

FIRST BANCORP /PR/  
Form 10-K  
March 16, 2017

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-K**

(Mark one)

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

**For the Fiscal Year Ended December 31, 2016**

or

**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 1-14793**

**FIRST BANCORP.**

(Exact name of registrant as specified in its charter)

**Puerto Rico**  
(State or other jurisdiction of

**66-0561882**  
(I.R.S. Employer

incorporation or organization)

Identification No.)

**1519 Ponce de León Avenue, Stop 23**  
**Santurce, Puerto Rico**  
(Address of principal executive office)

**00908**  
(Zip Code)

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

**(787) 729-8200**

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

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

**New York Stock Exchange**

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

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

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

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

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

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

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

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

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

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

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

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

Large accelerated filer

Accelerated  
filer

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

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

The aggregate market value of the voting common equity held by non-affiliates of the registrant as of June 30, 2016 (the last trading day of the registrant's most recently completed second fiscal quarter) was \$501,752,414 based on the closing price of \$3.97 per share of the registrant's common stock on the New York Stock Exchange on June 30, 2016. The registrant had no nonvoting common equity outstanding as of June 30, 2016. For the purposes of the foregoing calculation only, the registrant has defined affiliates to include (a) the executive officers named in Part III of this Annual Report on Form 10-K; (b) all directors of the registrant; and (c) each shareholder, including the registrant's employee benefit plans but excluding shareholders that file on Schedule 13G, known to the registrant to be the beneficial owner of 5% or more of the outstanding shares of common stock of the registrant as of June 30, 2016. The registrant's response to this item is not intended to be an admission that any person is an affiliate of the registrant for any purposes other than this response.

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date: 217,509,055 shares as of March 3, 2017.

Documents incorporated by reference: Portions of the definitive proxy statement relating to the registrant's annual meeting of stockholders scheduled to be held on May 23, 2017 are incorporated by reference in this Form 10-K in response to items 10, 11, 12, 13 and 14 of Part III.

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**FIRST BANCORP.**

**2016 ANNUAL REPORT ON FORM 10-K**

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## Forward Looking Statements

This Form 10-K contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the “Securities Act”), and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), which are subject to the safe harbor created by such sections. When used in this Form 10-K or future filings by First BanCorp. (the “Corporation”) with the U.S. Securities and Exchange Commission (“SEC”), in the Corporation’s press releases or in other public or stockholder communications, or in oral statements made with the approval of an authorized executive officer, the words or phrases “would,” “intends,” “will likely result,” “expect to,” “should,” “anticipate,” “look forward,” “believes,” and other terms of similar meaning or import in connection with any discussion of future operating, financial or other performance are meant to identify “forward-looking statements.”

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

- the ability of the Puerto Rico government or any of its public corporations or other instrumentalities to repay its respective debt obligations, including the effect of payment defaults on the Puerto Rico government general obligations, bonds of the Government Development Bank for Puerto Rico (the “GDB”) and certain bonds of government public corporations, and recent and any future downgrades of the long-term and short-term debt ratings of the Puerto Rico government, which could exacerbate Puerto Rico’s adverse economic conditions and, in turn, further adversely impact the Corporation;
- uncertainty as to the ultimate outcomes of actions resulting from the enactment by the U.S. government of the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA) to address Puerto Rico’s financial problems;
- uncertainty about whether the Corporation will be able to continue to fully comply with the written agreement dated June 3, 2010 (the “Written Agreement”) that the Corporation entered into with the Federal Reserve Bank of New York (the “New York FED” or “Federal Reserve”), that, among other things, requires the Corporation to serve as a source of strength to FirstBank Puerto Rico (“FirstBank” or the “Bank”) and that, except with the consent generally of the New York FED and the Board of Governors of the Federal Reserve System (the “Federal Reserve Board”, referred to together with the New York FED as the “Federal “Reserve”), prohibits the Corporation from paying dividends to stockholders or receiving dividends from FirstBank, making payments on trust preferred securities or subordinated debt, incurring, increasing or guaranteeing debt and repurchasing any capital securities and uncertainty whether such consent will be provided for future interest payments on the subordinated debt despite the consents that enabled the Corporation to pay all the accrued but deferred interest payments plus the interest for the second, third and fourth quarters of 2016 on

the Corporation's subordinated debentures associated with its trust preferred securities and for future monthly dividends on its non-cumulative perpetual preferred stock despite the consents that enabled the Corporation to pay monthly dividends on its non-cumulative perpetual preferred stock for December 2016, January and February 2017;

