)		(In thousands)			
Interest income on interest-earning assets:						
Money market & other short-term investments	\$ 49	\$ 21	\$ 70	\$ 129	\$ 57	\$ 186
Government obligations	(3,049)	(528)	(3,577)	(9,963)	1,152	(8,811)
Mortgage-backed securities	2,736	(802)	1,934	(4,421)	(5,409)	(9,830)
Corporate bonds	(16)	3	(13)	(18)	7	(11)
FHLB stock	(70)	(8)	(78)	(368)	(121)	(489)
Equity securities					(1)	(1)
Total investments	(350)	(1,314)	(1,664)	(14,641)	(4,315)	(18,956)
Residential mortgage loans	(156)	(769)	(925)	(7,962)	(5,416)	(13,378)
Construction loans	(1,067)	129	(938)	(5,206)	(1,162)	(6,368)
C&I and commercial mortgage loans	(7,664)	(154)	(7,818)	(15,432)	1,466	(13,966)
Finance leases	(436)	273	(163)	(1,764)	875	(889)
Consumer loans	12,456	6,292	18,748	11,243	9,410	20,653
Total loans	3,133	5,771	8,904	(19,121)	5,173	(13,948)
Total interest income	2,783	4,457	7,240	(33,762)	858	(32,904)
Interest expense on interest-bearing liabilities:						
Brokered CDs	(7,207)	(3,644)	(10,851)	(30,181)	(5,599)	(35,780)
Other interest-bearing deposits	841	(6,180)	(5,339)	3,168	(16,938)	(13,770)
Other borrowed funds	(1,790)	(2,403)	(4,193)	(8,759)	(6,732)	(15,491)
FHLB advances	(139)	(703)	(842)	(3,132)	(406)	(3,538)
Total interest expense	(8,295)	(12,930)	(21,225)	(38,904)	(29,675)	(68,579)
Change in net interest income	\$ 11,078	\$ 17,387	\$ 28,465	\$ 5,142	\$ 30,533	\$ 35,675

Portions of the Corporation's interest-earning assets, mostly investments in obligations of some U.S. Government agencies and sponsored entities, generate interest which is exempt from income tax, principally in Puerto Rico. Also, interest and gains on sales of investments held by the Corporation's international banking entities are tax-exempt under the Puerto Rico tax law, except for a temporary 5% tax rate imposed by the Puerto Rico Government on IBEs' net income effective for years that commenced after December 31, 2008 and before January 1, 2012 (refer to the Income Taxes discussion below for additional information). To facilitate the comparison of all interest data related to these assets, the interest income has been converted to an adjusted taxable equivalent basis. The tax equivalent yield was estimated by dividing the interest rate spread on exempt assets by 1 less the Puerto Rico statutory tax rate as adjusted for changes to enacted tax rates (30.0% for 2012; 30% for the Corporation's subsidiaries other than IBEs and 25.0% for the Corporation's IBEs in 2011) and adding to it the average cost of interest-bearing liabilities. The computation considers the interest expense disallowance required by Puerto Rico tax law. Refer to the Income Taxes discussion below for additional information of the Puerto Rico tax law.

Table of Contents

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

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

(Dollars in thousands)

	Quarter Ended		Nine-Month Period Ended	
	September 30, 2012	September 30, 2011	September 30, 2012	September 30, 2011
Interest Income - GAAP	\$ 166,964	\$ 158,542	\$ 472,723	\$ 502,863
Unrealized loss (gain) on derivative instruments	(170)	954	(469)	1,794
Interest income excluding valuations	166,794	159,496	472,254	504,657
Tax-equivalent adjustment	1,463	1,521	4,838	5,339
Interest income on a tax-equivalent basis excluding valuations	168,257	161,017	477,092	509,996
Interest Expense - GAAP	41,461	64,287	136,649	207,894
Unrealized gain (loss) on derivative instruments and liabilities measured at fair value		(1,601)	490	(2,176)
Interest expense excluding valuations	41,461	62,686	137,139	205,718
Net interest income - GAAP	\$ 125,503	\$ 94,255	\$ 336,074	\$ 294,969
Net interest income excluding valuations	\$ 125,333	\$ 96,810	\$ 335,115	\$ 298,939
Net interest income on a tax-equivalent basis excluding valuations	\$ 126,796	\$ 98,331	\$ 339,953	\$ 304,278
Average Balances				
Loans and leases	\$ 10,297,835	\$ 10,832,426	\$ 10,290,132	\$ 11,164,370
Total securities and other short-term investments	2,238,701	2,787,708	2,361,820	3,305,893
Average Interest-Earning Assets	\$ 12,536,536	\$ 13,620,134	\$ 12,651,952	\$ 14,470,263
Average Interest-Bearing Liabilities	\$ 10,518,169	\$ 11,944,454	\$ 10,606,471	\$ 12,743,832
Average Yield/Rate				
Average yield on interest-earning assets - GAAP	5.30 %	4.62 %	4.99 %	4.65 %
Average rate on interest-bearing liabilities - GAAP	1.57 %	2.14 %	1.72 %	2.18 %
Net interest spread - GAAP	3.73 %	2.48 %	3.27 %	2.47 %

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

Net interest margin - GAAP	3.98 %	2.75 %	3.55 %	2.73 %
Average yield on interest-earning assets excluding valuations	5.29 %	4.65 %	4.99 %	4.66 %
Average rate on interest-bearing liabilities excluding valuations	1.57 %	2.08 %	1.73 %	2.16 %
Net interest spread excluding valuations	3.72 %	2.57 %	3.26 %	2.50 %
Net interest margin excluding valuations	3.98 %	2.82 %	3.54 %	2.76 %
Average yield on interest-earning assets on a tax-equivalent basis and excluding valuations	5.34 %	4.69 %	5.04 %	4.71 %
Average rate on interest-bearing liabilities excluding valuations	1.57 %	2.08 %	1.73 %	2.16 %
Net interest spread on a tax-equivalent basis and excluding valuations	3.77 %	2.61 %	3.31 %	2.55 %
Net interest margin on a tax-equivalent basis and excluding valuations	4.02 %	2.86 %	3.59 %	2.81 %

The following table summarizes the components of the net unrealized gain and loss on derivatives (economic undesignated hedges) and net unrealized gain and loss on liabilities measured at fair value which are included in interest expense:

	Quarter ended		Nine-Month Period Ended	
	September 30, 2012	September 30, 2011	September 30, 2012	September 30, 2011
Unrealized loss on derivatives (economic undesignated hedges):				
Options on stock index notes	\$	\$ (40)	\$	\$ 7
Unrealized (gain) loss on liabilities measured at fair value:				
Unrealized (gain) loss on medium-term notes		1,641	(490)	2,169
Net unrealized (gain) loss on derivatives (economic undesignated hedges) and liabilities measured at fair value	\$	\$ 1,601	\$ (490)	\$ 2,176

Table of Contents

Interest income on interest-earning assets primarily represents interest earned on loans receivable and investment securities.

Interest expense on interest-bearing liabilities primarily represents interest paid on brokered CDs, branch-based deposits, repurchase agreements, advances from the FHLB and FED and notes payable.

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

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

Derivative instruments, such as interest rate swaps, are subject to market risk. While the Corporation does have certain trading derivatives to facilitate customer transactions, the Corporation does not utilize derivative instruments for speculative purposes. As of September 30, 2012, most of the interest rate swaps outstanding are used for protection against rising interest rates. Refer to Note 9 of the accompanying unaudited consolidated financial statements for further details concerning the notional amounts of derivative instruments and additional information. As is the case with investment securities, the market value of derivative instruments is largely a function of the financial market's expectations regarding the future direction of interest rates. Accordingly, current market values are not necessarily indicative of the future impact of derivative instruments on net interest income. This will depend, for the most part, on the shape of the yield curve, the level of interest rates, as well as the expectations for rates in the future.

Net interest income increased 33% to \$125.5 million for the third quarter of 2012 from \$94.3 million in the third quarter of 2011, and by 14% to \$336.1 million for the first nine months of 2012 from \$295.0 million for the first nine months of 2011. The increase was primarily driven by an increase in the net interest margin resulting from a reduction in the average cost of funds and interest income contributed by the recently acquired credit cards portfolio.

For the quarter and nine-months period ended September 30, 2012, the net interest margin, excluding valuations, improved by 116 and 78 basis points, respectively, when compared to the same periods in 2011. The improvement in the net interest margin was mainly derived from improved deposit pricing, an improved deposit mix, renewals of maturing brokered CDs at lower current rates, and funding cost reductions resulting from the re-structuring of repurchase agreements and maturities of high cost borrowings. The Corporation reduced the average cost of funds by lowering the rates paid on certain of its savings, interest-bearing checking accounts and retail CDs. The average rate paid on non-brokered deposits declined by 45 and 42 basis points during the third quarter and first nine months of 2012, or a reduction of approximately \$5.3 million and \$13.8 million, respectively, in interest expense. The Corporation continued with its planned reduction of brokered CDs, which decreased by \$1.5 billion and \$2.0 billion in average balances for the quarter and nine-month period ended September 30, 2012, compared to the same periods in 2011. The average cost of brokered CDs decreased by 32 and 14 basis points during the third quarter and first nine months of 2012, compared to the same period in 2011. Over the past 12 months, the Corporation repaid approximately \$2.9 billion of maturing brokered CDs with an all-in cost of 1.91% and new issuance amounted to \$1.8 billion with an all-in cost of 0.87%. Also, the Corporation benefited from the restructuring of \$900 million of repurchase agreements during the second half of 2011 and first quarter of 2012, which resulted in a reduction of \$2.0 million and \$7.0 million in interest expense when compared to the third quarter and first nine months of 2011, respectively. Further reductions in interest expense were achieved as the Corporation has repaid same high-cost borrowings such as \$100 million of repurchase agreements and \$21 million of medium-term notes over the last 12 months. Finally improvements in the cost of funds were also attributed to approximately \$191 million of FHLB advances with an average cost of 3.33% that matured over the last 12 months. The corporation entered into \$300 million of long-term FHLB advances during the third quarter with an average cost of 1.11%.

Also contributing to the improvement in net interest income and margin was additional interest income of \$18.6 million and \$24.8 million for the quarter and nine month period ended September 30, 2012, respectively, from the credit cards portfolio purchased late in May, 2012. This purchase increased the average volume of consumer loans by approximately \$366.9 million and \$164.9 million for the quarter and nine-month period ended on September 30, 2012, respectively. Partially offsetting these increases was a decline in the volume of interest-earning assets reflecting the execution in 2011 of deleveraging strategies included in the Corporation's capital plan in order to preserve and improve the capital position. Average interest-earning assets decreased by \$1.1 billion and \$1.8 billion when compared to the third quarter and nine-month period ended September 30, 2011, respectively, reflecting a \$534.6 million and \$874.2 million reduction in average total loans and leases for the quarter and nine-month period ended September 30, 2012, respectively, and a \$549.0 million and \$944.0 million reduction in average investment securities in the quarter and nine-month period ended September 30, 2012, compared to the respective periods in 2011. The decrease in average loans was driven by significant repayments of commercial credit facilities, foreclosures and charge-offs. The decrease in the average volume of investment securities mainly relates to sales of U.S. agency MBS completed throughout 2011, maturities of U.S. Treasury and agency debt securities and Puerto Rico Government securities called before their contractual maturities. Proceeds from sale, repayments and calls of loans and securities have been used, in part, to reduce maturing brokered CDs, repurchase agreements, advances from FHLB and notes payable.

Table of Contents

On an adjusted tax-equivalent basis, net interest income increased by \$28.5 million, or 29%, for the third quarter of 2012 compared to the same period in 2011, and by \$35.7 million, or 12%, for the first nine months of 2012 compared to the first nine months of 2011, mainly due to reductions in the overall cost of funding and the contribution of the recently acquired credit cards portfolio, as discussed above. The tax-equivalent adjustment decreased by \$0.1 million and \$0.5 million for the quarter and first nine month of 2012 respectively, as compared to the same period in 2011. The tax-equivalent adjustment increases interest income on tax-exempt securities and loans by an amount which makes tax-exempt income comparable, on a pre-tax basis, to the Corporation's taxable income as previously stated.

Provision and Allowance for Loan and Lease Losses

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

For the quarter and nine-month period ended on September 30, 2012, the Corporation recorded a provision for loan and lease losses of \$29.0 million and \$90.0 million, respectively, compared to \$46.4 million and \$194.4 million, for the comparable periods in 2011. The decline in the provision for the third quarter of 2012, as compared to the third quarter of 2011, was primarily related to the commercial mortgage loan portfolio, mainly in the United States, driven by improved trends in charge-offs, the decrease in the amount of adversely classified loans and the overall reduction of the size of this portfolio. For the nine month period ended on September 30, 2012, a lower provision was reflected in all major loan categories, except for consumer loans, due to reduced charges to the specific reserve of certain collateral dependent loans, the overall decrease in the size of the portfolios and the improvement in the cumulative charge-off history used for the general reserve determination. The allowance coverage for the non-impaired portfolio (general reserve) is determined using a methodology that incorporates loss rates and risk rating by loan category. Loss rates are based on the moving average of charge-off over a historical 24-month loss period, applying adjustments, as necessary, to each loss rate based on assessments of recent charge-off trends (12-months), collateral values, and economic and business influences impacting expected losses.

In terms of geography and categories, in Puerto Rico, the Corporation recorded a provision of \$26.3 million and \$88.6 million for the third quarter and first nine months of 2012, respectively, compared to of \$32.1 million and \$147.4 million for the comparable periods in 2011. The decrease for the third quarter of 2012, compared to the same period in 2011, primarily reflects decreases in the provision for residential and commercial mortgage loans, mainly due to improved charge-offs trends and in the case of commercial mortgage loans also due to a lower migration of loans to impaired status and the reduction in the size of the portfolio. The reduction for the nine month period ended on September 30, 2012, compared to the same periods in 2011, was mainly due to the decrease in the inflows of loans to impaired status, thus, lower charges to specific reserves were required; the reduction in the size of these portfolios and; the improvement in the cumulative charge-off history used for the general reserve determination. The provision for C&I loans decreased by \$37.6 million for the nine-month period ended September 30, 2012 and the provision for commercial mortgage loans decreased by \$26.0 million, for the nine-month period ended September 30, 2012, compared to the same period in 2011. Partially offsetting these decreases was an increase in the provision for consumer loans of \$4.3 million and \$11.0 million for the quarter and nine month period ended on September 30, 2012, compared to the same periods in 2011, mainly related to an allowance build for the credit cards portfolio.

With respect to the portfolio in the United States, the Corporation recorded a reserve release of \$6.9 million and \$12.2 million for the third quarter and first nine months of 2012, compared to a provision of \$5.4 million and \$15.5 million for the comparable periods in 2011. The decrease was mainly attributable to a reduction in the provision for commercial mortgage loans by \$10.3 million and \$11.1 million, for the quarter and nine-month period ended September 30, 2012, respectively, driven by improved charge-off trends, the reduction in the amount of adversely classified loans and stability in collateral values. The provision for residential mortgage loans decreased by \$0.9 million and \$10.9 million for the third quarter and first nine months of 2012, respectively, when compared to the provision recorded in the comparable periods in 2011. Reductions in net charge-offs and certain stabilization in the expectations of loss severities for this portfolio also contributed to the decrease in the provision.

The Virgin Islands region recorded an increase of \$0.6 million and a decrease of \$17.7 million in the provision for loan losses in the third quarter and first nine months of 2012, compared to 2011, mainly related to an increase of \$0.3 million and a decrease of \$17.8 million, respectively, in the provision for construction loans. The decrease for the first nine months of 2012, compared to 2011, was substantially related to the provision charged in 2011 to a construction loan relationship placed in non-accrual status early in 2011.

Table of Contents

Refer to the discussions under **Credit Risk Management** below for an analysis of the allowance for loan and lease losses, non-performing assets, impaired loans and related information, and refer to the discussions under **Financial Condition and Operating Analysis** **Loan Portfolio** and under **Risk Management** **Credit Risk Management** below for additional information concerning the Corporation's loan portfolio exposure in the geographic areas where the Corporation does business.

Non-Interest Income

	Quarter Ended		Nine-Month Period Ended	
	September 30,	September 30,	September 30,	September 30,
	2012	2011	2012	2011
	(In thousands)			
Service charges on deposit accounts	\$ 3,267	\$ 3,098	\$ 9,754	\$ 9,484
Other service charges	1,098	1,485	3,843	4,659
Mortgage banking activities	4,728	3,676	13,260	19,603
Insurance income	1,429	1,058	4,221	3,454
Broker-dealer income	20	173	2,630	1,004
Other operating income	7,330	5,687	16,738	18,996
Non-interest income before net gain on investments, loss on early extinguishment of borrowings and equity in losses of unconsolidated entities	17,872	15,177	50,446	57,200
Proceeds from securities litigation settlement and other proceeds	10		36	679
Net gain on sale of investments		12,506		53,117
OTTI on debt securities	(557)	(350)	(1,933)	(957)
Net (loss) gain on investments	(547)	12,156	(1,897)	52,839
Loss on early extinguishment of borrowings		(9,012)		(10,835)
Equity in losses of unconsolidated entities	(2,199)	(4,357)	(10,926)	(5,893)
Total	\$ 15,126	\$ 13,964	\$ 37,623	\$ 93,311

Non-interest income primarily consists of other service charges on loans; service charges on deposit accounts; commissions derived from various banking, securities and insurance activities; gains and losses on mortgage banking activities; 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 and other fees on deposit accounts.

Other service charges consist mainly of other non-deferrable fees (e.g. agent, commitment, and drawing fees) generated from lending activities.

Income from mortgage banking activities includes gains on sales and securitizations of loans and revenues earned for administering residential mortgage loans originated by the Corporation and subsequently sold with servicing retained. In addition, lower-of-cost-or-market valuation adjustments to the Corporation's residential mortgage loans held for sale portfolio and servicing rights 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.

Broker-dealer income consists of commissions earned by the Corporation's subsidiary, FirstBank Puerto Rico Securities.

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

The other operating income category is composed of miscellaneous fees such as debit, credit card and point of sale (POS) interchange fees and check and cash management fees and includes commissions from the Corporation's broker-dealer subsidiary, FirstBank Puerto Rico Securities.

The net gain (loss) on investment securities reflects gains or losses as a result of sales that are consistent with the Corporation's investment policies as well as OTTI charges on the Corporation's investment portfolio.

Equity in earnings (losses) of unconsolidated entities is related to the FirstBank's investment in CPG/GS, the entity that purchased \$269 million of loans from FirstBank during the first quarter of 2011. The Bank holds a 35% subordinated ownership interest in CPG/GS. The majority owner of CPG/GS is entitled to recover its initial investment and a priority return of 12% prior to any return paid to the Bank. Accordingly, the Bank's investment of \$32.3 million in CPG/GS is at risk. Refer to Financial Condition and

Table of Contents

Operating Data Analysis Commercial and Construction Loans and to Note 11 of the Corporation's unaudited financial statements for the quarter ended September 30, 2012 for additional information about the Bank's investment in CPG/GS, including information about the determination of the initial value of the investment.

Non-interest income increased \$1.2 million to \$15.1 million for the third quarter of 2012, compared to the third quarter of 2011, primarily due to:

The impact of the credit cards portfolio acquisition that resulted in \$3.1 million of interchange and other related fees included as part of Other operating income in the table above.

A \$1.1 million increase in revenues from mortgage banking activities, driven by both a higher volume of loans sales and improved margins.

Non-cash charges of \$2.2 million related to FirstBank's equity interest in CPG/GS, compared to \$4.4 million in the third quarter of 2011, a positive variance of \$2.2 million.

Non-interest income in the third quarter of 2011 was also affected by a \$3.5 million gain attributable to a tender offer by the Puerto Rico Housing Finance Authority to purchase certain of its outstanding bonds. Bonds held by the Corporation with a book value of \$19.8 million were exchanged for cash as part of the tender offer and the difference between the cash received and the book value of such instruments was recorded as part of Net gain on sale of investments in the table above.

Non-interest income decreased by \$55.7 million for the first nine months of 2012, compared to the first nine months of 2011, primarily due to:

The impact in the first nine months of 2011 of a \$40.6 million gain on sales of investments, mainly MBS as part of the Corporation's deleveraging strategies executed in 2011 and the aforementioned impact in 2011 of the \$3.5 million gain recorded as part of a tender offer. In addition, the Corporation recorded other-than-temporary impairment charge (OTTI) on debt securities of \$1.9 million for the first nine months of 2012, while \$1.0 million was recognized in the first nine months of 2011.

Non-cash charge associated with the equity in losses of unconsolidated entities of approximately \$10.9 million recorded in the first nine months of 2012, compared to \$5.9 million recorded in the first nine months of 2011. This non-cash adjustment relates to the Bank's investment in CPG/GS and includes \$4.2 million in the first nine months of 2012 that represents the amortization of the basis differential.

A \$6.3 million decrease in mortgage banking activities driven by the impact in the previous year of \$12.1 million in gains recorded for completed bulk sales of approximately \$518 million of performing residential mortgage loans, this was partially offset by increases in gains from the Corporation's mortgage loan securitization activities and recoveries in the value of servicing assets during 2012.

The impact in 2011 of a \$2.8 million gain recorded on the sale of substantially all the assets of First Bank Insurance Agency, included as part of Other operating income in the table above.

The aforementioned factors were partially offset by \$4.2 million in Interchange and other related fees earned on the recently acquired credit cards portfolio and an increase of \$1.6 million in fees from the broker-dealer subsidiary, FirstBank Securities, mainly due to higher underwriting fees.

Non-Interest Expenses

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

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

	Quarter Ended September 30,		Nine-Month Period Ended September 30,	
	2012	2011	2012	2011
	(In thousands)			
Employees compensation and benefits	\$ 31,058	\$ 29,375	\$ 93,770	\$ 89,221
Occupancy and equipment	15,208	15,468	46,065	46,321
Insurance and supervisory fees	13,023	15,041	39,333	44,622
Taxes, other than income taxes	3,499	3,420	10,350	9,953
Professional fees	6,295	5,983	16,796	17,192
Servicing and processing fees	5,305	2,329	10,482	6,691
Business promotion	4,004	2,509	10,026	8,801
Communications	1,797	1,651	5,276	5,393
Net loss on REO and REO operations	8,686	4,952	18,915	16,423
Other	2,968	2,203	12,965	7,611
	\$ 91,843	\$ 82,931	\$ 263,978	\$ 252,228

Table of Contents

Non-interest expenses increased by \$8.9 million to \$91.8 million for the third quarter of 2012 from \$82.9 million for the third quarter of 2011. The increase was principally attributable to:

A \$3.7 million increase in losses from REO activities primarily reflecting losses on the sale of certain commercial REO, properties, higher write-downs and, increased tax expenses related to REO properties in addition to higher operating expenses commensurate with a higher inventory.

A \$3.0 million increase in servicing and processing fees, mainly related to the servicing of the recently acquired credit cards portfolio.

A \$1.7 million increase in employee compensation and benefits driven by the filling of vacant positions including several managerial and supervisory positions and higher incentive and stock-based compensation expenses.

A \$1.5 million increase in business promotion expenses, including higher marketing expenses and accrued expenses related to the credit cards portfolio rewards program.

The increases were partially offset by the following decreases:

A \$1.9 million decrease in the deposit insurance premium mainly resulting from the decrease in the Bank's average total assets and the Bank's improved capital position. This charge is included as part of Insurance and Supervisory fees in the table above.

Non-interest expenses increased \$11.8 million for the nine-month period ended September 30, 2012, compared to the first nine months of 2011, primarily due to:

A \$4.5 million increase in employee compensation and benefits mainly due to the filling of vacant positions including several managerial and supervisory positions and higher incentive and stock-based compensation expenses.

A \$4.5 million negative variance, related to the provision for unfunded commitments and letters of credit. Reserve releases of \$5.6 million were recorded in the first nine months of 2011, mainly related to non-performing construction loans, including loans sold to CPG/GS early in 2011, this is included as part of Other in the table above.

A \$3.8 million increase in servicing and processing fees, mainly related to the servicing of the recently acquired credit cards portfolio.

A \$2.5 million increase in losses from REO activities mainly related to higher operating expenses, including taxes, resulting from a higher inventory.

A \$2.5 million non-recurring charge associated with a contingency adjustment related to the collectability of certain tax credits, included as part of Other in the table above.

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

A \$1.2 million increase in business promotion expenses, mainly due to accrued expenses related to the credit cards portfolio rewards program.

These increases were partially offset by a \$5.6 million decrease in the deposit insurance premium mainly resulting from the decrease in the Bank's average assets and the Bank's improved capital position, and a decrease in write-downs to the value of non-real estate repossessed assets.

Table of Contents

Income Taxes

Income tax expense includes Puerto Rico and Virgin Islands income taxes as well as applicable U.S. federal and state taxes. The Corporation is subject to Puerto Rico income tax on its income from all sources. As a Puerto Rico corporation, First BanCorp. is treated as a foreign corporation for U.S. income tax purposes and is generally subject to United States income tax only on its income from sources within the United States or income effectively connected with the conduct of a trade or business within the United States. Any such tax paid is also creditable against the Corporation's Puerto Rico tax liability, subject to certain conditions and limitations.

On January 31, 2011, the Puerto Rico Government approved Act No. 1, which repealed the 1994 Code (1994 PR Code) and replaces it with the Puerto Rico Internal Revenue Code of 2011 (2011 PR Code). The provisions of the 2011 PR Code are generally applicable to taxable years commencing after December 31, 2010. Under 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, a particular subsidiary must be able to demonstrate sufficient taxable income within the applicable carry forward period (7 years under the 2011 PR Code, except for losses incurred during tax years commenced after December 31, 2004 and before December 31, 2012, that the carry forward period is extended to 10 years). The 2011 PR Code provides a dividend received deduction of 100% on dividends received from controlled subsidiaries subject to taxation in Puerto Rico and 85% on dividends received from other taxable domestic corporations. Dividend payments from a U.S. subsidiary to the Corporation are subject to a 10% withholding tax based on the provisions of the U.S. Internal Revenue Code.

Under the 2011 PR Code, First BanCorp. is subject to a maximum statutory tax rate of 30% (25% for taxable years commencing after December 31, 2013 if certain economic conditions are met by the Puerto Rico economy). The 2011 PR Code also includes an alternative minimum tax of 20% that applies if the Corporation's regular income tax liability is less than the alternative minimum tax requirements.

The Corporation has maintained an effective tax rate lower than the maximum statutory rate mainly by investing in government obligations and mortgage-backed securities exempt from U.S. and Puerto Rico income taxes and by doing business through the International Banking Entity (IBE) of the Bank and through the Bank's subsidiary, FirstBank Overseas Corporation, in which the interest income and gain on sales is exempt from Puerto Rico and U.S. income taxation except for tax years that commenced after December 31, 2008 and before January 1, 2012, for which a special 5% tax was imposed to all IBEs. The IBEs and FirstBank Overseas Corporation were created under the International Banking Entity Act of Puerto Rico, which provides for total Puerto Rico tax exemption on the net income derived from eligible activities by IBEs operating in Puerto Rico. IBEs that operate as a unit of a bank pay income taxes at normal rates to the extent that the IBEs' net income exceeds 20% of the bank's total net taxable income.

For the quarter and nine-month period ended September 30, 2012, the Corporation recorded an income tax expense of \$0.7 million and \$4.4 million, respectively, compared to an income tax expense of \$2.9 million and \$9.1 million for the same periods in 2011. The decrease is primarily due to lower taxable income from profitable subsidiaries and for the nine-month period was also driven by a reduction in deferred tax assets of profitable subsidiaries due to a reduction in statutory tax rates in 2011. The income tax in the interim financial statements is calculated based on the income of the individual subsidiaries and the currently valid tax rates as a best possible estimate. As of September 30, 2012 the deferred tax asset, net of a valuation allowance of \$360.0 million, amounted to \$4.6 million compared to \$5.4 million as of December 31, 2011.

Accounting for income taxes requires that companies assess whether a valuation allowance should be recorded against their deferred tax asset based on the consideration of all available evidence, using a more likely than not realization standard. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount that is more likely than not to be realized. In making such assessment, significant weight is to be given to evidence that can be objectively verified, including both positive and negative evidence. Consideration must be given to all sources of taxable income available to realize the deferred tax asset, including the future reversal of existing temporary differences, future taxable income exclusive of the reversal of temporary differences and carryforwards, taxable income in carryback years and tax planning strategies. In estimating taxes, management assesses the relative merits and risks of the appropriate tax treatment of transactions taking into account statutory, judicial and regulatory guidance, and recognizes tax benefits only when deemed probable of realization.

In assessing the weight of positive and negative evidence, a significant negative factor that resulted in the maintenance of the valuation allowance was that the Corporation's banking subsidiary, FirstBank Puerto Rico, continues in a three-year historical cumulative loss position as of September 30, 2012, mainly due to charges to the provision for loan and lease losses in prior years as a result of the economic downturn. As of September 30, 2012, management concluded that \$4.6 million of the deferred tax asset will be realized as it relates to profitable subsidiaries and to amounts that can be realized through future reversals of existing taxable temporary differences. To the extent the realization of

Table of Contents

a portion, or all, of the tax asset becomes more likely than not based on changes in circumstances (such as, improved earnings, changes in tax laws or other relevant changes), a reversal of that portion of the deferred tax asset valuation allowance will then be recorded.

The authoritative accounting guidance prescribes a comprehensive model for the financial statement recognition, measurement, presentation and disclosure of income tax uncertainties with respect to positions taken or expected to be taken on income tax returns. Under this guidance, income tax benefits are recognized and measured based upon a two-step model: 1) a tax position must be more likely than not to be sustained based solely on its technical merits in order to be recognized, and 2) the benefit is measured as the largest dollar amount of that position that is more likely than not to be sustained upon settlement. The difference between the benefit recognized in accordance with this model and the tax benefit claimed on a tax return is referred to as an unrecognized tax benefit (UTB).

During the third quarter of 2011, the Corporation recorded new UTBs of \$2.4 million, all of which would, if recognized, affect the Corporation's effective tax rate. The Corporation classified all interest and penalties, if any, related to tax uncertainties as income tax expense. As of September 30, 2012 the Corporation's accrued interest that relates to tax uncertainties amounted to \$1.1 million and there is no need to accrue for the payment of penalties. For the nine-month period ended September 30, 2012, the total amount of interest recognized by the Corporation as part of income tax expense related to tax uncertainties was \$0.2 million. During the first nine months of 2012 there was no change to the UTB of \$2.4 million. The amount of UTBs may increase or decrease for various reasons, including changes in the amounts for current tax year positions, the expiration of open income tax returns due to the expiration of statutes of limitations, changes in management's judgment about the level of uncertainty, the status of examinations, litigation and legislative activity and the addition or elimination of uncertain tax positions. The years 2007 through 2009 have been examined by the United States Internal Revenue Service (IRS) and disputed issues have been taken to administrative appeals. Although the timing of the resolution and/or closure of audits is highly uncertain, the Corporation believes it is reasonably possible that the IRS will conclude this audit within the next twelve months. If any issues addressed in the IRS audit are resolved in a manner not consistent with the Corporation's expectations, the Corporation could be required to adjust its provision for income taxes in the period such resolution occurs. The Corporation currently cannot reasonably estimate a range of possible changes to existing reserves.

The Corporation's liability for income taxes includes the liability for UTBs, and interest which relates to tax years still subject to review by taxing authorities. Audit periods remain open for review until the statute of limitations has passed. The statute of limitations under the PR Code is 4 years; and for Virgin Islands and U.S. income tax purposes is 3 years after a tax return is due or filed, whichever is later. The completion of an audit by the taxing authorities or the expiration of the statute of limitations for a given audit period could result in an adjustment to the Corporation's liability for income taxes. Any such adjustment could be material to results of operations for any given quarterly or annual period based, in part, upon the results of operations for the given period. For Puerto Rico and Virgin Islands income tax purposes, all tax years subsequent to 2009 remain open to examination. Taxable years from 2007 remain open to examination for U.S. income tax purpose.

FINANCIAL CONDITION AND OPERATING DATA ANALYSIS**Assets**

Total assets were approximately \$13.1 billion as of September 30, 2012, up \$12.5 million from December 31, 2011. The increase is attributable to a higher liquidity obtained, in part, through FHLB advances and increases in non-brokered deposits. Cash and cash equivalents increased by \$557.2 million offset by reductions in investment securities and loans. Total available for sale investment securities decreased by \$325.4 million primarily reflecting maturities of \$765 million of U.S. Treasury and agency debt securities, calls of \$194 million of Puerto Rico government obligations and MBS prepayments. The proceeds of calls and maturities of investments securities were reinvested mostly in purchases of \$713 million of U.S. agency MBS. Total loans, net of the allowance for loan and lease losses, decreased by \$270.3 million, led by repayments of commercial facilities, foreclosures and charge-offs. The reduction was primarily related to C&I loan repayments, including a \$233 million reduction in loans granted to governmental entities. These decreases were partially offset by the completion of the purchase of the FirstBank-branded credit cards portfolio of approximately \$406 million. Proceeds from loan and MBS repayments and calls of investment securities were used, in part, to repay high cost borrowings, including brokered CDs, repurchase agreements, advances from the FHLB, and medium-term notes. Other variances within the assets side include an increase of \$62.7 million in REO, mainly in connection with foreclosed construction projects in the Virgin Islands and Puerto Rico.

Table of Contents**Loan Portfolio**

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

(In thousands)	September 30, 2012	December 31, 2011
Residential mortgage loans	\$ 2,762,418	2,873,785
Commercial loans:		
Commercial mortgage loans	1,459,118	1,565,411
Construction loans	352,891	427,863
Commercial and Industrial loans	3,369,305	3,856,695
Loans to local financial institutions collateralized by real estate mortgages	258,341	273,821
Total commercial loans	5,439,655	6,123,790
Finance leases	239,556	247,003
Consumer loans	1,746,535	1,314,814
Total loans held for investment	10,188,164	10,559,392
Less:		
Allowance for loan and lease losses	(445,531)	(493,917)
Total loans held for investment, net	\$ 9,742,633	\$ 10,065,475
Loans held for sale	68,349	15,822
Total loans, net	\$ 9,810,982	\$ 10,081,297

As of September 30, 2012, the Corporation's total loans, net of allowance, decreased by \$270.3 million, when compared with the balance as of December 31, 2011. All major loan categories, excluding consumer loans, decreased from 2011 levels mainly as a result of pay-offs, repayments, foreclosures and charge-offs. The reduction was primarily related to C&I loan repayments, including a net reduction of \$233 million from loans to governmental entities and four relationships amounting to \$131.6 million paid-off, and a net reduction of \$117.2 million in facilities granted to CPG/GS.

Of the total gross loan portfolio held for investment of \$10.2 billion as of September 30, 2012 approximately 85% have credit risk concentration in Puerto Rico, 7% in the United States (mainly in the state of Florida) and 8% in the Virgin Islands, as shown in the following table:

As of September 30, 2012	Puerto Rico	Virgin Islands	Florida	Total
	(In thousands)			
Residential mortgage loans	\$ 2,100,210	\$ 386,016	\$ 276,192	\$ 2,762,418
Commercial loans:				
Construction loans	229,636	100,612	22,643	352,891
Commercial mortgage loans	1,024,694	63,419	371,005	1,459,118
Commercial and Industrial loans	3,127,447	204,116	37,742	3,369,305

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

Loans to local financial institutions collateralized by real estate mortgages	258,341			258,341
Total commercial loans	4,640,118	368,147	431,390	5,439,655
Finance leases	239,556			239,556
Consumer loans	1,661,497	52,940	32,098	1,746,535
Total loans held for investment, gross	8,641,381	807,103	739,680	10,188,164
Allowance for loans and lease losses	(374,582)	(26,575)	(44,374)	(445,531)
Total loans held for investment, net	8,266,799	780,528	695,306	9,742,633
Loans held for sale	64,037	4,312		68,349
Total loans	\$ 8,330,836	784,840	695,306	9,810,982

Loan Production

First BanCorp relies primarily on its retail network of branches to originate residential and consumer loans. The Corporation supplements its residential mortgage originations with wholesale servicing released mortgage loan purchases from mortgage bankers. The Corporation manages its construction and commercial loan originations through centralized units and most of its originations come from existing customers as well as through referrals and direct solicitations.