- a decrease in demand for the Corporation's products and services and lower revenues and earnings because of the continued recession in Puerto Rico;
- uncertainty as to the availability of certain funding sources, such as brokered certificates of deposit ("brokered CDs");
- the Corporation's reliance on brokered CDs to fund operations and provide liquidity;
- the risk of not being able to fulfill the Corporation's cash obligations or resume paying dividends to the Corporation's common stockholders in the future due to the Corporation's need to receive regulatory approvals to declare or pay any dividends and to take dividends or any other form of payment representing a reduction in capital from FirstBank or FirstBank's failure to generate sufficient cash flow to make a dividend payment to the Corporation;
- the weakness of the real estate markets and of the consumer and commercial sectors and their impact on the credit quality of the Corporation's loans and other assets, which have contributed and may continue to contribute to, among other things, high levels of non-performing assets, charge-offs and provisions for loan and lease losses and may subject the Corporation to further risk from loan defaults and foreclosures;
- the ability of FirstBank to realize the benefits of its deferred tax assets subject to the remaining valuation allowance;

- adverse changes in general economic conditions in Puerto Rico, the United States (“U.S.”), and the U.S. Virgin Islands (“USVI”), and British Virgin Islands (“BVI”), including the interest rate environment, market liquidity, housing absorption rates, real estate prices, and disruptions in the U.S. capital markets, which reduced interest margins and affected funding sources, and has affected demand for all of the Corporation’s products and services and reduced the Corporation’s revenues and earnings, and the value of the Corporation’s assets, and may continue to have these effects;
- an adverse change in the Corporation’s ability to attract new clients and retain existing ones;
- the risk that additional portions of the unrealized losses in the Corporation’s investment portfolio are determined to be other-than-temporary, including additional impairments on the Puerto Rico government’s obligations;
- uncertainty about regulatory and legislative changes for financial services companies in Puerto Rico, the U.S., the USVI and the BVI, which could affect the Corporation’s financial condition or performance and could cause the Corporation’s actual results for future periods to differ materially from prior results and anticipated or projected results;
- changes in the fiscal and monetary policies and regulations of the U.S. federal government and the Puerto Rico and other governments, including those determined by the Federal Reserve Board, the New York FED, the Federal Deposit Insurance Corporation (“FDIC”), government-sponsored housing agencies, and regulators in Puerto Rico, the USVI and the BVI, including changes resulting from the recent U.S. election;
- the risk of possible failure or circumvention of controls and procedures and the risk that the Corporation’s risk management policies may not be adequate;
- the risk that the FDIC may increase the deposit insurance premium and/or require special assessments to replenish its insurance fund, causing an additional increase in the Corporation’s non-interest expenses;
- the impact on the Corporation’s results of operations and financial condition of acquisitions and dispositions;
- a need to recognize impairments on the Corporation’s financial instruments, goodwill or other intangible assets relating to acquisitions;



- the risk that downgrades in the credit ratings of the Corporation's long-term senior debt will adversely affect the Corporation's ability to access necessary external funds;
- the impact on the Corporation's businesses, business practices and results of operations of a potential higher interest rate environment;
- uncertainty as to whether FirstBank will be able to satisfy its regulators regarding, among other things, its asset quality, liquidity plans, maintenance of capital levels and compliance with applicable laws, regulations and related requirements; and
- general competitive factors and industry consolidation.

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

Investors should refer to Item 1A. Risk Factors, in this Annual Report on Form 10-K, for a discussion of such factors and certain risks and uncertainties to which the Corporation is subject.

## **PART I**

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

### **Item 1. Business**

#### **GENERAL**

First BanCorp. is a publicly owned financial holding company that is subject to regulation, supervision and examination by the Federal Reserve Board. The Corporation was incorporated under the laws of the Commonwealth of Puerto Rico to serve as the bank holding company for FirstBank. The Corporation is a full service provider of financial services and products with operations in Puerto Rico, the United States and the USVI and BVI. As of December 31, 2016, the Corporation had total assets of \$11.9 billion, total deposits of \$8.8 billion and total stockholders' equity of \$1.8 billion.

The Corporation provides a wide range of financial services for retail, commercial and institutional clients. As of December 31, 2016, the Corporation controlled two wholly owned subsidiaries: FirstBank and FirstBank Insurance Agency, Inc. (“FirstBank Insurance Agency”). FirstBank is a Puerto Rico-chartered commercial bank, and FirstBank Insurance Agency is a Puerto Rico-chartered insurance agency.

FirstBank is subject to the supervision, examination and regulation of both the Office of the Commissioner of Financial Institutions of Puerto Rico (“OCIF”) and the FDIC. Deposits are insured through the FDIC Deposit Insurance Fund. In addition, within FirstBank, the Bank’s USVI operations are subject to regulation and examination by the United States Virgin Islands Banking Board; its BVI operations are subject to regulation by the British Virgin Islands Financial Services Commission; and its operations in the state of Florida are subject to regulation and examination by the Florida Office of Financial Regulation and the FDIC. The Consumer Financial Protection Bureau (“CFBP”) regulates FirstBank’s consumer financial products and services. FirstBank Insurance Agency is subject to the supervision, examination and regulation of the Office of the Insurance Commissioner of the Commonwealth of Puerto Rico and operates three offices in Puerto Rico, and two offices in the USVI and BVI.

As of December 31, 2016, FirstBank conducts its business through its main office located in San Juan, Puerto Rico, 48 banking branches in Puerto Rico, 11 branches in the USVI and BVI, and 11 branches in the state of Florida (U.S.). As of December 31, 2016 FirstBank has 6 wholly owned subsidiaries with operations in Puerto Rico: First Federal Finance Corp. (d/b/a Money Express La Financiera), a finance company specializing in the origination of small loans

with 28 offices in Puerto Rico; First Management of Puerto Rico, a domestic corporation, which holds tax-exempt assets; FirstBank Puerto Rico Securities Corp., a broker-dealer subsidiary engaged in municipal securities underwriting and selling for local Puerto Rico municipal bond issuers and other investment banking activities, such as advisory services, capital raising efforts on behalf of clients and assistance with financial transaction structuring; FirstBank Overseas Corporation, an international banking entity organized under the International Banking Entity Act of Puerto Rico; and two other companies that hold and operate certain particular other real estate owned properties.

## **BUSINESS SEGMENTS**

The Corporation has six reportable segments: Commercial and Corporate Banking; Consumer (Retail) Banking; Mortgage Banking; Treasury and Investments; United States Operations; and Virgin Islands Operations. These segments are described below as well as in Note 33, "Segment Information," to the Corporation's audited financial statements for the year ended December 31, 2016 included in Item 8 of this Form 10-K.

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

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. FirstBank has developed expertise in a wide variety of industries. The Commercial and Corporate Banking segment offers commercial loans, including commercial real estate and construction loans, and floor plan financings, as well as other products, such as cash management and business management services. A substantial portion of the commercial and corporate banking portfolio is secured by the underlying value of the real estate collateral and the personal guarantees of the borrowers. This segment also includes the Corporation's broker-dealer activities.

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

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

Retirement Accounts (IRA) and retail certificates of deposit (“retail CDs”). Retail deposits gathered through each branch of FirstBank’s retail network serve as one of the funding sources for the lending and investment activities.

### ***Mortgage Banking***

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

Mortgage loans that do not qualify under these programs are commonly referred to as conventional loans. Conventional real estate loans can be conforming or non-conforming. Conforming loans are residential real estate loans that meet the standards for sale under the Fannie Mae (“FNMA”) and Freddie Mac (“FHLMC”) programs whereas loans that do not meet those standards are referred to as non-conforming residential real estate loans. The Corporation’s strategy is to penetrate markets by providing customers with a variety of high quality mortgage products to serve their financial needs through a faster and simpler process and at competitive prices. The Mortgage Banking segment also acquires and sells mortgages in the secondary markets. Residential real estate conforming loans are sold to investors like FNMA and FHLMC. Most of the Corporation’s residential mortgage loan portfolio consists of fixed-rate, fully amortizing, full documentation loans. The Corporation has commitment authority to issue Government National Mortgage Association (“GNMA”) mortgage-backed securities. Under this program, the Corporation has been selling FHA/VA mortgage loans into the secondary market since 2009.

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

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

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

The United States Operations segment consists of all banking activities conducted by FirstBank on the United States mainland. FirstBank provides a wide range of banking services to individual and corporate customers primarily in southern Florida through 11 branches. The United States Operations segment offers an array of both consumer and commercial banking products and services. Consumer banking products include checking, savings and money market accounts, retail CDs, internet banking services, residential mortgages, home equity loans, lines of credit, and automobile loans. Retail deposits, as well as FHLB advances and brokered CDs assigned to this operation, serve as funding sources for its lending activities. Deposits gathered through FirstBank's branches in the United States also serve as one of the funding sources for lending and investment activities in Puerto Rico.