Table of Contents

The following table details First BanCorp's loan production, including purchases, refinancings, and draws from existing revolving and non-revolving commitments for the periods indicated:

	Quarter Ended		Nine-Month Period Ended	
	September 30, 2012	September 30, 2011	September 30, 2012	September 30, 2011
	(In thousands)			
Residential real estate	\$ 187,035	\$ 147,841	\$ 542,437	\$ 403,048
C&I and commercial mortgage	252,572	441,488	880,380	1,126,223
Construction	11,689	25,267	38,073	79,661
Finance leases	23,934	20,827	71,337	62,373
Consumer	279,931	127,873	629,939	351,782
Total loan production	\$ 755,161	\$ 763,296	\$ 2,162,166	\$ 2,023,087

The Corporation is experiencing continued loan demand and has continued with its targeted originations strategies. During the third quarter and nine month period ended on September 30, 2012 total loan originations, including refinancings and draws from existing commitments, amounted to approximately \$755.2 million and \$2.2 billion, respectively, compared to \$763.3 million and \$2.0 billion, respectively, for the comparable periods in 2011. The decrease for the third quarter of 2012, compared to 2011, was mainly related to government loan originations that decreased \$218 million, partially offset by an increased volume of auto and residential mortgage loan originations. The increase for the nine month period is primarily related to an increase in residential mortgage loan originations and purchases. Consumer loan originations, including finance leases, increased by \$155.2 million and \$287.1 million for the quarter and nine month period ended September 30, 2012, compared to the same period in 2011, and include \$95.0 million for the third quarter and \$129.2 million for the first nine months of 2012 related to the utilization activity on outstanding credit cards. Originations of auto loans (including finance leases) amounted to \$151.2 million and \$414.0 million for the third quarter and the nine-month period ended on September 30, 2012, respectively, compared to \$104.1 million and \$299.7 million closed for the comparable periods in 2011. Loan production statistics exclude the purchase of the \$406 million credit cards portfolio acquired in the second quarter of 2012.

Residential Real Estate Loans

As of September 30, 2012, the Corporation's residential real estate loan portfolio held for investment decreased by \$111.4 million as compared to the balance as of December 31, 2011, reflecting sales of \$156.3 million of loans to FNMA and FHLMC, foreclosures of \$42.9 million, charge-offs and principal repayments, partially offset by loan originations during the period. The majority of the Corporation's outstanding balance of residential mortgage loans consists of fixed-rate, fully amortizing, full documentation loans. In accordance with the Corporation's underwriting guidelines, residential real estate loans are mostly fully documented loans, and the Corporation is not actively involved in the origination of negative amortization loans, non-materially involved in adjustable-rate mortgage loans. Refer to the Contractual Obligations and Commitments discussion below for additional information about outstanding commitments to sell mortgage loans.

Commercial and Construction Loans

As of September 30, 2012, the Corporation's commercial and construction loan portfolio held for investment decreased by \$684.1 million, as compared to the balance as of December 31, 2011. The reduction was primarily related to C&I and commercial mortgage loans repayments, in both geographic segments, Puerto Rico and the United States, including four relationships amounting to \$131.6 million paid-off, a net reduction of \$233.0 million in loans granted to governmental entities and a \$117.2 million reduction in facilities granted to CPG/GS. Additionally, the construction loan portfolio decrease of \$75.0 million was led by the foreclosure of the underlying collateral of two commercial projects in the Virgin Islands with an aggregate book value of \$16.8 million (net of charge-offs of \$4.9 million at the time of foreclosure), the in-substance foreclosure of two projects in Puerto Rico amounting to \$16 million in the aggregate, and \$22.7 million of charge-offs against one relationship in the Virgin Islands. The Corporation's commercial loans are primarily variable- and adjustable-rate loans.

As of September 30, 2012, the Corporation had \$148.7 million outstanding in credit facilities granted to the Puerto Rico Government and/or its political subdivisions, down from \$360.1 million as of December 31, 2011, and \$117.7 million granted to the Government of the Virgin Islands, down from \$139.4 million as of December 31, 2011. A substantial portion of these credit facilities consist of loans to municipalities in Puerto Rico for which the good faith, credit and unlimited taxing power of the applicable municipality have been pledged to their repayment. Another portion of these obligations consists of loans to public corporations that obtain revenues from rates charged for services or products, such as

electric power and water utilities. Public corporations have varying degrees of independence from the central Government and many receive appropriations or other payments from it.

Table of Contents

In addition to loans extended to government entities, the largest loan to one borrower as of September 30, 2012 in the amount of \$258.3 million is with one mortgage originator in Puerto Rico, Doral Financial Corporation. This commercial loan is secured by individual real-estate loans, mostly 1-4 residential mortgage loans.

Construction loans originations decreased by \$13.6 million and \$41.6 million for the quarter and nine-month period ended on September 30, 2012, respectively, when compared to the same periods in 2011, due to the strategic decision by the Corporation to reduce its exposure to construction projects in both Puerto Rico and the United States. The Corporation has significantly reduced its exposure to construction loans in its Florida operations and construction loan originations in Puerto Rico are mainly draws from existing commitments. More than 88% of the construction loan originations in 2012 are related to disbursements from previous established commitments.

The composition of the Corporation's construction loan portfolio held for investment as of September 30, 2012 by category and geographic location follows:

As of September 30, 2012	Puerto Rico	Virgin Islands (In thousands)	Florida	Total
Loans for residential housing projects:				
High-rise ⁽¹⁾	\$ 5,158	\$	\$	\$ 5,158
Mid-rise ⁽²⁾	31,627	4,905	37	36,569
Single-family, detached	35,094	211	3,272	38,577
Total for residential housing projects	71,879	5,116	3,309	80,304
Construction loans to individuals secured by residential properties	9,802	7,212		17,014
Condo-conversion loans	75			75
Loans for commercial projects	34,436	57,489		91,925
Bridge loans - residential	42,825			42,825
Bridge loans - commercial		15,700	12,398	28,098
Land loans - residential	38,108	12,084	6,939	57,131
Land loans - commercial	32,040	2,126		34,166
Working capital	1,447	1,041		2,488
Total before net deferred fees and allowance for loan losses	230,612	100,768	22,646	354,026
Net deferred fees	(976)	(156)	(3)	(1,135)
Total construction loan portfolio, gross	229,636	100,612	22,643	352,891
Allowance for loan losses	(37,662)	(16,653)	(11,596)	(65,911)
Total construction loan portfolio, net	\$ 191,974	\$ 83,959	\$ 11,047	\$ 286,980

(1) For purposes of the above table, high-rise portfolio is composed of buildings with more than 7 stories, composed of two projects in Puerto Rico.

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

Table of Contents

The following table presents further information on the Corporation's construction portfolio as of and for the nine-month period ended September 30, 2012:

	(Dollars in thousands)
Total undisbursed funds under existing commitments	\$ 137,298
Construction loans held for investment in non-accrual status	\$ 189,458
Net charge offs - Construction loans ⁽¹⁾	\$ 38,904
Allowance for loan losses - Construction loans	\$ 65,911
Non-performing construction loans to total construction loans	53.69 %
Allowance for loan losses - construction loans to total construction loans	18.68 %
Net charge-offs (annualized) to total average construction loans ⁽¹⁾	13.00 %

(1) Includes net charge-offs of \$14.0 million related to construction loans in Puerto Rico, \$27.0 million related to construction loans in the Virgin Islands, and an aggregate \$2.1 million recovery related to construction loans in Florida.

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

(In thousands)	
Under \$300k	\$ 26,103
\$300k - \$600k	10,037
Over \$600k ⁽¹⁾	35,739
	\$ 71,879

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

Consumer Loans and Finance Leases

As of September 30, 2012, the Corporation's consumer loan and finance leases portfolio increased by \$424.3 million, as compared to the portfolio balance as of December 31, 2011. This increase is primarily related to the completion on May 30, 2012 of the acquisition of an approximate \$406 million portfolio of FirstBank-branded credit cards portfolio from FIA. These loans were recorded on the Consolidated Statement of Financial Condition at estimated fair value on acquisition date of approximately \$369 million, and the Corporation recognized a purchased credit card relationship intangible asset of \$24.4 million (\$23.9 million as of September 30, 2012). The carrying value of the credit cards portfolio as of September 30, 2012, net of discount of \$22.6 million, amounted to \$365.5 million. Credit card loans continue to accrue finance charges and fees until charged-off at 180 days delinquent and the methodology employed to calculate the allowance for loan losses for non-PCI loans is similar to the methodology used for other consumer loans, except for that the loss rates are determined evaluating 12 months of

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

historical performance, instead of 24 months. The auto loan portfolio (including finance leases) increased by \$51.6 million driven by an increased volume of originations.

Investment Activities

As part of its strategy to diversify its revenue sources and maximize its net interest income, First BanCorp maintains an investment portfolio that is classified as available-for-sale. The Corporation's total investment securities portfolio as of September 30, 2012 amounted to \$1.6 billion, a reduction of \$323.7 million from December 31, 2011 mainly due to \$194.5 million in PR government obligations called prior to their contractual maturity, maturities of \$765 million of U.S Treasury and agency securities, and MBS prepayments, partially offset by the purchase of approximately \$713 million of U.S. Agency MBS.

Over 92% of the Corporation's available-for-sale portfolio is invested in U.S. Government and Agency debentures and fixed-rate U.S. government sponsored-agency MBS (mainly FNMA and FHLMC fixed-rate securities). The Corporation's investment in equity securities is minimal, approximately \$0.1 million, which consists of common stock of a financial institution in Puerto Rico. As of September 30, 2012, the Corporation held approximately \$63.3 million of Puerto Rico Government Obligations. In July 2012, Moody's cut Puerto Rico Sales Tax Financing Corp.'s senior sale tax revenue bonds by one notch to Aa3 From Aa2 and its subordinated bonds by two notches to A3 from A1. These downgrades could have an adverse impact on economic conditions, but its ultimate impact is unpredictable and may not be immediately apparent.

Table of Contents

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

	As of September 30, 2012	As of December 31, 2011
	(In thousands)	
Money market investments	\$ 216,932	\$ 239,669
Investment securities available-for-sale, at fair value:		
U.S. Government and agencies obligations	33,156	778,577
Puerto Rico Government obligations	63,346	222,613
Mortgage-backed securities	1,501,305	921,024
Corporate bonds		1,013
Equity securities	40	41
	1,597,847	1,923,268
Other equity securities, including \$38.4 million and \$36.7 million of FHLB stock as of September 30, 2012 and December 31, 2011, respectively	39,656	37,951
Total money market and investment securities	\$ 1,854,435	\$ 2,200,888

Mortgage-backed securities at the indicated dates consist of:

(In thousands)	As of September 30, 2012	As of December 31, 2011
Available-for-sale:		
FHLMC certificates	\$ 139,905	\$ 26,148
GNMA certificates	649,861	762,006
FNMA certificates	656,474	71,664
Collateralized Mortgage Obligations issued or guaranteed by FHLMC	376	
Other mortgage pass-through certificates	54,689	61,206
Total mortgage-backed securities	\$ 1,501,305	\$ 921,024

The carrying values of investment securities classified as available-for-sale as of September 30, 2012 by contractual maturity (excluding mortgage-backed securities and equity securities) are shown below:

(Dollars in thousands)	Carrying Amount	Weighted Average Yield %
U.S. Government and agencies obligations		
Due within one year	\$ 7,495	0.17
Due after one year through five years	25,661	0.35

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

	33,156	0.31
Puerto Rico Government obligations		
Due after five years through ten years	41,079	4.49
Due after ten years	22,267	5.78
	63,346	4.94
Total	96,502	3.31
Mortgage-backed securities	1,501,305	3.13
Equity securities	40	
Total investment securities available for sale	\$ 1,597,847	3.15

Table of Contents

Net interest income of future periods could be affected by prepayments of mortgage-backed securities. Acceleration in the prepayments of mortgage-backed securities would lower yields on these securities, as the amortization of premiums paid upon acquisition of these securities would accelerate. Conversely, acceleration in the prepayments of mortgage-backed securities would increase yields on securities purchased at a discount, as the amortization of the discount would accelerate. These risks are directly linked to future period market interest rate fluctuations. Also, net interest income in future periods might be affected by the Corporation's investment in callable securities. Approximately \$194.5 million of Puerto Rico Government obligations with an average yield of 4.20% were called during the first nine months of 2012. As of September 30, 2012, the Corporation has approximately \$26.6 million in debt securities (mainly U.S. agency securities) with embedded calls and with an average yield of 0.53%. Refer to the Risk Management section below for further analysis of the effects of changing interest rates on the Corporation's net interest income and of the interest rate risk management strategies followed by the Corporation. Also refer to Note 4 to the accompanying unaudited consolidated financial statements for additional information regarding the Corporation's investment portfolio.

RISK MANAGEMENT

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

The Corporation has in place a risk management framework to monitor, evaluate and manage the principal risks assumed in conducting its activities. First BanCorp's business is subject to eight broad categories of risks: (1) liquidity risk, (2) interest rate risk, (3) market risk, (4) credit risk, (5) operational risk, (6) legal and compliance risk, (7) reputational risk, and (8) contingency risk. First BanCorp. has adopted policies and procedures designed to identify and manage risks to which the Corporation is exposed, specifically those relating to liquidity risk, interest rate risk, credit risk, and operational risk.

The Corporation's risk management policies are described below as well as in the Management's Discussion and Analysis of Financial Condition and Results of Operations section of First BanCorp.'s 2011 Annual Report on Form 10-K.

Liquidity and Capital Adequacy

Liquidity is the ongoing ability to accommodate liability maturities and deposit withdrawals, fund asset growth and business operations, and meet contractual obligations through unconstrained access to funding at reasonable market rates. Liquidity management involves forecasting funding requirements and maintaining sufficient capacity to meet the needs for liquidity and accommodate fluctuations in asset and liability levels due to changes in the Corporation's business operations or unanticipated events.

The Corporation manages liquidity at two levels. The first is the liquidity of the parent company, which is the holding company that owns the banking and non-banking subsidiaries. The second is the liquidity of the banking subsidiary. As of September 30, 2012, FirstBank could not pay any dividend to the parent company except upon receipt of prior approval by the FED.

The Asset and Liability Committee of the Board of Directors is responsible for establishing the Corporation's liquidity policy as well as approving operating and contingency procedures, and monitoring liquidity on an ongoing basis. Management's Investment and Asset Liability Committee (MIALCO), using measures of liquidity developed by management, which involve the use of several assumptions, reviews the Corporation's liquidity position on a monthly basis. The MIALCO oversees liquidity management, interest rate risk and other related matters. The MIALCO, which reports to the Board of Directors' Asset and Liability Committee, is composed of senior management officers, including the Chief Executive Officer, the Chief Financial Officer, the Chief Risk Officer, the Retail Financial Services Director, the Risk Manager of the Treasury and Investments Division, the Financial Analysis and Asset/Liability Director and the Treasurer. The Treasury and Investments Division is responsible for planning and executing the Corporation's funding activities and strategy, monitoring liquidity availability on a daily basis and reviewing liquidity measures on a weekly basis. The Treasury and Investments Accounting and Operations area of the Comptroller's Department is responsible for calculating the liquidity measurements used by the Treasury and Investment Division to review the Corporation's liquidity position on a monthly basis, the Financial Analysis and Asset/Liability Director estimates the liquidity gap for longer periods.

In order to ensure adequate liquidity through the full range of potential operating environments and market conditions, the Corporation conducts its liquidity management and business activities in a manner that will preserve and enhance funding stability, flexibility and diversity. Key components of this operating strategy include a strong focus on the continued development of customer-based funding, the maintenance of direct relationships with wholesale market funding providers, and the maintenance of the ability to liquidate certain assets when, and if, requirements warrant.

Table of Contents

The Corporation develops and maintains contingency funding plans. These plans evaluate the Corporation's liquidity position under various operating circumstances and allow the Corporation to ensure that it will be able to operate through periods of stress when access to normal sources of funds is constrained. The plans project funding requirements during a potential period of stress, specify and quantify sources of liquidity, outline actions and procedures for effectively managing through a difficult period, and define roles and responsibilities. In the Contingency Funding Plan, the Corporation stresses the balance sheet and the liquidity position to critical levels that imply difficulties in getting new funds or even maintaining its current funding position, thereby ensuring the ability to honor its commitments, and establishing liquidity triggers monitored by the MIALCO in order to maintain the ordinary funding of the banking business. Three different scenarios are defined in the Contingency Funding Plan: local market event, credit rating downgrade, and a concentration event. They are reviewed and approved annually by the Board of Directors' Asset and Liability Committee.

The Corporation manages its liquidity in a proactive manner, and maintains a sound liquidity position. Multiple measures are utilized to monitor the Corporation's liquidity position, including basic liquidity and time-based reserve measures. The Corporation has maintained a basic liquidity (cash, free liquid assets, and secured lines of credit) in excess of the self-imposed minimum limit of 5%. As of September 30, 2012, the estimated basic liquidity ratio was approximately 10.29%, including un-pledged investment securities, FHLB line of credit and cash. At period end, the Corporation had \$300.4 million available for additional credit on the FHLB lines of credit. Unpledged liquid securities as of September 30, 2012 mainly consisted of fixed-rate U.S. agency MBS and U.S. agency debentures amounting to approximately \$62.6 million. The Corporation does not rely on uncommitted inter-bank lines of credit (federal funds lines) to fund its operations and does not include them in the basic liquidity computation. Most of the cash balances are deposited with the Federal Reserve Bank and in money market instruments generating interest income between 0.25% and 0.35%. As of September 30, 2012, the holding company had \$42.7 million of cash and cash equivalents. Cash and cash equivalents at the Bank level as of September 30, 2012 were approximately \$996.9 million. The Bank has \$165.0 million in FHLB advances maturing over the next twelve months. Liquidity at the Bank level is highly dependent on bank deposits, which fund 75.75% of the Bank's assets (or 49.78% excluding brokered CDs). The Corporation has continued to issue brokered CDs pursuant to approvals received from the FDIC to renew or roll over brokered CD up to certain amount through December 31, 2012. Management cannot be certain it will continue to obtain waivers from the restrictions to issue brokered CDs under the Order to meet its obligations and execute its business plans.

Sources of Funding

The Corporation utilizes different sources of funding to help ensure that adequate levels of liquidity are available when needed. Diversification of funding sources is of great importance to protect the Corporation's liquidity from market disruptions. The principal sources of short-term funds are deposits, including brokered CDs, securities sold under agreements to repurchase, and lines of credit with the FHLB. The Asset Liability Committee of the Board of Directors reviews credit availability on a regular basis. The Corporation has also securitized and sold mortgage loans as a supplementary source of funding. Issuances of commercial paper have also in the past provided additional funding. Long-term funding has also been obtained through the issuance of notes and, to a lesser extent, long-term brokered CDs. The cost of these different alternatives, among other things, is taken into consideration.

The Corporation has continued reducing the amounts of brokered CDs. The reductions in brokered CDs are consistent with the requirements of the Order that preclude the issuance of brokered CDs without FDIC approval and require a plan to reduce the amount of brokered CDs. Brokered CDs decreased \$323.1 million to \$3.4 billion as of September 30, 2012 from \$3.7 billion as of December 31, 2011. At the same time, as the Corporation focuses on reducing its reliance on brokered deposits, it is seeking to add core deposits.