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

### *Virgin Islands Operations*

The Virgin Islands Operations segment consists of all banking activities conducted by FirstBank in the USVI and BVI, including retail and commercial banking services, with a total of 11 branches serving the islands in the USVI of St. Thomas, St. Croix, and St. John, and the island of Tortola in the BVI. The Virgin Islands Operations segment is driven by its consumer, commercial lending and deposit-taking activities.

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

## **Employees**

As of March 1, 2017, the Corporation and its subsidiaries employed 2,701 persons. None of its employees is represented by a collective bargaining group. The Corporation considers its employee relations to be good.

## **SIGNIFICANT EVENTS SINCE THE BEGINNING OF 2016**

### **Repurchase of Trust Preferred Securities and Dividend Payments on Trust Preferred Securities and Preferred Stock**

During the first quarter of 2016, the Corporation completed the repurchase of \$10 million of trust preferred securities of the FBP Statutory Trust II that were auctioned in a public sale at which the Corporation was invited to participate. The Corporation repurchased and cancelled the repurchased trust preferred securities, resulting in a commensurate reduction in the related Floating Rate Junior Subordinated Debentures. The Corporation's winning bid equated to 70% of the \$10 million par value. The 30% discount, plus accrued interest, resulted in a gain of approximately \$4.2 million.

During the second quarter of 2016, the Corporation received approval from the Federal Reserve and OCIF that enabled it to pay \$31.2 million for all the accrued but deferred interest payments plus the interest for the second quarter on the Corporation's subordinated debentures associated with its trust preferred securities. Subsequently, the Corporation received quarterly approvals that enabled it to pay the interest for the third and fourth quarters of 2016. As of December 31, 2016, the Corporation is current on all interest payments related to its subordinated debt. Future interest payments are subject to Federal Reserve and OCIF approval. It is the intent of the Corporation to request approvals in future periods to continue regularly scheduled quarterly interest payments.

For the first time since July 2009, following receipt of the requisite regulatory approval, on December 8, 2016, the Corporation announced the declaration of a cash dividend on its outstanding shares of Series A through E Noncumulative Perpetual Monthly Income Preferred Stock for the month of December 2016. The Corporation paid cash dividends on its Series A through E Preferred Stock in February and January 2017 and declared the cash dividend for March 2017. Although there is no assurance that any dividends will be declared on the Corporation's Series A through E Preferred Stock in any future periods, the Corporation intends to continue to request regulatory approval pursuant to the requirements of the Written Agreement to enable it to continue to pay the monthly dividends on its Series A through E Preferred Stock. The Corporation has received approval to pay the monthly dividends on the Corporation's Series A through E Preferred Stock through March 2017.

## **Sale of Non-Performing Assets**

During the fourth quarter of 2016, the Corporation completed the sale of a pool of non-performing assets with a book value of \$16.3 million (principal balance of \$20.1 million), in a cash transaction. The proceeds from this sale were \$11.3 million net of escrow and principal and interest collected on behalf of the purchaser subsequent to the effective date of the transaction. Approximately \$2.8 million of reserves had been allocated to the loans. This transaction resulted in total net charge-offs of \$4.6 million and an incremental pre-tax loss of \$1.8 million recorded as a charge to the provision for loan and lease losses.

## **Sale of the Puerto Rico Electric Power Authority (“PREPA”) Loan**

During the first quarter of 2017, the Corporation received an unsolicited offer and sold its outstanding participation in the PREPA line of credit with a book value of \$64 million at the time of sale (principal balance of \$75 million), thereby reducing its direct exposure to the Puerto Rico government. A specific reserve of approximately \$10.2 million had been allocated to this loan. Gross proceeds from the sale of \$53.2 million have resulted in an incremental loss of \$0.6 million as compared to the book value, net of reserve. This loss was recognized at the time of the sale in the first quarter of 2017.

## **Puerto Rico Government Fiscal Situation, Government Actions, enactment of PROMESA and Exposure**

A significant portion of our financial activities and credit exposure is concentrated in the Commonwealth of Puerto Rico, which has been in an economic recession since 2006. Based on the most recent information available, the main economic indicators suggest that the Puerto Rico economy remains weak. For fiscal years 2017 and 2018, the Puerto Rico government projects a continued economic contraction in the Commonwealth’s real gross national product (“GNP”) of 2.2% and 2.8%, respectively, while the Government Development Bank for Puerto Rico economic activity index (“GDB-EAI”) in December 2016 decreased 2.9% on a year-over-year basis to 121.1, the lowest number in 25 years. The GDB-EAI is a coincident index of economic activity for Puerto Rico made up of four indicators (non-farm payroll employment, electric power generation, cement sales and gasoline consumption). The seasonally adjusted unemployment rate in Puerto Rico was 12.4% in December 2016, which is higher than in any U.S. state. Puerto Rico population decreased by an estimated 6.8% from 2010 – 2015, driven primarily by falling birth rate, a rising death rate, and migration to the United States mainland, according to the U.S. census data.

On April 6, 2016, the Puerto Rico Emergency Moratorium and Financial Rehabilitation Act (“Act 21”) was enacted, which gives Puerto Rico’s governor emergency powers to deal with the challenging fiscal situation, including the ability to declare a moratorium on any debt payment. Puerto Rico’s governor also issued an executive order intended to protect the GDB’s liquidity by allowing withdrawals only to fund necessary costs for essential services such as health, public safety and education services.

On June 30, 2016, pursuant to Act 21, the Puerto Rico governor ordered a moratorium on the payment of \$780 million of the Puerto Rico government’s general obligations and guaranteed debt, along with the payment obligations of certain other issuers. The Puerto Rico government has continued to default on general obligation bonds, including the payment due on January 1, 2017. This followed a default on the principal payment of \$367 million of GDB notes due on May 1, 2016. On August 1, 2016, the GDB defaulted on a \$28 million payment of interest due to its creditors, including interest due on GDB bonds held by the Corporation. The GDB default marked the first time the GDB, or any other Puerto Rico agency or instrumentality, failed to pay interest on Puerto Rico government bonds held by the Corporation. On October 1, 2016, the Puerto Rico Public Buildings Authority failed to make a full payment of interest due on its obligation bonds, including bonds held by the Corporation. Generally, based on specific facts and circumstances of the issuer, a default event requires us to classify the defaulted bonds as a non-performing asset. Accordingly, during the third quarter of 2016, bonds of the GDB and the Puerto Rico Public Buildings Authority with an aggregate fair value as of December 31, 2016 of \$20.5 million (\$35.6 million- amortized cost, including accrued interest of \$0.9 million) were classified as non-performing and placed in non-accrual status by the Corporation. These bonds are held as part of the available-for-sale securities portfolio. In the first quarter of 2016, the Corporation recorded a \$6.3 million other-than-temporary impairment (“OTTI”) charge on the aforementioned bonds of the GDB and the Puerto Rico Public Buildings Authority. This was the third OTTI charge on these securities recorded since June 30, 2015, as OTTI charges of \$12.9 million and \$3.0 million were booked in the second and fourth quarters of 2015. The credit-related impairment loss estimates were based on the probability of default and loss severity in the event of default in consideration of the latest available information about the Puerto Rico government’s financial condition, including the enactment of a debt moratorium law and the declaration of a state of emergency at the GDB, the issuance of the GDB and the Commonwealth’s audited financial statements for the fiscal year ended June 30, 2014, as well as issuance of exchange proposals with the Commonwealth’s creditors related to its outstanding bond obligations. In addition to bonds of the GDB and the Puerto Rico Public Buildings Authority, the Corporation owns bonds of the Puerto Rico Housing Finance Authority in the aggregate amount of \$7.9 million carried on the Corporation’s books at the aggregate fair value of \$6.3 million, which are current as to contractual payments as of December 31, 2016.

On June 30, 2016, President Obama signed HR5278 Bill, PROMESA, which established an oversight board, a process for restructuring debt, and expedited procedures for approving critical infrastructure projects in order to address the Puerto Rico government fiscal situation. The independent seven-member oversight board that was appointed by the House of Representatives, Senate and President Obama pursuant to PROMESA (the “PROMESA oversight board”) has fiscal oversight over Puerto Rico’s finances for an initial term of five years. This marks the largest federal intervention ever in to the U.S. municipal bond market. PROMESA enables Puerto Rico to restructure its debt. The PROMESA oversight board had its first meeting on September 30, 2016, and its term will expire once Puerto Rico has posted four structurally balanced budgets in a row and is deemed to have adequate access to the capital markets. The PROMESA oversight board has the power to approve or reject the general government’s proposed budgets until the PROMESA oversight board is satisfied that the budgets are structurally responsible and based on reasonable expectations and accounting standards.