The Corporation continues to have the support of creditors, including repurchase agreements counterparties, the FHLB, and other agents such as wholesale funding brokers. While liquidity is an ongoing challenge for all financial institutions, management believes that the Corporation's available borrowing capacity and efforts to grow retail deposits and the \$525 million capital raise completed in 2011 will be adequate to provide the necessary funding for the Corporation business plans in the foreseeable future.

The Corporation's principal sources of funding are:

Brokered CDs A large portion of the Corporation's funding has been retail brokered CDs issued by FirstBank. Total brokered CDs decreased from \$3.7 billion at December 31, 2011 to \$3.4 billion as of September 30, 2012. Although all of the Bank's regulatory capital ratios exceeded the established well capitalized levels at September 30, 2012, and the minimum capital requirements of the FDIC Order, because of the Order with the FDIC, Firstbank cannot be considered a well capitalized institution under regulatory guidance and cannot replace maturing brokered CDs without the prior approval of the FDIC. Since the issuance of the Order, the FDIC has granted the Bank temporary waivers to enable it to continue accessing the brokered deposit market through December 31, 2012. The Bank will request approvals for future periods. The Corporation used proceeds from repayments of loans and investments to pay down maturing borrowings, including brokered CDs. Also, the Corporation successfully implemented its non-brokered deposit growth strategy that resulted in an increase of \$311.8 million during the first nine months of 2012.

Table of Contents

The average remaining term to maturity of the retail brokered CDs outstanding as of September 30, 2012 is approximately 0.91 year. Approximately 0.12% or \$4.3 million, of the principal value of these certificates are callable at the Corporation's option.

The use of brokered CDs has been particularly important for the growth of the Corporation. The Corporation encounters intense competition in attracting and retaining regular retail deposits in Puerto Rico. The brokered CDs market is very competitive and liquid, and the Corporation has been able to obtain substantial amounts of funding in short periods of time. This strategy has enhanced the Corporation's liquidity position, since the brokered CDs are insured by the FDIC up to regulatory limits and can be obtained faster compared to regular retail deposits. During the first nine months of 2012, the Corporation issued \$1.6 billion in brokered CDs with an average cost of 0.87% to renew maturing brokered CDs. Management believes it will continue to obtain waivers from the restrictions in the issuance of brokered CDs under the Order to meet its obligations and execute its business plans.

The following table presents a maturity summary of brokered and retail CDs with denominations of \$100,000 or higher as of September 30, 2012:

	Total (In thousands)
Three months or less	\$ 1,044,263
Over three months to six months	911,544
Over six months to one year	1,532,216
Over one year	1,342,307
Total	\$ 4,830,330

Certificates of deposit in denominations of \$100,000 or higher include brokered CDs of \$3.4 billion issued to deposit brokers in the form of large (\$100,000 or more) certificates of deposit that are generally participated out by brokers in shares of less than \$100,000 and are therefore insured by the FDIC. Certificates of deposit with denominations of \$100,000 or higher also include \$5.6 million of deposits through the Certificate of Deposit Account Registry Service (CDARS).

Retail deposits The Corporation's deposit products also include regular savings accounts, demand deposit accounts, money market accounts and retail CDs. Total deposits, excluding brokered CDs, increased by \$311.8 million to \$6.5 billion from the balance of \$6.2 billion as of December 31, 2011, reflecting increases in core-deposit products such as savings and interest-bearing checking accounts spread through the Corporation's geographic segments as well as increases in government deposits. Refer to Note 12 in the accompanying unaudited financial statements for further details.

Refer to the Net Interest Income discussion above for information about average balances of interest-bearing deposits, and the average interest rate paid on deposits for the quarter and nine-month period ended September 30, 2012 and 2011.

Securities sold under agreements to repurchase The Corporation's investment portfolio is funded in part with repurchase agreements. Securities sold under repurchase agreements were \$900 million and \$1 billion as of September 30, 2012 and December 31, 2011, respectively. During 2012, the Corporation restructured \$200 million of repurchase agreements through amendments that include three to four year maturity extensions and are expected to result in additional reductions in the average cost of funding. This transaction contributed to improvements in the net interest margin. One of the Corporation's strategies has been the use of structured repurchase agreements and long-term repurchase agreements to reduce exposure to interest rate risk by lengthening the final maturities of its liabilities while keeping funding costs at reasonable levels. All of the \$900 million of repurchase agreements outstanding as of September 30, 2012 consist of structured repurchase agreements. In addition to repos, the Corporation has been able to maintain access to credit by using cost-effective sources such as FHLB advances. Refer to Note 13 in the Corporation's unaudited financial statements for the period ended September 30, 2012 for further details about repurchase agreements outstanding by counterparty and maturities.

Under the Corporation's repurchase agreements, as is the case with derivative contracts, the Corporation is required to pledge cash or qualifying securities to meet margin requirements. To the extent that the value of securities previously pledged as collateral declines due to changes in interest rates, a liquidity crisis or any other factor, the Corporation will be required to deposit additional cash or securities to meet its margin requirements, thereby adversely affecting its liquidity. Given the quality of the collateral pledged, recently the Corporation has not experienced significant margin calls from counterparties arising from credit-quality-related write-downs in valuations and, as of September 30, 2012, it had only \$0.5 million of cash equivalent instruments deposited in connection with collateralized interest rate swap agreements.

Table of Contents

Advances from the FHLB The Corporation's Bank subsidiary is a member of the FHLB system and obtains advances to fund its operations under a collateral agreement with the FHLB that requires the Bank to maintain qualifying mortgages as collateral for advances taken. As of September 30, 2012 and December 31, 2011, the outstanding balance of FHLB advances was \$518.4 million and \$367.4 million, respectively. During the third quarter of 2012, the Corporation entered into \$300 million of long-term FHLB advances with an average rate of 1.11%. Approximately \$353.4 million of outstanding advances from the FHLB have maturities of over one year. At September 30, 2012, the Corporation had \$300.4 million available for additional credit on FHLB lines of credit.

Though currently not in use, other sources of short-term funding for the Corporation include commercial paper and federal funds purchased. Furthermore, in previous years the Corporation entered into several financing transactions to diversify its funding sources, including the issuance of notes payable and Junior subordinated debentures as part of its longer-term liquidity and capital management activities. No assurance can be given that these sources of liquidity will be available and, if available, will be on comparable terms.

In 2004, FBP Statutory Trust I, a statutory trust that is wholly owned by the Corporation and not consolidated in the Corporation's financial statements, sold to institutional investors \$100 million of its variable rate trust preferred securities. The proceeds of the issuance, together with the proceeds of the purchase by the Corporation of \$3.1 million of FBP Statutory Trust I variable rate common securities, were used by FBP Statutory Trust I to purchase \$103.1 million aggregate principal amount of the Corporation's Junior Subordinated Deferrable Debentures.

Also in 2004, FBP Statutory Trust II, a statutory trust that is wholly-owned by the Corporation and not consolidated in the Corporation's financial statements, sold to institutional investors \$125 million of its variable rate trust preferred securities. The proceeds of the issuance, together with the proceeds of the purchase by the Corporation of \$3.9 million of FBP Statutory Trust II variable rate common securities, were used by FBP Statutory Trust II to purchase \$128.9 million aggregate principal amount of the Corporation's Junior Subordinated Deferrable Debentures.

The trust preferred debentures are presented in the Corporation's consolidated statement of financial condition as Other Borrowings, net of related issuance costs. The variable rate trust preferred securities are fully and unconditionally guaranteed by the Corporation. The \$100 million Junior Subordinated Deferrable Debentures issued by the Corporation in April 2004 and the \$125 million issued in September 2004 mature on September 17, 2034 and September 20, 2034, respectively; however, under certain circumstances, the maturity of Junior Subordinated Debentures may be shortened (such shortening would result in a mandatory redemption of the variable rate trust preferred securities). The trust preferred securities, subject to certain limitations, qualify as Tier I regulatory capital under current Federal Reserve rules and regulations. Section 171 of the Dodd-Frank Act (the Collins Amendment) excludes Trust Preferred Securities from Tier 1 Capital and has a provision to effectively phase-out the use of trust preferred securities issued before May 19, 2010 as Tier 1 Capital over a 3-year period commencing on January 1, 2013. At September 30, 2012, the Corporation had \$225 million in trust preferred securities that are subject to the phase-out.

With respect to the outstanding subordinated debentures, the Corporation had elected to defer the interest payments that were due in September 2012. Future interest payments are subject to Federal Reserve approval.

The Corporation's principal uses of funds are the origination of loans and the repayment of maturing deposits and borrowings. The Corporation has committed substantial resources to its mortgage banking subsidiary, FirstMortgage Inc. As a result, the ratio of residential real estate loans as a percentage of total loans has increased over time from 14% at December 31, 2004 to 27% at September 30, 2012. Commensurate with the increase in its mortgage banking activities, the Corporation has also invested in technology and personnel to enhance the Corporation's secondary mortgage market capabilities. The enhanced capabilities improve the Corporation's liquidity profile as they allow the Corporation to derive liquidity, if needed, from the sale of mortgage loans in the secondary market. The U.S. (including Puerto Rico) secondary mortgage market is still highly liquid in large part because of the sale or guarantee programs of the FHA, VA, HUD, FNMA and FHLMC. The Corporation obtained Commitment Authority to issue GNMA mortgage-backed securities from GNMA and, under this program, the Corporation completed the securitization of approximately \$165.3 million of FHA/VA mortgage loans into GNMA MBS during the first nine months of 2012. Any regulatory actions affecting GNMA, FNMA or FHLMC could adversely affect the secondary mortgage market.

Impact of Credit Ratings on Access to Liquidity and Valuation of Liabilities

The Corporation's liquidity is contingent upon its ability to obtain external sources of funding to finance its operations. The Corporation's current credit ratings and any further downgrades in credit ratings can hinder the Corporation's access to external funding and/or cause external funding to be more expensive, which could in turn adversely affect results of operations. Also, changes in credit ratings may further affect the fair value of certain liabilities and unsecured derivatives that consider the Corporation's own credit risk as part of the valuation.

The Corporation does not have any outstanding debt or derivative agreements that would be affected by credit downgrades. Furthermore, given our non-reliance on corporate debt or other instruments directly linked in terms of pricing or volume to credit ratings, the liquidity of the Corporation so far has not been affected in any material way by downgrades in the past. The Corporation's ability to access new non-deposit

sources of funding, however, could be adversely affected by credit downgrades.

Table of Contents

The Corporation's credit as a long-term issuer is currently rated B+ by Standard & Poor's (S&P) and B- by Fitch Ratings Limited (Fitch). At the FirstBank subsidiary level, long-term issuer ratings are currently B3 by Moody's Investor Service (Moody's), six notches below their definition of investment grade; B+ by S&P four notches below their definition of investment grade, and B- by Fitch, six notches below their definition of investment grade.

Cash Flows

Cash and cash equivalents were \$1.0 billion and \$800.4 million at September 30, 2012 and 2011, respectively. These balances increased by \$557.2 million from December 31, 2011 and increased by \$430.1 million from December 31, 2010. The following discussion highlights the major activities and transactions that affected the Corporation's cash flows during the nine-month period ended on September 30, 2012 and 2011.

Table of Contents

Cash Flows from Operating Activities

First BanCorp. s operating assets and liabilities vary significantly in the normal course of business due to the amount and timing of cash flows. Management believes cash flows from operations, available cash balances and the Corporation s ability to generate cash through short- and long-term borrowings will be sufficient to fund the Corporation s operating liquidity needs.

For the first nine months of 2012 and 2011, net cash provided by operating activities was \$190.8 million and \$128.5 million, respectively. Net cash generated from operating activities was higher than net income reported largely as a result of adjustments for operating items such as the provision for loan and lease losses, depreciation and amortization, and due to sales of loans held for sale.

Cash Flows from Investing Activities

The Corporation s investing activities primarily relate to originating loans to be held to maturity and purchasing, selling and repayments of available-for-sale and held-to-maturity investment securities. For the nine-month period ended September 30, 2012, net cash provided by investing activities was \$355.9 million, primarily reflecting proceeds from loans (including sales and paydowns), as well as proceeds from securities called and matured during the first nine months of 2012 and MBS prepayments. Proceeds from sales of loans and from repayments of loans and MBS were used in part to pay down maturing brokered CDs and other funding sources. The cash provided by investing activities in 2012 was lower than 2011 due to significant proceeds from sales of loans and securities in 2011 as part of the Corporation s deleveraging strategies executed for capital preservation. In addition, the purchase of the credit cards portfolio in 2012 impacted this figure as compared to 2011.

For the first nine months of 2011, net cash provided by investing activities was \$2.4 billion, primarily reflecting proceeds from loans held for investment, as well as proceeds from securities sold or called during the first nine months of 2011 and MBS prepayments.

Cash Flows from Financing Activities

The Corporation s financing activities primarily include the receipt of deposits and issuance of brokered CDs, the issuance and payments of long-term debt, the issuance of equity instruments and activities related to its short-term funding. In addition, the Corporation paid monthly dividends on its preferred stock and quarterly dividends on its common stock until it announced the suspension of dividends beginning in August 2009. During the first nine months of 2012, net cash provided by financing activities was \$10.5 million due to proceeds from new FHLB advances and the increase in non-brokered deposits, partially offset by repayments of repurchase agreements, notes payable and brokered CDs.

In the first nine months of 2011, net cash used in financing activities was \$2.1 billion due to paydowns of maturing brokered CDs coupled with paydowns of FHLB Advances and repurchase agreements.

Capital

The Corporation s stockholders equity amounted to \$1.5 billion as of September 30, 2012, a increase of \$40.0 million compared to the balance as of December 31, 2011, driven by an increase of \$23.3 million in other comprehensive income due to higher unrealized gains on available for sale securities, net income of \$15.2 million, and net proceeds of \$1.0 million related to 165,000 shares of common stock sold to a director and 115,787 shares of common stock sold to institutional investors that exercised their anti-dilution rights. Based on the Agreement with the FED, currently neither First BanCorp., nor FirstBank, is permitted to pay dividends on capital securities without prior approval.

Effective June 2, 2010, FirstBank, by and through its Board of Directors, entered into the Order with the FDIC (see Note 22 to the accompanying unaudited consolidated financial statements). Although all the regulatory capital ratios exceeded the established well capitalized levels and the minimum capital requirements established by the Order, because of the Order with the FDIC, FirstBank cannot be treated as a well capitalized institution under regulatory guidance. Set forth below are First BanCorp. s, and FirstBank Puerto Rico s regulatory capital ratios as of September 30, 2012 and December 31, 2011, based on existing established FED and FDIC guidelines.

	First BanCorp	FirstBank	Banking Subsidiary To be well capitalized	Consent Order Requirements over time
As of September 30, 2012				

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

Total capital (Total capital to risk-weighted assets)	17.52 %	17.03 %	10.00 %	12.00 %
Tier 1 capital ratio (Tier 1 capital to risk-weighted assets)	16.20 %	15.71 %	6.00 %	10.00 %
Leverage ratio	12.71 %	12.35 %	5.00 %	8.00 %
As of December 31, 2011				
Total capital (Total capital to risk-weighted assets)	17.12 %	16.58 %	10.00 %	12.00 %
Tier 1 capital ratio (Tier 1 capital to risk-weighted assets)	15.79 %	15.25 %	6.00 %	10.00 %
Leverage ratio	11.91 %	11.52 %	5.00 %	8.00 %

Table of Contents

The improvement in the capital ratios was driven by internal capital generation (net income of \$15.2 million), a reduction in risk-weighted assets mainly associated with reduction in commercial loans that carried a 100% risk weighting for purposes of the capital ratios calculation, and, in the case of the leverage ratio, due to the decrease in average total assets.

On October 7, 2011, the Corporation successfully completed a private placement of \$525 million in shares of common stock (the capital raise). The proceeds from the capital raise amounted to approximately \$490 million (net of offering cost), of which \$435 million have been contributed to the Corporation's wholly owned banking subsidiary, FirstBank.

In connection with the closing, the Corporation issued 150 million shares of common stock at \$3.50 per share to institutional investor. The completion of the capital raise allowed the conversion of the 424,174 shares of the Corporation's Series G Preferred Stock, held by the U.S. Treasury, into 32.9 million shares of common stock at a conversion price of \$9.66. This conversion required for completion the payment of \$26.4 million for past due undeclared cumulative dividends on the Series G Preferred Stock as required by the agreement with the U.S. Treasury.

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

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

The tangible common equity ratio and tangible book value per common share are non-GAAP measures generally used by the financial community to evaluate capital adequacy. Tangible common equity is total equity less preferred equity, goodwill, core deposit intangibles and purchased credit card relationship intangible assets. Tangible assets are total assets less goodwill, core deposit intangibles and purchased credit card relationship intangible assets. Management and many stock analysts use the tangible common equity ratio and tangible book value per common share in conjunction with more traditional bank capital ratios to compare the capital adequacy of banking organizations with significant amounts of goodwill or other intangible assets, typically stemming from the use of the purchase accounting method of accounting for mergers and acquisitions. Neither tangible common equity, nor tangible assets, or related measures should be considered in isolation or as a substitute for stockholders' equity, total assets or any other measure calculated in accordance with GAAP. Moreover, the manner in which the Corporation calculates its tangible common equity, tangible assets and any other related measures may differ from that of other companies reporting measures with similar names.

The following table is a reconciliation of the Corporation's tangible common equity and tangible assets for the periods ended September 30, 2012 and December 31, 2011 respectively:

(In thousands)	September 30, 2012	December 31, 2011
Total equity - GAAP	\$ 1,484,117	\$ 1,444,144
Preferred equity	(63,047)	(63,047)
Goodwill	(28,098)	(28,098)
Purchased credit card relationship	(23,920)	
Core deposit intangible	(9,923)	(11,689)
Tangible common equity	\$ 1,359,129	\$ 1,341,310
Total assets - GAAP	\$ 13,139,747	13,127,275
Goodwill	(28,098)	(28,098)
Purchased credit card relationship	(23,920)	
Core deposit intangible	(9,923)	(11,689)
Tangible assets	\$ 13,077,806	\$ 13,087,488
Common shares outstanding	206,134	205,134

Tangible common equity ratio		10.39%		10.25%
Tangible book value per common share		\$ 6.59		\$ 6.54

Table of Contents

The Tier 1 common equity to risk-weighted assets ratio is calculated by dividing (a) Tier 1 capital less non-common elements including qualifying perpetual preferred stock and qualifying trust preferred securities, by (b) risk-weighted assets, which assets are calculated in accordance with applicable bank regulatory requirements. The Tier 1 common equity ratio is not required by GAAP or on a recurring basis by applicable bank regulatory requirements. Management is currently monitoring this ratio, along with the other ratios discussed above, in evaluating the Corporation's capital levels and believes that, at this time, the ratio may continue to be of interest to investors.