During their first meeting, the PROMESA oversight board announced the designation of a number of entities as covered entities under PROMESA, including the Commonwealth, all of its public corporations and retirement systems, the University of Puerto Rico and all affiliates and subsidiaries of the foregoing. The designation of an entity as a covered entity has various implications under PROMESA. First, it means that the Governor will have to submit such entity's annual budgets and, if the PROMESA oversight board so requests, its fiscal plans, to the PROMESA oversight board for its review and approval. Second, covered territorial instrumentalities may not issue debt or guarantee, exchange, modify, repurchase, redeem, or enter into similar transactions with respect to their debts without the prior approval of the PROMESA oversight board. Third, pursuant to certain contracting guidelines approved by the PROMESA oversight board, prior PROMESA oversight board approval is required in connection with any transaction undertaken by a covered entity that (i) is outside the ordinary course of business or (ii) has a material financial impact. Finally, covered entities could also potentially be eligible to use the restructuring procedures provided by PROMESA. The first, Title VI, is a largely out-of-court process through which a government entity and its financial creditors can agree on terms to restructure such entity's debt. If a supermajority of creditors of a certain category agree, that agreement can bind all other creditors in such category. The second, Title III, draws on the federal bankruptcy code and provides a court-supervised process for a comprehensive restructuring led by the PROMESA oversight board.

PROMESA also created a bipartisan Congressional Task Force on Economic Growth in Puerto Rico. The Task Force consists of an eight-member panel of Congressional members that will review federal laws and programs to improve Puerto Rico's economy. The Task Force submitted a report during December 2016 with over 75 recommendations to Congress to jump start Puerto Rico's economy that included dealing with Medicaid, competitive tax treatment for U.S. subsidiaries, granting child tax credits and increasing loans for small businesses and the rum cover-over tax. They also stated that if the government conducts a plebiscite authorized by Congress, they would analyze and take any appropriate legislative action. As of the date of submission of this Form 10-K, the U.S. Congress has not taken action on any of the recommendations in the report.

On November 8, 2016, a new governor of Puerto Rico was elected and assumed office in January 2017. In addition a new Resident Commissioner was designated to represent Puerto Rico in the U.S. House of Representatives. Since taking office, Puerto Rico's governor signed an executive order reducing spending by 10%, created an expedited process for infrastructure projects, implemented a zero-based budgeting methodology, introduced several bills to promote economic development and outlined several labor reforms aimed at reducing the cost of doing business in Puerto Rico. Puerto Rico's governor also signed an extension to an excise tax on foreign manufacturers which contributes a significant amount of revenue to the general fund. Furthermore, Puerto Rico's governor signed the "Financial Emergency and Fiscal Responsibility Act," which replaces the prior administration's debt moratorium with a new approach that segregates revenues available after the payment of essential services to pay debt service.

In January 2017, the PROMESA oversight board sent a letter to the Puerto Rico governor outlining a minimum of \$4.5 billion in fiscal measures that would need to be included in the government's next fiscal plan in order for the PROMESA oversight board to certify it, the first step before negotiations with creditors can occur. In response to the Puerto Rico governor's request for more time to develop a fiscal plan, the PROMESA oversight board established a number of milestones and conditions it would require if the then-current deadlines were extended. On January 28, 2017, the PROMESA oversight board officially extended various deadlines including moving to (i) February 28, 2017 the deadline for the updated fiscal plan, (ii) March 15, 2017 for the PROMESA oversight board to certify the fiscal plan and (iii) May 1, 2017 for the stay on debt-related litigation. On February 28, 2017, the Puerto Rico governor submitted to the PROMESA oversight board the Puerto Rico government fiscal plan which, among other initiatives, calls for significant reductions, in operational expenses and subsidies for municipalities and the University of Puerto Rico. The plan, which relies on significant change in economic assumptions vis a vis the baseline, projects a surplus before debt service of \$11.6 billion in the aggregate during the ten year projection period (against \$35.1 billion in contractual debt service). Estimated savings under the fiscal plan of \$3.8 billion fall short of the \$4.5 billion figure the PROMESA oversight board recommended. This initial fiscal plan was rejected by the PROMESA oversight board, which claimed the proposal relied on overly optimistic baseline revenue assumptions, economic projections and forecasted savings resulting from measures to reduce public expenditures. A revised fiscal plan was submitted by the Puerto Rico governor on March 11, 2017, including \$262 million in additional revenue and changes to healthcare funding. On March 13, 2017, the PROMESA oversight board certified the revised fiscal plan, provided that two amendments are made. One amendment would institute the PROMESA oversight board's earlier proposal for furloughing most government employees four days a month, with two days for teachers and none for law enforcement officers, by July 1<sup>st</sup>, 2017 (the beginning of fiscal year 2018), and eliminate the annual Christmas bonus for government workers if the Puerto Rico government does not come up with plans to increase liquidity by \$200 million and implement its plan to "right-size" its operations in a fiscal year 2018 budget proposal by April 30. If it does, the cost-savings measures would be delayed until September 1<sup>st</sup>. A further determination would then be made as to whether the savings measures are needed or to what extent needed. The other amendment would require an agreement between the Puerto Rico government and the PROMESA oversight board to reduce pension costs 10% by 2020 to be reached within 30 days and finalized by June 30<sup>th</sup>.

With respect to PREPA, on December 23, 2015, PREPA and more than 70% of its creditors reached an agreement on an Amended and Restated Restructuring Support Agreement ("RSA") that would provide, among other things, for a restructuring of some of PREPA's outstanding debt at 85 cents on the dollar. The RSA also included a Bond Purchase Agreement ("BPA") whereby certain of those creditors would purchase new bonds to be issued by PREPA. The implementation of the RSA would provide the basis for PREPA to provide more reliable and lower-cost service, fund its capital needs for the medium term, help ensure environmental compliance, diversify generation resources to include more natural gas, and provide jobs.

Legislation to establish the necessary securitization framework for the new PREPA debt was passed on February 16, 2016. In June 2016, the Puerto Rico Energy Commission approved a "transition" charge to PREPA customers that will secure the new debt that will be issued to facilitate the PREPA restructuring. In May and June of 2016, certain

bondholders purchased \$115 million of bonds pursuant to the BPA. The BPA was amended in late June and bondholders purchased another \$264 million on June 30, 2016. Following the BPA amendment, PREPA made the full principal and interest payment due on July 1, 2016. On January 1, 2017, PREPA made its full interest payment and did so without requiring any type of BPA.

On January 27, 2017, the Puerto Rico Fiscal Agency and Financial Advisory Authority (“AAFAF”) notified all creditors involved that it was extending the January 31, 2017 expiration date of the RSA until March 31, 2017. In addition, AAFAF also notified the parties together with its financial advisors Rothchild, that it would lead negotiations with PREPA creditors.

As of December 31, 2016, the Corporation had \$323.3 million of direct exposure to the Puerto Rico government, its municipalities and public corporations, compared to \$360.7 million as of December 31, 2015. Approximately \$191.9 million of the exposure consisted of loans and obligations of municipalities in Puerto Rico that are supported by assigned property tax revenues and for which, in most cases, the good faith, credit and unlimited taxing power of the applicable municipality have been pledged to their repayment. Approximately 89% of the Corporation’s municipality exposure consists primarily of senior priority obligations concentrated in five of the largest municipalities in Puerto Rico (San Juan, Carolina, Bayamon, Mayaguez and Guaynabo). These municipalities are required by law to levy special property taxes in such amounts as shall be required for the payment of all of their respective general obligation bonds and loans. The PROMESA oversight board has not designated any of the Puerto Rico’s 78 municipalities as covered entities under PROMESA. In addition to municipalities, the total exposure to the Puerto Rico government included \$6.9 million of

loans to units of the Puerto Rico central government, and approximately \$81.9 million consisted of loans to public corporations (entities covered by PROMESA), including the direct exposure to PREPA with a book value of \$65.5 million as of December 31, 2016 that was sold in the first quarter of 2017 as described above. The PREPA credit facility was placed in non-accrual status in the first quarter of 2015, and interest payments recorded on a cost-recovery basis. The Corporation's total direct exposure also includes obligations of the Puerto Rico government with an amortized cost of \$42.7 million as part of its available-for-sale investment securities portfolio, net of \$22.2 million in cumulative OTTI charges, and recorded at a fair value of \$26.8 million as of December 31, 2016.