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

(In thousands)	September 30, 2012	December 31, 2011
Total equity - GAAP	\$ 1,484,117	\$ 1,444,144
Qualifying preferred stock	(63,047)	(63,047)
Unrealized gain on available-for-sale securities ⁽¹⁾	(42,528)	(19,234)
Disallowed deferred tax asset ⁽²⁾	(40)	
Goodwill	(28,098)	(28,098)
Core deposit intangible	(9,923)	(11,689)
Cumulative change gain in fair value of liabilities accounted for under a fair value option		(2,009)
Other disallowed assets	(4,155)	(922)
Tier 1 common equity	\$ 1,336,326	\$ 1,319,145
Total risk-weighted assets	\$ 10,026,572	\$ 10,180,226
Tier 1 common equity to risk-weighted assets ratio	13.33%	12.96%

- 1- Tier 1 capital excludes net unrealized gains (losses) on available-for-sale debt securities and net unrealized gains on available-for-sale equity securities with readily determinable fair value, in accordance with regulatory risk-based capital guidelines. In arriving at Tier 1 capital, institutions are required to deduct net unrealized losses on available-for sale equity securities with readily determinable fair value, net of tax.
- 2- Approximately \$12 million and \$13 million of the Corporation's deferred tax assets at September 30, 2012 and December 31, 2011, respectively was included without limitation in regulatory capital pursuant to the risk-based capital guidelines, while approximately \$40K of such assets at September 30, 2012 and \$0 at December 31, 2011 exceeded the limitation imposed by these guidelines and as disallowed deferred tax assets, were deducted in arriving at Tier 1 capital. According to regulatory capital guidelines, the deferred tax assets that are dependent upon future taxable income are limited for inclusion in Tier 1 capital to the lesser of: (i) the amount of such deferred tax asset that the entity expects to realize within one year of the calendar quarter end-date, based on its projected future taxable income for that year or (ii) 10% of the amount of the entity's Tier 1 capital. Approximately \$7 million of the Corporation's other net deferred tax liability at September 30, 2012 and \$8 million as of December 31, 2011 represented primarily the deferred tax effects of unrealized gains and losses on available-for-sale debt securities, which are permitted to be excluded prior to deriving the amount of net deferred tax assets subject to limitation under the guidelines.

Off-Balance Sheet Arrangements

In the ordinary course of business, the Corporation engages in financial transactions that are not recorded on the balance sheet, or may be recorded on the balance sheet in amounts that are different from the full contract or notional amount of the transaction. These transactions are designed to (1) meet the financial needs of customers, (2) manage the Corporation's credit, market or liquidity risks, (3) diversify the Corporation's funding sources and (4) optimize capital.

As a provider of financial services, the Corporation routinely enters into commitments with off-balance sheet risk to meet the financial needs of its customers. These financial instruments may include loan commitments and standby letters of credit. These commitments are subject to the same credit policies and approval process used for on-balance sheet instruments. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the statement of financial

Table of Contents

position. As of September 30, 2012, commitments to extend credit and commercial and financial standby letters of credit amounted to approximately \$1.5 billion, (including \$1.0 billion pertaining to credit card loans) and \$83.4 million, respectively. Commitments to extend credit are agreements to lend to customers as long as the conditions established in the contract are met. Generally, the Corporation's mortgage banking activities do not enter into interest rate lock agreements with prospective borrowers.

Contractual Obligations and Commitments

The following table presents a detail of the maturities of the Corporation's contractual obligations and commitments, which consist of CDs, long-term contractual debt obligations, commitments to sell mortgage loans and commitments to extend credit:

	Contractual Obligations and Commitments				
	As of September 30, 2012				
	Total	Less than 1 year	1-3 years	3-5 years	After 5 years
	(In thousands)				
Contractual obligations: ⁽¹⁾					
Certificates of deposit	\$ 5,710,985	\$ 4,133,347	\$ 1,403,783	\$ 168,820	\$ 5,035
Securities sold under agreements to repurchase	900,000			600,000	300,000
Advances from FHLB	518,440	165,000	53,440	300,000	
Notes payable					
Other borrowings	231,959				231,959
Total contractual obligations	\$ 7,361,384	\$ 4,298,347	\$ 1,457,223	\$ 1,068,820	\$ 536,994
Commitments to sell mortgage loans	\$ 20,464	\$ 20,464			
Standby letters of credit	\$ 18,963	\$ 18,963			
Commitments to extend credit:					
Lines of credit	\$ 1,526,380	\$ 1,526,380			
Letters of credit	64,407	64,407			
Commitments to originate loans	141,169	141,169			
Total commercial commitments	\$ 1,731,956	\$ 1,731,956			

(1) \$3.5 million of tax liability, including accrued interest of \$1.1 million, associated with unrecognized tax benefits have been excluded due to the high degree of uncertainty regarding the timing of future cash flows associated with such obligations.

The Corporation has obligations and commitments to make future payments under contracts, such as debt and lease agreements, and under other commitments to sell mortgage loans at fair value and to extend credit. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Other contractual obligations result mainly from contracts for the rental and maintenance of equipment. Since certain commitments are expected to expire without being drawn upon, the total commitment amount does not necessarily represent future cash requirements. For most of the commercial lines of credit, the Corporation has the option to reevaluate the agreement prior to additional disbursements. There have been no significant or unexpected draws on existing commitments. In the case of credit cards and personal lines of credit, the Corporation can cancel at any time and without cause cancel the unused credit facility.

Lehman Brothers Special Financing, Inc. (Lehman) was the counterparty to the Corporation on certain interest rate swap agreements. During the third quarter of 2008, Lehman failed to pay the scheduled net cash settlement due to the Corporation, which constituted an event of default under those interest rate swap agreements. The Corporation terminated all interest rate swaps with Lehman and replaced them with other counterparties under similar terms and conditions. In connection with the unpaid net cash settlement under the swap agreements, the Corporation has an unsecured counterparty exposure with Lehman, which filed for bankruptcy on October 3, 2008, of approximately \$1.4 million. This exposure

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

was reserved in the third quarter of 2008. The Corporation had securities pledged as collateral with a \$63.6 million face value to guarantee its performance under the swap agreements in the event payment there under was required.

Since the second quarter of 2009, the Corporation has maintained a non-performing asset with a book value of \$64.5 million in addition to accrued interest of \$2.1 million related to the collateral pledged with Lehman. The Corporation believes that the securities pledged as collateral should not be part of the Lehman bankruptcy estate given the facts that the posted collateral constituted a performance guarantee under the swap agreements and was not part of a financing agreement, and that ownership of the securities was never transferred to Lehman. Upon termination of the interest rate swap agreements, Lehman's obligation was to return the collateral to the Corporation. During the fourth quarter of 2009, the Corporation discovered that Lehman Brothers, Inc., acting as agent of Lehman, had deposited the securities in a custodial account at JP Morgan Chase, and that, shortly before the filing of the Lehman bankruptcy proceedings, it had provided instructions to have most of the securities transferred to Barclays Capital (Barclays) in New York. After Barclays' refusal to turn over the securities, the Corporation filed a lawsuit against Barclays in federal court in New York demanding the return of the securities

Table of Contents

in December 2009. During February 2010, Barclays filed a motion with the court requesting that the Corporation's claim be dismissed on the grounds that the allegations of the complaint are not sufficient to justify the granting of the remedies therein sought. Shortly thereafter, the Corporation filed its opposition motion. A hearing on the motions was held in court on April 28, 2010. The court, on that date, after hearing the arguments by both sides, concluded that the Corporation's equitable-based causes of action, upon which the return of the investment securities is being demanded, contain allegations that sufficiently plead facts warranting the denial of Barclays' motion to dismiss the Corporation's claim. Accordingly, the judge ordered the case to proceed to trial.

Subsequent to the court decision, the district court judge transferred the case to the Lehman bankruptcy court for trial. Discovery pursuant to that case management has been completed. The parties filed dispositive motions on September 13, 2012. Oppositions to such motions and replies thereto must be filed by October 15, 2012 and November 14, 2012, respectively, but this timing is subject to adjustment. The Corporation may not succeed in its litigation against Barclays to recover all or a substantial portion of the securities.

Additionally, the Corporation continues to pursue its claim filed in January 2009 in the proceedings under the Securities Protection Act with regard to Lehman Brothers Inc. in the United States Bankruptcy Court for the Southern District of New York.

An estimated loss was not accrued as the Corporation is unable to determine the timing of the claim resolution or whether it will succeed in recovering all or a substantial portion of the collateral or its equivalent value.

Because the Corporation has not had the benefit of the use of the investment securities pledged to Lehman (i.e., ability to sell, pledge or transfer), and because the Corporation has not received principal or interest payments since 2008 (after the collapse of Lehman), the appropriate carrying value of these securities has been under review with our regulators, with recent heightened concern due to the complex and lengthy litigation regarding this matter. If, as a result of these discussions, developments in the litigation, or for other reasons, the Corporation should determine that it is probable that the asset has been impaired and that the Corporation needs to recognize a partial or full loss for the investment securities pledged to Lehman, such action would adversely affect the Corporation's results of operations in the period in which such action is taken. The Corporation expects to reassess the recoverability of the asset upon the resolution of the dispositive motions filed with the court, which motions could be resolved in the fourth quarter of 2012.

Interest Rate Risk Management

First BanCorp. manages its asset/liability position in order to limit the effects of changes in interest rates on net interest income and to maintain stability of profitability under varying interest rate scenarios. The MIALCO oversees interest rate risk and meetings focus on, among other things, current and expected conditions in world financial markets, competition and prevailing rates in the local deposit market, liquidity, securities market values, recent or proposed changes to the investment portfolio, alternative funding sources and related costs, hedging and the possible purchase of derivatives such as swaps and caps, and any tax or regulatory issues which may be pertinent to these areas. The MIALCO approves funding decisions in light of the Corporation's overall strategies and objectives.

The Corporation performs on a quarterly basis a consolidated net interest income simulation analysis to estimate the potential change in future earnings from projected changes in interest rates. These simulations are carried out over a one-to-five-year time horizon, assuming upward and downward yield curve shifts. The rate scenarios considered in these disclosures reflect gradual upward and downward interest rate movements of 200 basis points, during a twelve-month period. Simulations are carried out in two ways:

- (1) Using a static balance sheet, as the Corporation had it on the simulation date, and
- (2) Using a dynamic balance sheet based on recent patterns and current strategies.

The balance sheet is divided into groups of assets and liabilities detailed by maturity or re-pricing structure and their corresponding interest yields and costs. As interest rates rise or fall, these simulations incorporate expected future lending rates, current and expected future funding sources and costs, the possible exercise of options, changes in prepayment rates, deposits decay and other factors which may be important in projecting net interest income.

The Corporation uses a simulation model to project future movements in the Corporation's balance sheet and income statement. The starting point of the projections generally corresponds to the actual values on the balance sheet on the date of the simulations.

These simulations are highly complex, and are based on many assumptions that are intended to reflect the general behavior of the balance sheet components over the period in question. It is unlikely that actual events will match these assumptions in all cases. For this reason, the results of these forward-looking computations are only approximations of the true sensitivity of net interest income to changes in market interest rates.

Several benchmark and market rate curves were used in the modeling process; primarily the

Table of Contents

LIBOR/SWAP curve, Prime, Treasury, FHLB rates, Brokered CDs rates, repurchase agreements rates and the Mortgage Commitment Rate of 30 years. Rate indices are assumed to remain constant at September 2012 end of month levels, under the flat rate scenario; a gradual (ramp) parallel upward shift of the yield curve is assumed during the first twelve months of the projection for the +200 ramp scenario. Under the 200 basis points (ramp) parallel falling rate scenario, rates move downward 200 basis points for the first twelve months of projection. Due to the historically yield curve indices low levels, the downward 200 basis points parallel effect is not completely achieved, reflecting a flattening yield curve instead of a parallel downward scenario. The Libor/Swap curve for September 2012, as compared to December 2011, showed an average decrease of 16 basis points in the short term horizon, between one to twelve months, while market rates increase an average of 34 basis points in the long term horizon. The Treasury curve showed an average increase of 6 basis points in the short term horizon, while showed a decrease of 16 basis points in the long term horizon, as compared to December 2011 end of month levels.

The following table presents the results of the simulations as of September 30, 2012 and December 31, 2011. Consistent with prior years, these exclude non-cash changes in the fair value of derivatives and liabilities measured at fair value:

	September 30, 2012				December 31, 2011			
	Net Interest Income Risk (Projected for the next 12 months)				Net Interest Income Risk (Projected for the next 12 months)			
	Static Simulation		Growing Balance Sheet		Static Simulation		Growing Balance Sheet	
(Dollars in millions)	Change	% Change	Change	% Change	Change	% Change	Change	% Change
+ 200 bps ramp	\$ 14.0	2.74 %	\$ 9.8	1.83 %	\$ 19.2	4.47 %	\$ 29.2	6.74 %
- 200 bps ramp	\$ (0.5)	(0.10)%	\$ (2.0)	(0.39)%	\$ (3.8)	(0.88)%	\$ 3.7	0.85 %

The Corporation continues to manage its balance sheet structure to control the overall interest rate risk. As part of the Corporation's balance sheet restructuring strategies, the net interest income and the exposure at different market scenarios were affected during the first nine months of 2012, as compared with 2011 year end levels. The major changes during the first nine months of 2012, are mainly driven by the increase in excess liquidity, loans paid-off and repayments, a decrease in investment securities due to maturities, calls and MBS repayments levels, an increase in consumer loan due to the acquisition of the \$406 million credit cards portfolio, the restructuring and maturity of repurchase agreements and a decrease in brokered CDs. The Corporation continues reducing its reliance on brokered CDs with the intend to grow its core deposits base at lower costs, while adjusting the mix of its funding sources to better match the expected average life of the assets.

Taking into consideration the above-mentioned facts for modeling purposes, the net interest income for the next twelve months under a non-static balance sheet scenario, is estimated to increase by \$9.8 million in a gradual parallel upward move of 200 basis points when compared against the Corporation's flat or unchanged interest rate forecast scenario.

Following the Corporation's risk management policies, modeling of the downward parallel rates moves by anchoring the short end of the curve, (falling rates with a flattening curve) was performed, even though, given the current level of rates as of September 30, 2012, some market interest rate were projected to be close to zero. Under this scenario the net interest income for the next twelve months in a non-static balance sheet scenario is estimated to decrease by \$2.0 million.

Derivatives

First BanCorp. uses derivative instruments and other strategies to manage its exposure to interest rate risk caused by changes in interest rates beyond management's control.

The following summarizes major strategies, including derivative activities, used by the Corporation in managing interest rate risk:

Interest rate cap agreements Interest rate cap agreements provide the right to receive cash if a reference interest rate rises above a contractual rate. The value increases as the reference interest rate rises. The Corporation enters into interest rate cap agreements for protection from rising interest rates. Specifically, the interest rate on certain of the Corporation's commercial loans to other financial institutions is generally a variable rate limited to the weighted-average coupon of the referenced residential mortgage collateral, less a contractual servicing fee.

Interest rate swaps Interest rate swap agreements generally involve the exchange of fixed and floating-rate interest payment obligations without the exchange of the underlying notional principal amount. As of September 30, 2012, most of the interest rate swaps outstanding are used for protection against rising interest rates. Similar to unrealized gains and losses arising from changes in fair value, net interest settlements on interest rate swaps are recorded as an adjustment to interest income or interest expense depending on whether an asset or liability is being

economically hedged.

Indexed options Indexed options are generally over-the-counter (OTC) contracts that the Corporation enters into in order to receive the appreciation of a specified Stock Index (e.g., Dow Jones Industrial Composite Stock Index) over a specified period in exchange for a premium paid at the contract's inception. The option period is determined by the contractual maturity of the notes payable tied to the performance of the Stock Index. The credit risk inherent in these options is the risk that the exchange party may not fulfill its obligation.

Table of Contents

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

For detailed information regarding the volume of derivative activities (e.g. notional amounts), location and fair values of derivative instruments in the Statement of Financial Condition and the amount of gains and losses reported in the Statement of Income (Loss), refer to Note 9 in the accompanying unaudited consolidated financial statements.

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

(In thousands)	Asset Derivatives	Liability Derivatives
	Nine-Month Period	Nine-Month Period
	Ended	Ended
	September 30, 2012	September 30, 2012
Fair value of contracts outstanding at the beginning of the period	\$ 1,277	\$ (7,834)
Changes in fair value during the period	(941)	1,406
Fair value of contracts outstanding as of September 30, 2012	\$ 336	\$ (6,428)

Sources of Fair Value

(In thousands)	Payment Due by Period				
	Maturity Less Than One Year	Maturity 1-3 Years	Maturity 3-5 Years	Maturity in Excess of 5 Years	Total Fair Value
As of September 30, 2012					
Pricing from observable market inputs - Asset Derivatives	\$ 19	\$ 317	\$	\$	\$ 336
Pricing from observable market inputs - Liability Derivatives	(420)	(322)	(5,686)		(6,428)
	\$ (401)	\$ (5)	\$ (5,686)	\$	\$ (6,092)

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

As of September 30, 2012 and December 31, 2011, all of the derivative instruments held by the Corporation were considered economic undesignated hedges.

The use of derivatives involves market and credit risk. The market risk of derivatives stems principally from the potential for changes in the value of derivative contracts based on changes in interest rates. The credit risk of derivatives arises from the potential of default from the counterparty. To manage this credit risk, the Corporation deals with counterparties of good credit standing, enters into master netting agreements

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

whenever possible and, when appropriate, obtains collateral. Master netting agreements incorporate rights of set-off that provide for the net settlement of contracts with the same counterparty in the event of default. All of the Corporation's interest rate swaps are supported by securities collateral agreements, which allow the delivery of securities to and from the counterparties depending on the fair value of the instruments, to minimize credit risk.

Refer to Note 19 of the accompanying unaudited consolidated financial statements for additional information regarding the fair value determination of derivative instruments.

Table of Contents

Set forth below is a detailed analysis of the Corporation's credit exposure by counterparty with respect to derivative instruments outstanding as of September 30, 2012 and December 31, 2011.

		As of September 30, 2012				
(In thousands)			Total Exposure at Fair Value ⁽²⁾	Negative Fair Value	Total Fair Value	Accrued interest receivable (payable)
Counterparty	Rating ⁽¹⁾	Notional				
Interest rate swaps with rated counterparties:						
JP Morgan	A	\$ 33,157	\$	\$ (5,915)	\$ (5,915)	\$
		33,157		(5,915)	(5,915)	
Other Derivatives:						
Other Derivatives (3)		31,440	336	(513)	(177)	(148)
Total		\$ 64,597	\$ 336	\$ (6,428)	\$ (6,092)	\$ (148)

		As of December 31, 2011				
(In thousands)			Total Exposure at Fair Value ⁽²⁾	Negative Fair Value	Total Fair Value	Accrued interest receivable (payable)
Counterparty	Rating ⁽¹⁾	Notional				
Interest rate swaps with rated counterparties:						
JP Morgan	A	\$ 34,347	\$	\$ (6,386)	\$ (6,386)	\$
Credit Suisse First Boston	A+	2,720		(381)	(381)	
Goldman Sachs	A-	6,515	899		899	
Morgan Stanley	A-	107,894				
		151,476	899	(6,767)	(5,868)	
Other Derivatives:						
Other Derivatives (3)		136,128	378	(1,067)	(689)	(166)
Total		\$ 287,604	\$ 1,277	\$ (7,834)	\$ (6,557)	\$ (166)

(1) Based on the S&P and Fitch Long Term Issuer Credit Ratings.

(2) For each counterparty, this amount includes derivatives with positive fair value excluding the related accrued interest receivable/payable

(3) Credit exposure with several counterparties for which a credit rating is not readily available and forward contracts.

The discounting of the cash flows is performed using US dollar LIBOR-based discount rates or yield curves that account for the industry sector and the credit rating of the counterparty and/or the Corporation. Although most of the derivative instruments are fully collateralized, a credit spread is considered for those that are not secured in full. The cumulative mark-to-market effect of credit risk in the valuation of derivative instruments for the first nine months of 2012 and 2011 was immaterial.

Credit Risk Management

First BanCorp. is subject to credit risk mainly with respect to its portfolio of loans receivable and off-balance sheet instruments, mainly derivatives and loan commitments. Loans receivable represents loans that First BanCorp. holds for investment and, therefore, First BanCorp. is

at risk for the term of the loan. Loan commitments represent commitments to extend credit, subject to specific conditions, for specific amounts and maturities. These commitments may expose the Corporation to credit risk and are subject to the same review and approval process as for loans. Refer to Contractual Obligations and Commitments above for further details. The credit risk of derivatives arises from the potential of the counterparty's default on its contractual obligations. To manage this credit risk, the Corporation deals with counterparties of good credit standing, enters into master netting agreements whenever possible and, when appropriate, obtains collateral. For further details and information on the Corporation's derivative credit risk exposure, refer to Interest Rate Risk Management section above. The Corporation manages its credit risk through credit policy, underwriting, independent loan review and quality control procedures, statistical analysis, comprehensive financial analysis, and established management committees. The Corporation also employs proactive collection and loss mitigation efforts. Furthermore, personnel performing structured loan workout functions are responsible for mitigating defaults and minimizing losses upon default within each region and for each business segment. In the case of C&I, commercial mortgage and construction loan portfolios, the Special Asset Group (SAG) focuses on strategies for the accelerated reduction of non-performing

Table of Contents

assets through note sales, short sales, loss mitigation programs, and sales of REO. In addition to the management of the resolution process for problem loans, the SAG oversees collection efforts for all loans to prevent migration to the non-performing and/or adversely classified status. The SAG utilizes relationship officers, collection specialists and attorneys. In the case of residential construction projects, the workout function monitors project specifics, such as project management and marketing, as deemed necessary.

The Corporation may also have risk of default in the securities portfolio. The securities held by the Corporation are principally fixed-rate U.S. agency mortgage-backed securities and U.S. Treasury and agency securities. Thus, a substantial portion of these instruments is backed by mortgages, a guarantee of a U.S. government-sponsored entity or the full faith and credit of the U.S. government.

Management, comprised of the Corporation's Commercial Credit Risk Officer, Retail Credit Risk Officer, Chief Lending Officer and other senior executives, has the primary responsibility for setting strategies to achieve the Corporation's credit risk goals and objectives. These goals and objectives are documented in the Corporation's Credit Policy.

Allowance for Loan and Lease Losses and Non-performing Assets

Allowance for Loan and Lease Losses

The allowance for loan and lease losses represents the estimate of the level of reserves appropriate to absorb inherent credit losses. The amount of the allowance was determined by empirical analysis and judgments regarding the quality of each individual loan portfolio. All known relevant internal and external factors that affected loan collectability were considered, including analyses of historical charge-off experience, migration patterns, changes in economic conditions, and changes in loan collateral values. For example, factors affecting the economies of Puerto Rico, Florida (USA), the US Virgin Islands and the British Virgin Islands may contribute to delinquencies and defaults above the Corporation's historical loan and lease losses. Such factors are subject to regular review and may change to reflect updated performance trends and expectations, particularly in times of severe stress such as have been experienced since 2008. The process includes judgmental and quantitative elements that may be subject to significant change. There is no certainty that the allowance will be adequate over time to cover credit losses in the portfolio because of continued adverse changes in the economy, market conditions, or events adversely affecting specific customers, industries or markets. To the extent actual outcomes differ from our estimates, the credit quality of our customer base materially decreases or the risk profile of a market, industry, or group of customers changes materially, or if the allowance is determined to not be adequate, additional provisions for credit losses could be required, which could adversely affect our business, financial condition, liquidity, capital, and results of operations in future periods.

The allowance for loan and lease losses provides for probable losses that have been identified with specific valuation allowances for individually evaluated impaired loans and for probable losses believed to be inherent in the loan portfolio that have not been specifically identified. Internal risk ratings are assigned to each business loan at the time of approval and are subject to subsequent periodic reviews by the Corporation's senior management. The allowance for loan and lease losses is reviewed on a quarterly basis as part of the Corporation's continued evaluation of its asset quality. In connection with the recently acquired credit cards portfolio, the methodology employed to calculate the allowance for loan losses is similar to the methodology used for other consumer loans, except for that the loss rates are determined evaluating 12 months of historical performance, instead of 24 months. The Corporation does not maintain an allowance for held for sale loans or purchased credit-impaired (PCI) loans that are performing in accordance with or better than our expectations as of the date of acquisition, as the fair value of these loans already reflect a credit component.

The allowance for loan losses to total loans for the residential mortgage loan portfolio increased from 2.39% at December 31, 2011 to 2.50% at September 30, 2012, while the allowance to total loans for the C&I portfolio increased from 3.98% at December 31, 2011 to 4.46% at September 30, 2012. For the commercial mortgage loan portfolio, the reserve coverage decreased from 6.96% at December 31, 2011 to 6.12% at September 30, 2012 driven by improved trends in charge-offs and the reduction in adversely classified loans. The construction loans reserve coverage ratio decreased from 21.36% as of December 31, 2011 to 18.68% at September 30, 2012 due to decreases in non-performing loans, while the consumer and finance leases reserve coverage ratio decreased from 3.86% as of December 31, 2011 to 2.99% at September 30, 2012 due to decreases in delinquency levels and historical loss rates. This ratio was also impacted by the recent acquisition of a \$406 million credit cards portfolio which was recorded at a fair value of approximately \$369 million at the time of acquisition which reflected a credit component.

Substantially all of the Corporation's loan portfolio is located within the boundaries of the U.S. economy. Whether the collateral is located in Puerto Rico, the U.S. and British Virgin Islands or the U.S. mainland (mainly in the state of Florida), the performance of the Corporation's loan portfolio and the value of the collateral supporting the transactions are dependent upon the performance of and conditions within each specific area real estate market. The real estate market in Puerto Rico experienced readjustments in value driven by the loss of income due to the unemployment of consumers, reduced demand and the general economic conditions. The Corporation sets adequate loan-to-value ratios upon original approval following its regulatory and credit policy standards. The real estate market for the U.S. Virgin Islands remains fairly stable. In the Florida market, residential real estate is experiencing a higher demand. The Corporation continues to reduce its credit exposure in Florida

through disposition of assets and different loss mitigation initiatives.

Table of Contents

As shown in the following table, the allowance for loan and lease losses amounted to \$445.5 million at September 30, 2012, or 4.37% of total loans compared with \$493.9 million, or 4.68% of total loans at December 31, 2011. Refer to the Provision for Loan and Lease Losses discussion above for additional information.

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

(Dollars in thousands)	Quarter Ended September 30,		Nine-Month Period Ended September 30,	
	2012	2011	2012	2011
Allowance for loan and lease losses, beginning of period	\$ 457,153	\$ 540,878	\$ 493,917	\$ 553,025
Provision (release) for loan and lease losses:				
Residential Mortgage	9,083	17,744	27,787	36,916
Commercial Mortgage	(6,617)	13,324	(4,897)	32,767
Commercial and Industrial	8,117	10,437	30,702	73,409
Construction	6,379	(2,547)	13,429	41,270
Consumer and Finance Leases	11,990	7,488	23,012	10,000
Provision for loan and lease losses	28,952	46,446	90,033	194,362
Charge-offs				
Residential Mortgage	(7,586)	(16,076)	(27,976)	(30,571)
Commercial Mortgage	(5,681)	(3,316)	(15,588)	(37,647)
Commercial and Industrial	(12,795)	(22,703)	(35,494)	(50,858)
Construction	(9,012)	(17,008)	(42,908)	(83,483)
Consumer and Finance Leases	(9,444)	(11,086)	(29,327)	(35,168)
	(44,518)	(70,189)	(151,293)	(237,727)
Recoveries:				
Residential Mortgage	228	260	676	657
Commercial Mortgage	679	7	721	84
Commercial and Industrial	534	177	2,179	1,281
Construction	686	185	4,004	2,215
Consumer and Finance Leases	1,817	1,923	5,294	5,790
	3,944	2,552	12,874	10,027
Net Charge Offs	(40,574)	(67,637)	(138,419)	(227,700)
Allowance for loan and lease losses, end of period	\$ 445,531	\$ 519,687	\$ 445,531	\$ 519,687
Allowance for loan and lease losses to period end total loans receivable	4.37%	4.89%	4.37%	4.89%
Net charge-offs annualized to average loans outstanding during the period	1.58%	2.50%	1.79%	2.72%
Provision for loan and lease losses to net charge-offs during the period	0.71x	0.69x	0.65x	0.85x

The following table sets forth information concerning the allocation of the loan allowance for loan and lease losses by loan category and the percentage of loan balances in each category to the total of such loans as of the dates indicated:

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

(In thousands)	As of September 30, 2012		As of December 31 2011	
	Amount	Percent	Amount	Percent
Residential mortgage	\$ 69,165	27%	\$ 68,678	27%
Commercial mortgage loans	89,227	14%	108,992	15%
Construction loans	65,911	3%	91,386	4%
Commercial and Industrial loans (including loans to local financial institutions)	161,877	37%	164,490	39%
Consumer loans and finance leases	59,351	19%	60,371	15%
	\$ 445,531	100%	\$ 493,917	100%

Table of Contents

The following table sets forth information concerning the composition of the Corporation's allowance for loan and lease losses as of September 30, 2012 and December 31, 2011 by loan category and by whether the allowance and related provisions were calculated individually or through a general valuation allowance.

(Dollars in thousands)	Residential Mortgage Loans	Commercial Mortgage Loans	C&I Loans	Construction Loans	Consumer and Finance Leases	Total
As of September 30, 2012						
Impaired loans without specific reserves:						
Principal balance of loans, net of charge-offs	\$ 106,554	\$ 50,043	\$ 31,047	\$ 38,863	\$ 1,647	\$ 228,154
Impaired loans with specific reserves:						
Principal balance of loans, net of charge-offs	488,234	313,490	207,465	139,599	23,196	1,171,984
Allowance for loan and lease losses	49,640	51,351	57,001	33,349	2,813	194,154
Allowance for loan and lease losses to principal balance	10.17%	16.38%	27.47%	23.89%	12.13%	16.57%
PCI loans:						
Carrying value of PCI loans					12,741	12,741
Allowance for PCI loans						
Allowance for PCI loans to carrying value						
Loans with general allowance:						
Principal balance of loans	2,167,630	1,095,585	3,389,134	174,429	1,948,507	8,775,285
Allowance for loan and lease losses	19,525	37,876	104,876	32,562	56,538	251,377
Allowance for loan and lease losses to principal balance	0.90%	3.46%	3.09%	18.67%	2.90%	2.86%
Total loans held for investment:						
Principal balance of loans	\$ 2,762,418	\$ 1,459,118	\$ 3,627,646	\$ 352,891	\$ 1,986,091	\$ 10,188,164
Allowance for loan and lease losses	69,165	89,227	161,877	65,911	59,351	445,531
Allowance for loan and lease losses to principal balance (1)	2.50%	6.12%	4.46%	18.68%	2.99%	4.37%
(Dollars in thousands)	Residential Mortgage Loans	Commercial Mortgage Loans	C&I Loans	Construction Loans	Consumer and Finance Leases	Total
As of December 31, 2011						
Impaired loans without specific reserves:						
Principal balance of loans, net of charge-offs	\$ 181,081	\$ 13,797	\$ 40,453	\$ 33,759	\$ 2,840	\$ 271,930
Impaired loans with specific reserves:						
Principal balance of loans, net of charge-offs	423,340	354,954	223,572	213,388	20,192	1,235,446
Allowance for loan and lease losses	48,566	59,167	58,652	44,768	3,749	214,902
Allowance for loan and lease losses to principal balance	11.47%	16.67%	26.23%	20.98%	18.57%	17.39%
Loans with general allowance:						
Principal balance of loans	2,269,364	1,196,660	3,866,491	180,716	1,538,785	9,052,016
Allowance for loan and lease losses	20,112	49,824	105,838	46,618	56,623	279,015
Allowance for loan and lease losses to principal balance	0.89%	4.16%	2.74%	25.80%	3.68%	3.08%
Total loans held for investment:						
Principal balance of loans	\$ 2,873,785	\$ 1,565,411	\$ 4,130,516	\$ 427,863	\$ 1,561,817	\$ 10,559,392
Allowance for loan and lease losses	68,678	108,991	164,490	91,386	60,372	493,917
	2.39%	6.96%	3.98%	21.36%	3.87%	4.68%

Allowance for loan and lease losses to principal
balance

- (1) Loans used in the denominator include PCI loans of \$12.7 million as of September 30, 2012. However, the Corporation separately tracks and reports PCI loans and exclude these loans from delinquency, non-performing loans, impaired, TDRs and non-performing assets statistics.

Table of Contents

The following tables show the activity for impaired loans and the related specific reserve for the quarter and nine-month period ended September 30, 2012:

	Quarter ended September 30, 2012 (In thousands)	Nine-Month Period Ended September 30, 2012 (In thousands)
Impaired Loans:		
Balance at beginning of period	\$ 1,432,469	\$ 1,507,376
Loans determined impaired during the period	55,292	222,841
Net charge-offs	(30,971)	(107,458)
Increases to impaired loans (disbursements)	11,039	30,160
Foreclosures	(26,353)	(113,737)
Loans no longer considered impaired	(5,351)	(42,269)
Paid in full or partial payments	(35,987)	(96,775)
Balance at end of period	\$ 1,400,138	\$ 1,400,138
	Quarter Ended September 30, 2012 (In thousands)	Nine-Month Period Ended September 30, 2012 (In thousands)
Specific Reserve:		
Balance at beginning of period	\$ 209,860	\$ 214,902
Provision for loan losses	15,265	86,710
Net charge-offs	(30,971)	(107,458)
Balance at end of period	\$ 194,154	\$ 194,154

On May 30, 2012, the Corporation re-entered the credit card business with the acquisition of an approximate \$406 million portfolio of FirstBank-branded credit cards portfolio from FIA. These loans were recorded on the Consolidated Statement of Financial Condition at estimated fair value on acquisition date of \$368.9 million. The Corporation concluded that a portion of these loans acquired were PCI loans. PCI loans are acquired loans with evidence of credit quality deterioration since origination for which it is probable at the date of purchase that the Corporation will be unable to collect all contractually required payments. The loans for which the Corporation concluded were credit impaired had a contractual outstanding unpaid principal and interest balance of \$34.6 million and an estimated fair value of \$15.7 million at the time of acquisition. Given the initial fair value of these loans included an estimate of credit losses expected to be realized over the remaining lives of the loans, the Corporation's subsequent accounting for PCI loans differs from the accounting for non-PCI loans, therefore, the Corporation separately tracks and report PCI loans and exclude these loans from delinquency, non-performing loans, impaired, TDRs and non-performing asset statistics.

Credit Quality

Credit quality performance in the first nine months of 2012 continued its slow but steady pace of improvement. Total non-performing loans decreased \$135.1 million led by foreclosures, charge-offs, principal repayments and a decrease in the inflows of non-performing loans. Total non-performing assets, which include repossessed assets, decreased by \$78.0 million, or 6%. Total delinquencies, which include all loans 30 days or more past due and non-accrual loans, decreased by \$120.7 million, during 2012 and the level of adversely classified commercial and construction loans decreased by \$159.3 million or 13%.

Non-performing Loans and Non-performing Assets

Total non-performing assets consist of non-performing loans, foreclosed real estate and other repossessed properties as well as non-performing investment securities. Non-performing loans are those loans on which the accrual of interest is discontinued. When a loan is placed in non-performing status, any interest previously recognized and not collected is reversed and charged against interest income.

Non-performing Loans Policy

Residential Real Estate Loans The Corporation classifies real estate loans in non-performing status when interest and principal have not been received for a period of 90 days or more.

Table of Contents

Commercial and Construction Loans The Corporation places commercial loans (including commercial real estate and construction loans) in non-performing status when interest and principal have not been received for a period of 90 days or more or when collection of all of principal or interest is not expected due to deterioration in the financial condition of the borrower.

Finance Leases Finance leases are classified in non-performing status when interest and principal have not been received for a period of 90 days or more.

Consumer Loans Consumer loans are classified in non-performing status when interest and principal have not been received for a period of 90 days or more. Credit card loans continue to accrue finance charges and fees until charged-off at 180 days delinquent.

PCI Loans Recorded at fair value at acquisition. Since the initial fair value of these loans included an estimate of credit losses expected to be realized over the remaining lives of the loans, the subsequent accounting for PCI loans differs from the accounting for non-PCI loans. The Corporation, therefore, separately tracks and reports PCI loans and excludes these from its delinquency and non-performing statistics.

Cash payments received on certain loans that are impaired and collateral dependent are recognized when collected in accordance with the contractual terms of the loans. The principal portion of the payment is used to reduce the principal balance of the loan, whereas the interest portion is recognized on a cash basis (when collected). However, when management believes that the ultimate collectability of principal is in doubt, the interest portion is applied to principal. The risk exposure of this portfolio is diversified as to individual borrowers and industries among other factors. In addition, a large portion is secured with real estate collateral.

Other Real Estate Owned (OREO)

OREO acquired in settlement of loans is carried at the lower of cost (carrying value of the loan) or fair value less estimated costs to sell off the real estate. Appraisals are obtained periodically, generally, on an annual basis.

Other Repossessed Property

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

Other Non-Performing Assets

This category consists of assets pledged to Lehman Brothers Special Financing, Inc. at their book value.

Past Due Loans 90 days and still accruing

These are accruing loans which are contractually delinquent 90 days or more. These past due loans are either current as to interest but delinquent in the payment of principal or are insured or guaranteed under applicable FHA and VA programs.

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

Table of Contents

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

(Dollars in thousands)	September 30, 2012	December 31, 2011
Non-performing loans held for investment:		
Residential mortgage	\$ 320,913	\$ 338,208
Commercial mortgage	231,163	240,414
Commercial and Industrial	230,459	270,171
Construction	189,458	250,022
Finance leases	3,061	3,485
Consumer	32,990	36,062
Total non-performing loans held for investment	\$ 1,008,044	\$ 1,138,362
Other real estate owned	177,001	114,292
Other repossessed property	9,775	15,392
Other assets ⁽¹⁾	64,543	64,543
Total non-performing assets, excluding loans held for sale	\$ 1,259,363	\$ 1,332,589
Non-performing loans held for sale		4,764
Total non-performing assets, including loans held for sale ⁽²⁾	\$ 1,259,363	\$ 1,337,353
Past due loans 90 days and still accruing ⁽³⁾	\$ 141,028	\$ 130,816
Non-performing assets to total assets	9.58%	10.19%
Non-performing loans held for investment to total loans held for investment	9.89%	10.78%
Allowance for loan and lease losses	445,531	493,917
Allowance to total non-performing loans held for investment	44.20%	43.39%
Allowance to total non-performing loans held for investment, excluding residential real estate loans	64.84%	61.73%

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

(2) Amounts exclude purchased credit impaired loans with a carrying value of approximately \$12.7 million acquired as part of a credit cards portfolio purchased in the second quarter of 2012.

(3) It is the Corporation's policy to report delinquent residential mortgage loans insured by 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 \$34.6 million of residential mortgage loans insured by FHA or guaranteed by the VA, which are over 18 months delinquent, that are no longer accruing interest as of September 30, 2012.

Table of Contents

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

(Dollars in thousands)	September 30, 2012	December 31, 2011
Puerto Rico:		
Non-performing loans held for investment:		
Residential mortgage	\$ 285,994	\$ 297,595
Commercial mortgage	175,007	170,949
Commercial and Industrial	216,602	261,189
Construction	110,378	137,478
Finance leases	3,061	3,485
Consumer	30,005	34,888
Total non-performing loans held for investment	821,047	905,584
REO	137,877	85,788
Other repossessed property	9,700	15,283
Other assets	64,543	64,543
Total non-performing assets, excluding loans held for sale	\$ 1,033,167	\$ 1,071,198
Non-performing loans held for sale		4,764
Total non-performing assets, including loans held for sale ⁽¹⁾	\$ 1,033,167	\$ 1,075,962
Past due loans 90 days and still accruing	\$ 138,431	\$ 118,888
Virgin Islands:		
Non-performing loans held for investment:		
Residential mortgage	\$ 18,559	\$ 11,470
Commercial mortgage	11,751	12,851
Commercial and Industrial	12,657	7,276
Construction	72,786	110,594
Consumer	921	518
Total non-performing loans held for investment	116,674	142,709
REO	26,642	7,200
Other repossessed property	57	67
Total non-performing assets, excluding loans held for sale	\$ 143,373	\$ 149,976
Non-performing loans held for sale		
Total non-performing assets, including loans held for sale	\$ 143,373	\$ 149,976
Past due loans 90 days and still accruing	\$ 2,597	\$ 11,204
Florida:		
Non-performing loans held for investment:		
Residential mortgage	\$ 16,360	\$ 29,143
Commercial mortgage	44,405	56,614
Commercial and Industrial	1,200	1,706
Construction	6,294	1,950
Consumer	2,064	656

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

Total non-performing loans held for investment	70,323	90,069
REO	12,482	21,304
Other repossessed property	18	42
Total non-performing assets, excluding loans held for sale Non-performing loans held for sale	\$ 82,823	\$ 111,415
Total non-performing assets, including loans held for sale	\$ 82,823	\$ 111,415
Past due loans 90 days and still accruing	\$	\$ 724

- (1) Amount excludes purchased credit impaired loans with a carrying value of approximately \$12.7 million acquired as part of the credit cards portfolio acquired from FIA.

Table of Contents

Total non-performing loans were \$1.01 billion at September 30, 2012, which represented 9.89% of total loans held for investment. This represents a decrease of \$135.1 million, or 11.82%, from \$1.14 billion, or 10.78% of total loans held for investment at December 31, 2011.

Non-performing construction loans decreased by \$65.3 million, or 26%, from the end of the fourth quarter of 2011, mainly due to the transfer to REO of properties acquired in foreclosure aggregating approximately \$37.8 million and charge-offs. Most of the foreclosures were concentrated in four projects in both Puerto Rico and the Virgin Islands regions.

C&I non-performing loans decreased by \$39.7 million, or 15% when compared to the balance at December 31, 2011, reflecting primarily net charge-offs of \$33.3 million and foreclosures of approximately \$30 million. Borrowers' payments and payoffs and modified loans restored to accrual status after a sustained period of performance also contributed to the decrease in non-performing C&I loans. The decline was primarily in Puerto Rico.

Non-performing residential mortgage loans decreased \$17.3 million, or 5%, from December 31, 2011. The decrease was driven by several factors, including: (i) loans brought current, (ii) foreclosures of approximately \$42.9 million, and (iii) the restoration to accrual status of modified loans that successfully completed a trial performance period aggregating to approximately \$30 million. Borrowers' payments, payoffs and charge-offs also contributed to the decrease. The level of inflows of non-performing residential mortgage loans was approximately \$148.4 million during the first nine months of 2012, however, the level of inflows decreased 6% from \$46.9 million for the second quarter of 2012 to \$44.1 million in the third quarter. Approximately \$157.4 million, or 49%, of total non-performing residential mortgage loans have been written down to their net realizable value.

Non-performing commercial mortgage loans decreased \$9.3 million, or 4%, from December 31, 2011, reflecting primarily net charge-off of \$14.9 million, foreclosures of \$18.8 million and restoration to accrual status after a sustained performance period of \$7.5 million of modified loans. The decrease was primarily in the United States and the Virgin Islands regions.

The levels of non-performing consumer loans, including finance leases, showed a \$3.5 million decrease during the first nine months of 2012. The decrease was mainly related to a reduction in the auto financing category.

At September 30, 2012, approximately \$302.3 million of the loans placed in non-accrual status, mainly construction and commercial loans, were current, or had delinquencies of less than 90 days in their interest payments, including \$203.6 million of TDRs maintained in nonaccrual status until the restructured loans meet the criteria of sustained payment performance under the revised terms for reinstatement to accrual status and there is no doubt about full collectability. Collections are being recorded on a cash basis through earnings, or on a cost-recovery basis, as conditions warrant.

During the nine-month period ended September 30, 2012, interest income of approximately \$7.6 million related to non-performing loans with a carrying value of \$682.2 million as of September 30, 2012, mainly non-performing construction and commercial loans, was applied against the related principal balances under the cost-recovery method.

Table of Contents

The allowance to non-performing loans held for investment ratio as of September 30, 2012, was 44.20%, compared to 43.39% as of December 31, 2011. As of September 30, 2012, approximately \$216.7 million, or 22%, of total non-performing loans held for investment have been charged-off to their net realizable value as shown in the following table.

<i>(Dollars in thousands)</i>	Residential Mortgage Loans	Commercial Mortgage Loans	C&I Loans	Construction Loans	Consumer and Finance Leases	Total
As of September 30, 2012						
Non-performing loans held for investment charged-off to realizable value	\$ 157,399	\$ 8,722	\$ 25,102	\$ 24,330	\$ 1,175	\$ 216,728
Other non-performing loans held for investment	163,514	222,441	205,357	165,128	34,876	791,316
Total non-performing loans held for investment	\$ 320,913	\$ 231,163	\$ 230,459	\$ 189,458	\$ 36,051	\$ 1,008,044
Allowance to non-performing loans held for investments	21.55%	38.60%	70.74%	34.79%	164.63%	44.20%
Allowance to non-performing loans held for investments, excluding non-performing loans charged-off to realizable value	42.30%	40.11%	78.83%	39.92%	170.18%	56.30%
As of December 31, 2011						
Non-performing loans held for investment charged-off to realizable value	\$ 233,703	\$ 21,925	\$ 70,462	\$ 70,959	\$ 2,605	\$ 399,654
Other non-performing loans held for investment	104,505	218,489	199,709	179,063	36,942	738,708
Total non-performing loans held for investment	\$ 338,208	\$ 240,414	\$ 270,171	\$ 250,022	\$ 39,547	\$ 1,138,362
Allowance to non-performing loans held for investments	20.31%	45.33%	60.88%	36.55%	152.66%	43.39%
Allowance to non-performing loans held for investments, excluding non-performing loans charged-off to realizable value	65.72%	49.88%	82.36%	51.04%	163.42%	66.86%

The Corporation provides homeownership preservation assistance to its customers through a loss mitigation program in Puerto Rico and in accordance with the 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 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 September 30, 2012, the Corporation's total TDR loans of \$925.1 million consisted of \$410.2 million of residential mortgage loans, \$107.5 million of commercial and industrial loans, \$298.1 million of commercial mortgage loans, \$86.6 million of construction loans and \$22.7 million of consumer loans. Outstanding unfunded commitments on TDR loans amounted to \$4.4 million as of September 30, 2012.

The Corporation's loss mitigation programs for residential mortgage and consumer loans can provide for one or a combination of the following: movement of interest past due to the end of the loan, extension of the loan term, deferral of principal payments for a significant period of time, and reduction of interest rates either permanently, offered up to 2010, or for a period of up to two years (step-up rates). Additionally, in remote 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

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

to only those borrowers who have defaulted, or are likely to default, permanently on their loan and would lose their homes in foreclosure action absent some lender concession. Notwithstanding, if the Corporation is not reasonably assured that the borrower will comply with its contractual commitment, properties are foreclosed.

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

Prior to permanently modifying a loan, the Corporation may enter into trial modifications with certain borrowers. Trial modifications generally represent a three month period whereby 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 enters into a permanent modification. As a result of new accounting guidance on TDRs, 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 TDR regardless of whether the borrower enters into a permanent modification. At September 30, 2012, we classified an additional \$5.7 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 the construction portfolios, at the time of the 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; waiving of borrower covenants; forgiveness of principal or interest; or other contract changes that would be considered a concession. The

Table of Contents

Corporation mitigates loan defaults for its commercial loan portfolios through its collections function. The function's objective is to minimize both early stage delinquencies and losses upon default of commercial loans. In the case of C&I, commercial mortgage and construction loan portfolios, the SAG focuses on strategies for the accelerated reduction of non-performing assets through note sales, short sales, loss mitigation programs, and sales of REO. In addition to the management of the resolution process for problem loans, the SAG oversees collection efforts for all loans to prevent migration to the non-performing and/or adversely classified status. The SAG utilizes relationship officers, collection specialists and attorneys. In the case of residential construction projects, the workout function monitors project specifics, such as project management and marketing, as deemed necessary. The SAG utilizes its collections infrastructure of workout collection officers, credit work-out specialists, in-house legal counsel, and third party consultants. In the case of residential construction projects and large commercial loans, the function also utilizes third-party specialized consultants to monitor the residential and commercial construction projects in terms of construction, marketing and sales, and 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 not considered concessions, and the loans continue to be recorded as performing.

TDRs are classified as either accrual or nonaccrual loans. A loan on nonaccrual and restructured as a TDR will remain on nonaccrual status until the borrower has proven the ability to perform under the modified structure for a minimum of six months and there is evidence that such payments can and are likely to continue as agreed. Performance prior to the restructuring, or significant events that coincide with the restructuring, are included in assessing whether the borrower can meet the new terms and may result in the loans being returned to accrual at the time of the restructuring or after a shorter performance period. If the borrower's ability to meet the revised payment schedule is uncertain, the loan remains classified as a nonaccrual loan. Loan modifications increase the Corporation interest income by returning a non-performing loan to performing status, if applicable, and increase cash flows by providing for payments to be made by the borrower, and avoid increases in foreclosure and real estate owned costs. The Corporation continues to consider a modified loan as an impaired loan for purposes of estimating the allowance for loan and lease losses.

The following table provides a breakdown between accrual and nonaccrual status of TDRs as of September 30, 2012:

(In Thousands)	September 30, 2012		
	Accrual	Nonaccrual (1)	Total TDRs
Non-FHA/VA Residential Mortgage loans	\$ 294,184	\$ 116,063	\$ 410,247
Commercial Mortgage Loans	157,445	140,601	298,046
Commercial & Industrial Loans	24,749	82,808	107,557
Construction Loans	2,490	84,091	86,581
Consumer Loans - Auto	7,114	4,699	11,813
Finance Leases	1,985	59	2,044
Consumer Loans - Other	7,037	1,819	8,856
Total Troubled Debt Restructurings	\$ 495,004	\$ 430,140	\$ 925,144

(1) Included in non-accrual loans are \$203.6 million in loans that are performing under the terms of the restructuring agreement but are reported in non-accrual until the restructured loans meet the criteria of sustained payment performance under the revised terms for reinstatement to accrual status and there is no doubt about full collectability.

The REO portfolio, which is part of non-performing assets, increased by \$62.7 million. The following table shows the activity during the first nine-months of 2012 of the REO portfolio by geographic region and type of property:

(In thousands)	As of September 30, 2012								
	Puerto Rico		Virgin Islands		Florida		Consolidated		
	Residential	Commercial	Construction	Residential	Commercial	Construction	Residential	Commercial	Construction

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

Beginning Balance	\$ 55,381	\$ 24,629	\$ 5,778	\$ 6,520	\$	\$ 680	\$ 5,710	\$ 11,613	\$ 3,981	\$ 114,292
Additions	39,656	43,460	20,445		4,244	17,388	3,256	4,674		133,123
Sales	(28,587)	(5,707)	(1,830)	(540)			(6,228)	(8,535)		(51,427)
Fair value adjustments	(7,101)	(6,634)	(1,614)	(1,280)	(43)	(327)	(411)	(1,337)	(240)	(18,987)
	\$ 59,349	\$ 55,748	\$ 22,779	\$ 4,700	\$ 4,201	\$ 17,741	\$ 2,327	\$ 6,415	\$ 3,741	\$ 177,001

The over 90-day delinquent, but still accruing loans, excluding loans guaranteed by the U.S. Government, increased during the nine-month period ended September 30, 2012 by \$4.0 million to \$49.6 million, or 0.49% of total loans held for investment at September 30, 2012. Loans 30 to 89 days delinquent decreased by \$.06 million to \$283.0 million as of September 30, 2012.

Table of Contents*Net Charge-offs and Total Credit Losses*

Total net charge-offs for the first nine months of 2012 were \$138.4 million, or 1.79% of average loans on an annualized basis. This was down \$89.3 million, or 39%, from \$227.7 million, or an annualized 2.72%, in the first nine months of 2011.

Construction loans net charge-offs for the first nine months of 2012 were \$38.9 million, or an annualized 13.00%, compared to \$81.3 million, or an annualized 16.30% of related loans, in the first nine months of 2011. Approximately \$27.0 million, of the construction loans net charge-offs in the first nine months of 2012 were in the Virgin Islands, including charge-offs of \$22.7 million related to a commercial project. In Puerto Rico, construction loans net charge-offs of \$14.0 million in the first nine months of 2012 include an individual charge-off of \$7.6 million related to a commercial project. The United States construction loan portfolio reflected a net recovery of \$2.1 million, including a \$1.5 million recovery related to a residential land loan that was fully charged-off previously. The construction portfolio in Florida has been considerably reduced over the past three years to \$22.6 million as of September 30, 2012.

C&I loan net charge-offs in the first nine months of 2012 were \$33.3 million, or an annualized 1.15% of related average loans, down from \$49.6 million, or an annualized 1.55% of related loans, in the first nine months of 2011. Substantially all of the charge-offs recorded in the first nine months of 2012 were in Puerto Rico spread through several industries. Approximately 71%, or \$23.5 million, of the net charge-offs in the first nine months of 2012 were related to nine relationships with individual charge-offs in excess of \$1 million.

Commercial mortgage loans net charge-offs in the first nine months of 2012 were \$14.9 million, or an annualized 1.32% of related average loans, down from \$37.6 million, or an annualized 3.14% of related loans, in the first nine months of 2011. Commercial mortgage loans net charge-offs in the first nine months of 2012 were \$11.1 million in Puerto Rico and \$3.8 million in the United States. Most of the charge-offs were concentrated in four relationships with individual charge-offs in excess of \$1 million.

Residential mortgage loan net charge-offs were \$27.8 million, or an annualized 1.30% of related average loans compared to \$36.9 million, or an annualized 1.33% for the comparable period in 2011. Approximately \$14.2 million in charge-offs for the first nine months of 2012 (\$13.0 million in Puerto Rico, \$1.1 million in Florida and \$0.1 million in the Virgin Islands) resulted from valuations for impairment purposes of residential mortgage loan portfolios considered homogeneous given high delinquency and loan-to-value levels, compared to \$20.6 million recorded in the same period of 2011. Net charge-offs on residential mortgage loans also included \$6.8 million related to the foreclosure of loans during the first nine months of 2012, compared to \$7.0 million recorded for foreclosures in the first nine months of 2011.

Net charge-offs on consumer loans and finance leases in the first nine months of 2012 were \$24.0 million, or an annualized 1.85% of related average loans down from \$29.4 million, or an annualized 2.39% of average loans for the first nine months of 2011. This decrease reflected the continued high credit quality of originations and an improved ratio also impacted by a larger portfolio led by the recently acquired credit cards portfolio.

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

	For the Quarter Ended		For the Nine-Month Period Ended	
	September 30, 2012	September 30, 2011	September 30, 2012	September 30, 2011
Residential mortgage loans	1.05%	2.24%	1.30%	1.33%
Commercial mortgage	1.36%	0.84%	1.32%	3.14%
Commercial and industrial	1.33%	2.09%	1.15%	1.55%
Construction loans	9.11%	12.78%	13.00%	16.30%
Consumer loans ⁽¹⁾⁽²⁾	1.55%	2.30%	1.85%	2.39%
Total loans	1.58%	2.50%	1.79%	2.72%

(1) Includes lease financing.

(2) Loans used in the denominator in calculating the ratio include PCI loans.

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

Table of Contents

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

	Quarter Ended		Nine-Month Period Ended	
	September 30, 2012	September 30, 2011	September 30, 2012	September 30, 2011
PUERTO RICO:				
Residential mortgage	1.33%	2.50%	1.57%	1.37%
Commercial mortgage	2.08%	0.99%	1.41%	4.05%
Commercial and Industrial	1.43%	2.20%	1.25%	1.61%
Construction	2.28%	15.02%	7.46%	9.76%
Consumer and finance leases	1.56%	2.33%	1.83%	2.44%
Total loans	1.53%	2.62%	1.64%	2.35%
VIRGIN ISLANDS:				
Residential mortgage ⁽¹⁾	(0.02)%	0.19%	0.05%	0.03%
Commercial mortgage	0.00%	0.00%	0.00%	0.00%
Commercial and Industrial	0.00%	0.00%	0.01%	0.43%
Construction	26.04%	9.78%	28.78%	29.62%
Consumer and finance leases	1.16%	2.34%	1.03%	1.35%
Total loans	3.48%	1.84%	4.29%	5.62%
FLORIDA:				
Residential mortgage	0.30%	3.27%	1.03%	2.87%
Commercial mortgage ⁽²⁾	(0.40)%	0.62%	1.28%	1.43%
Commercial and Industrial ⁽³⁾	(0.01)%	2.32%	(0.93)%	1.06%
Construction ⁽⁴⁾	(0.50)%	6.38%	(11.62)%	25.45%
Consumer and finance leases	1.64%	1.02%	4.06%	1.82%
Total loans ⁽⁵⁾	(0.04)%	1.93%	0.79%	3.56%

- (1) For the third quarter of 2012 recoveries in residential mortgage loans in the Virgin Islands exceeded charge-offs.
- (2) For the third quarter of 2012 recoveries in commercial mortgage loans in Florida exceeded charge-offs.
- (3) For the third quarter and nine-month period ended September 30, 2012 recoveries in commercial and industrial loans in Florida exceeded charge-offs.
- (4) For the third quarter and nine-month period ended September 30, 2012 recoveries in construction loans in Florida exceeded charge-offs.
- (5) For the third quarter of 2012, recoveries in total loans in Florida exceeded charge-offs.

Total credit losses (equal to net charge-offs plus losses on REO operations) for the first nine months of 2012 amounted to \$157.3 million, or 2.01% on an annualized basis to average loans and repossessed assets in contrast to credit losses of \$244.1 million, or a loss rate of 2.89%, for the first nine months of 2011.

Table of Contents

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

Credit Loss Performance	Quarter Ended September 30,		Nine-Month Period Ended September 30,	
	2012	2011	2012	2011
REO (Dollars in thousands)				
REO balances, carrying value:				
Residential	\$ 66,376	\$ 67,704	\$ 66,376	\$ 67,704
Commercial	66,364	32,388	66,364	32,388
Construction	44,261	9,422	44,261	9,422
Total	\$ 177,001	\$ 109,514	\$ 177,001	\$ 109,514
REO activity (number of properties):				
Beginning property inventory,	647	495	575	479
Properties acquired	129	127	396	337
Properties disposed	(106)	(81)	(301)	(275)
Ending property inventory	670	541	670	541
Average holding period (in days)				
Residential	369	288	369	288
Commercial	270	315	270	315
Construction	197	439	197	439
	289	309	289	309
REO operations (loss) gain:				
Market adjustments and (losses) gain on sale:				
Residential	\$ (2,285)	\$ (1,714)	\$ (5,263)	\$ (6,070)
Commercial	(1,736)	(491)	(1,946)	(3,411)
Construction	(681)	(461)	(1,067)	(379)
	(4,702)	(2,666)	(8,276)	(9,860)
Other REO operations expenses	(3,984)	(2,286)	(10,639)	(6,563)
Net Loss on REO operations	\$ (8,686)	\$ (4,952)	\$ (18,915)	\$ (16,423)
CHARGE-OFFS				
Residential charge-offs, net	(7,358)	(15,816)	(27,300)	(29,914)
Commercial charge-offs, net	(17,263)	(25,835)	(48,182)	(87,140)
Construction charge-offs, net	(8,326)	(16,823)	(38,904)	(81,268)
Consumer and finance leases charge-offs, net	(7,627)	(9,163)	(24,033)	(29,378)
Total charge-offs, net	(40,574)	(67,637)	(138,419)	(227,700)
TOTAL CREDIT LOSSES ⁽¹⁾	\$ (49,260)	\$ (72,589)	\$ (157,334)	\$ (244,123)

LOSS RATIO PER CATEGORY ⁽²⁾

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

Residential	1.34%	2.43%	1.52%	1.57%
Commercial	1.45%	1.78%	1.24%	2.05%
Construction	9.00%	12.88%	12.57%	16.08%
Consumer	1.54%	2.28%	1.83%	2.37%
TOTAL CREDIT LOSS RATIO⁽³⁾	1.88%	2.65%	2.01%	2.89%

- (1) Equal to REO operations (losses) gains plus Charge-offs, net.
- (2) Calculated as net charge-offs plus market adjustments and gains (losses) on sale of REO divided by average loans and repossessed assets.
- (3) Calculated as net charge-offs plus net loss on REO operations divided by average loans and repossessed assets.

Table of Contents

Operational Risk

The Corporation faces ongoing and emerging risk and regulatory pressure related to the activities that surround the delivery of banking and financial products. Coupled with external influences such as market conditions, security risks, and legal risk, the potential for operational and reputational loss has increased. In order to mitigate and control operational risk, the Corporation has developed, and continues to enhance, specific internal controls, policies and procedures that are designated to identify and manage operational risk at appropriate levels throughout the organization. The purpose of these mechanisms is to provide reasonable assurance that the Corporation's business operations are functioning within the policies and limits established by management.

The Corporation classifies operational risk into two major categories: business specific and corporate-wide affecting all business lines. For business specific risks, a risk assessment group works with the various business units to ensure consistency in policies, processes and assessments. With respect to corporate-wide risks, such as information security, business recovery, and legal and compliance, the Corporation has specialized groups, such as the Legal Department, Information Security, Corporate Compliance, Information Technology and Operations. These groups assist the lines of business in the development and implementation of risk management practices specific to the needs of the business groups.

Legal and Compliance Risk

Legal and compliance risk includes the risk of non-compliance with applicable legal and regulatory requirements, the risk of adverse legal judgments against the Corporation, and the risk that a counterparty's performance obligations will be unenforceable. The Corporation is subject to extensive regulation in the different jurisdictions in which it conducts its business, and this regulatory scrutiny has been significantly increasing over the last several years. The Corporation has established and continues to enhance procedures based on legal and regulatory requirements that are designed to ensure compliance with all applicable statutory and regulatory requirements. The Corporation has a Compliance Director who reports to the Chief Risk Officer and is responsible for the oversight of regulatory compliance and implementation of an enterprise-wide compliance risk assessment process. The Compliance division has officer roles in each major business areas with direct reporting relationships to the Corporate Compliance Group.

Concentration Risk

The Corporation conducts its operations in a geographically concentrated area, as its main market is Puerto Rico. However, the Corporation has diversified its geographical risk as evidenced by its operations in the Virgin Islands and in Florida.

As of September 30, 2012, the Corporation had \$148.7 million outstanding in credit facilities granted to the Puerto Rico Government and/or its political subdivisions, down from \$360.1 million as of December 31, 2011, and \$117.7 million granted to the Government of the Virgin Islands, down from \$139.4 million as of December 31, 2011. A substantial portion of these credit facilities consist of loans to municipalities in Puerto Rico for which the good faith, credit and unlimited taxing power of the applicable municipality have been pledged to their repayment. Another portion of these obligations consists of loans to public corporations that obtain revenues from rates charged for services or products, such as electric power and water utilities. Public corporations have varying degrees of independence from the central Government and many receive appropriations or other payments from it.

In addition to loans extended to government entities, the largest loan to one borrower as of September 30, 2012 in the amount of \$258.3 million is with one mortgage originator in Puerto Rico, Doral Financial Corporation. This commercial loan is secured by individual real-estate loans, mostly 1-4 residential mortgage loans.

Of the total gross loans held for investment portfolio of \$10.2 billion as of September 30, 2012 approximately 85% have credit risk concentration in Puerto Rico, 7% in the United States and 8% in the Virgin Islands.

Table of Contents

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

ITEM 4. CONTROLS AND PROCEDURES

Disclosure Control and Procedures

First BanCorp's management, including its Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of First BanCorp's disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of September 30, 2012, except as otherwise noted below. Based on this evaluation, as of the end of the period covered by this Form10-Q, the Chief Executive Officer and Chief Financial Officer concluded that the design and operation of these disclosure controls and procedures were effective.

As described in Note 6, Loans Held for Investment Acquired loans including Purchased Credit-Impaired Loans, to the consolidated financial statements included in this Quarterly Report on Form 10-Q, the Corporation acquired on May 30, 2012 an approximate \$406 million portfolio of FirstBank-branded credit cards from FIA Card Services (FIA). As part of the credit cards portfolio acquisition, FIA has been retained as servicer of the portfolio for an eighteen month period. Prior to completing the acquisition, the Corporation performed due diligence on the assets and the business. This due diligence process provided the Corporation with a reasonable level of assurance that, as of the date the acquisition was completed, the disclosure controls and procedures in place with respect to the administration by FIA of the credit cards portfolio to be acquired were effective. After the referenced acquisition, and as of September 30, 2012, however, the Corporation has not yet completed its own assessment of the design and operation of the disclosure controls and procedures relating to the administrative systems and processes being provided by FIA as the servicer of the acquired credit cards portfolio.

Internal Control over Financial Reporting

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

Table of Contents**PART II OTHER INFORMATION****ITEM 1. LEGAL PROCEEDINGS**

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

ITEM 1A. RISK FACTORS

Our business, operating results and/or the market price of our common and preferred stock may be significantly affected by a number of factors. For a detailed discussion of certain risk factors that could affect the Corporation's operations, financial condition or results for future periods see the risk factors below and in Item 1A, Risk Factors, in the Corporation's 2011 Annual Report on Form 10-K. These factors could also cause actual results to differ materially from historical results or the results contemplated by the forward-looking statements contained in this report. Also refer to the discussion in Part I Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations in this report for additional information that may supplement or update the discussion of risk factors in the Corporation's 2011 Form 10-K.

The risks described in the Corporation's 2011 Form 10-K and in this report are not the only risks facing the Corporation. Additional risks and uncertainties not currently known to the Corporation or currently deemed by the Corporation to be immaterial also may materially adversely affect the Corporation's business, financial condition or results of operations.

Our business concentration in Puerto Rico imposes risks.

We conduct our operations in a geographically concentrated area, as our main market is Puerto Rico. This imposes risks from lack of diversification in our geographical portfolio. Our financial condition and results of operations are highly dependent on the economic conditions of Puerto Rico, where adverse political or economic developments, among other things, could affect the volume of loan originations, increase the level of non-performing assets, increase the rate of foreclosure losses on loans, and reduce the value of our loans and loan servicing portfolio.

Since March 2006, a number of key economic indicators have shown that the economy of Puerto Rico has been in a recession.

On April 19, 2012, the Puerto Rico Planning Board announced the release of Puerto Rico's macroeconomic data for the projections for the fiscal year ending on June 30, 2012 (FY 2012) and for the fiscal year ending on June 30, 2013 (FY 2013). Projections show an increase of 0.9% in the real gross national product (the GNP) for FY2012, and an increase of 1.1% for FY 2013. The Government Development Bank for Puerto Rico's Economic Activity Index (EAI), which is a coincident index consisting of four major monthly economic indicators (namely total payroll employment, total electric power generation, cement sales and gas consumption), and which monitors the actual trend of Puerto Rico's economy, reflected a year-over year increase of 0.5% for December 2011 its first positive growth since March 2006. Since then, the EAI has experienced its fifth consecutive month of positive year-over year growth. Construction has remained weak since 2009 as Puerto Rico's fiscal situation and decreasing public investment in construction projects has affected the sector.

Although the government of Puerto Rico has implemented various measures in order to achieve a balanced budget for FY 2012 and FY 2013, on August 8, 2011, Moody's downgraded the general obligation (GO) rating of the Commonwealth of Puerto Rico. The downgrade also applies to those ratings that are based on or capped at the general obligation rating of the Commonwealth of Puerto Rico. Moody's revised the GO on June 6, 2012 and changed its outlook from stable to negative. Moody's based the decision on its strong concerns with the continued deterioration of the severely underfunded government retirement systems, weak economic trends and weak finances. On June 26, 2012, Standard and Poor's (S&P) revised its outlook on the Government Development Bank for Puerto Rico from stable to negative, while maintaining the current rating. According to S&P, the decision was based on the strong ties that the Government Development Bank has with the Puerto Rico Government, especially given that it provides funding to the Puerto Rico Government and certain Puerto Rico public corporations; and, since the outlook for Puerto Rico GO was downgraded, the logical progression called for a downgrade of the Government Development Bank's rating.

Some of the measures implemented by the government to reduce expenses included public-sector employee layoffs. Since the government is an important source of employment in Puerto Rico, these measures had a temporary adverse effect on the island's economy. In order to increase revenues, the government passed Law 154 of 2010 which imposes a variable rate excise tax on Controlled Foreign Corporations. The law, which was enacted in December of 2010, will be in effect up to December 2016.

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

Although recent economic indicators have shown positive year-over-year trends, the Puerto Rico Labor Department reported an unemployment rate of 13.6% for the month of September 2012.

The economy of Puerto Rico is sensitive to the price of oil in the global market since it does not have a significant mass transit system available to the public and most of its electricity is powered by oil. The substantial increase in the price of oil has adversely impacted the economy by reducing disposable income and increasing the operating costs of most businesses and government. Consumer spending is particularly sensitive to wide fluctuations in oil prices.

This decline in Puerto Rico's economy has resulted in, among other things, a downturn in our loan originations, an increase in the level of our non-performing assets, loan loss provisions and charge-offs, particularly in our construction and commercial loan portfolios, an increase in the rate of foreclosure loss on mortgage loans, and a reduction in the value of our loans and loan servicing portfolio, all of which have adversely affected our profitability. If the decline in economic activity continues, there could be further adverse effects on our profitability.

The above economic concerns and uncertainty in the private and public sectors may continue to have an adverse effect on the credit quality of our loan portfolios, as delinquency rates have increased, until the economy stabilizes.

Table of Contents***We may not be able to recover all assets pledged to Lehman Brothers Special Financing, Inc.***

Lehman Brothers Special Financing, Inc. (Lehman) was the counterparty to the Corporation on certain interest rate swap agreements. During the third quarter of 2008, Lehman failed to pay the scheduled net cash settlement due to the Corporation, which constituted an event of default under those interest rate swap agreements. The Corporation terminated all interest rate swaps with Lehman and replaced them with other counterparties under similar terms and conditions. In connection with the unpaid net cash settlement under the swap agreements, the Corporation has an unsecured counterparty exposure with Lehman, which filed for bankruptcy on October 3, 2008, of approximately \$1.4 million. This exposure was reserved in the third quarter of 2008. The Corporation had securities pledged as collateral with a \$63.6 million face value to guarantee its performance under the swap agreements in the event payment there under was required.

Since the second quarter of 2009, the Corporation has maintained a non-performing asset with a book value of \$64.5 million in addition to accrued interest of \$2.1 million related to the collateral pledged with Lehman. The Corporation believes that the securities pledged as collateral should not be part of the Lehman bankruptcy estate given the facts that the posted collateral constituted a performance guarantee under the swap agreements and was not part of a financing agreement, and that ownership of the securities was never transferred to Lehman. Upon termination of the interest rate swap agreements, Lehman's obligation was to return the collateral to the Corporation. During the fourth quarter of 2009, the Corporation discovered that Lehman Brothers, Inc., acting as agent of Lehman, had deposited the securities in a custodial account at JP Morgan Chase, and that, shortly before the filing of the Lehman bankruptcy proceedings, it had provided instructions to have most of the securities transferred to Barclays Capital (Barclays) in New York. After Barclays' refusal to turn over the securities, the Corporation filed a lawsuit against Barclays in federal court in New York demanding the return of the securities in December 2009. During February 2010, Barclays filed a motion with the court requesting that the Corporation's claim be dismissed on the grounds that the allegations of the complaint are not sufficient to justify the granting of the remedies therein sought. Shortly thereafter, the Corporation filed its opposition motion. A hearing on the motions was held in court on April 28, 2010. The court, on that date, after hearing the arguments by both sides, concluded that the Corporation's equitable-based causes of action, upon which the return of the investment securities is being demanded, contain allegations that sufficiently plead facts warranting the denial of Barclays' motion to dismiss the Corporation's claim. Accordingly, the judge ordered the case to proceed to trial.

Subsequent to the court decision, the district court judge transferred the case to the Lehman bankruptcy court for trial. Discovery pursuant to that case management plan has been completed. The parties filed dispositive motions on September 13, 2012. Oppositions to such motions and replies thereto must be filed by October 15, 2012 and November 14, 2012, respectively, but this timing is subject to adjustment. The Corporation may not succeed in its litigation against Barclays to recover all or a substantial portion of the securities.

Additionally, the Corporation continues to pursue its claim filed in January 2009 in the proceedings under the Securities Protection Act with regard to Lehman Brothers Inc. in the United States Bankruptcy Court for the Southern District of New York.

An estimated loss has not been accrued as the Corporation is unable to determine the timing of the claim resolution or whether it will succeed in recovering all or a substantial portion of the collateral or its equivalent value.

Because the Corporation has not had the benefit of the use of the investment securities pledged to Lehman (i.e., ability to sell, pledge or transfer), and because the Corporation has not received principal or interest payments since 2008 (after the collapse of Lehman), the appropriate carrying value of these securities has been under review with our regulators, with recent heightened concern due to the complex and lengthy litigation regarding this matter. If, as a result of these discussions, developments in the litigation, or for other reasons, the Corporation should determine that it is probable that the asset has been impaired and that the Corporation needs to recognize a partial or full loss for the investment securities pledged to Lehman, such an action would adversely affect the Corporation's results of operations in the period in which such action is taken. The Corporation expects to reassess the recoverability of the asset upon the resolution of the dispositive motions filed with the court, which motions could be resolved in the fourth quarter of 2012.

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

Not applicable.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4. MINE SAFETY DISCLOSURE

ITEM 5. OTHER INFORMATION

Not applicable.

ITEM 6. EXHIBITS

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

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Corporation has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized:

First BanCorp.

Registrant

Date: November 9, 2012

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

Date: November 9, 2012

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

Table of Contents

Exhibit Index

- 12.1 - Ratio of Earnings to Fixed Charges.
- 12.2 - Ratio of Earnings to Fixed Charges and Preference Dividends.
- 31.1 - CEO Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 - CFO Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 - CEO Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 - CFO Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101 - Interactive Data File (Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2012, furnished in XBRL (eXtensible Business Reporting Language))