Furthermore, as of December 31, 2016, the Corporation had \$127.7 million outstanding (book value of \$111.8 million) in credit facilities extended to the hotel industry in Puerto Rico under which the borrower and the operations of the underlying collateral are the primary sources of repayment and the Puerto Rico Tourism Development Fund (the "TDF") provides a secondary guarantee for payment performance, compared to \$129.4 million outstanding as of December 31, 2015. The TDF is a subsidiary of the GDB that facilitates private sector financings to Puerto Rico's hotel industry. Adverse developments related to the Puerto Rico government's fiscal situation introduced additional uncertainty regarding the TDF's ability to honor its guarantee, including the enactment of Act 21. These facilities were placed in non-accrual status and classified as impaired in the first quarter of 2016, and interest payments are now applied against principal. Approximately \$2.0 million of interest payments received on loans guaranteed by the TDF since late March 2016 have been applied against principal. The Corporation has been receiving payments on the largest of these three facilities sufficient to cover the monthly contractual payments. This facility matured on February 1, 2017 and is currently under renegotiation. In addition, the borrower's cash flows related to the other two facilities are insufficient to cover debt service and the Corporation is not receiving collections from the TDF guarantee. As such, these two facilities are collateral dependent loans and charge-offs amounting to \$13.9 million were recorded during the second half of 2016, of which \$13.0 million was charged against reserves established in prior periods. These loans have been adversely classified since the third quarter of 2015. As of December 31, 2016, the loans guaranteed by the TDF are being carried at 72% of unpaid principal balance, net of reserves and accumulated charge-offs. The Corporation measures impairment on these loans based on the fair value of the collateral and the existence of the government guarantee. Developments of the Puerto Rico government debt restructuring process, with the automatic stay on litigations under PROMESA set to expire on May 1, 2017, and actions taken or those that may have to be taken by the Commonwealth or the PROMESA oversight board to address Puerto Rico's fiscal and economic crisis could ultimately adversely affect the value of the Puerto Rico government guarantees, including the TDF guarantee. If as a result of developments, including discussions with regulators, loan rating downgrades, progress in the debt restructuring process, or for other reasons, the Corporation determines that additional impairment charges are necessary, such an action would adversely affect the Corporation's results of operations in the period in which such determination is taken. The Corporation's collections of principal and interest from the TDF in 2016 amounted to \$0.6 million compared to \$5.3 million in 2015.

In addition, the Corporation had \$119.9 million in exposure to residential mortgage loans that are guaranteed by the Puerto Rico Housing Finance Authority. Residential mortgage loans guaranteed by the Puerto Rico Housing Finance Authority are secured by the underlying properties and the guarantees serve to cover shortfalls in collateral in the event of a borrower default. The Puerto Rico government guarantees up to \$75 million of the principal guaranteed under the mortgage loans insurance program. According to the most recently released audited financial statements of the Puerto Rico Housing Financing Authority, as of June 30, 2015, the Puerto Rico Housing Finance Authority's mortgage loans insurance program covered loans aggregating approximately \$552 million. The regulations adopted by the Puerto Rico Housing Finance Authority require the establishment of adequate reserves to guarantee the solvency of the mortgage loans insurance fund. As of June 30, 2015, the most recent date as to which information is available,

the Puerto Rico Housing Finance Authority had a restricted net position for such purposes of approximately \$77.4 million.

Furthermore, as of December 31, 2016, the Corporation had \$408.8 million of public sector deposits in Puerto Rico. Approximately 28% is from municipalities and municipal agencies in Puerto Rico and 72% is from public corporations and the central government and agencies in Puerto Rico.

## **WEBSITE ACCESS TO REPORT**

The Corporation makes available annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports, filed or furnished pursuant to section 13(a) or 15(d) of the Exchange Act, free of charge on or through its internet website at [www.1firstbank.com](http://www.1firstbank.com) (under “Investor Relations”), as soon as reasonably practicable after the Corporation electronically files such material with, or furnishes it to, the SEC.

The Corporation also makes available the Corporation’s corporate governance guidelines and principles, the charters of the audit, asset/liability, compensation and benefits, credit, compliance, risk, corporate governance and nominating committees and the codes of conduct and independence principles mentioned below, free of charge on or through its internet website at [www.1firstbank.com](http://www.1firstbank.com) (under “Investor Relations”):

- Code of Ethics for CEO and Senior Financial Officers

- Code of Ethics applicable to all employees
- Corporate Governance Standards
- Independence Principles for Directors
- Luxury Expenditure Policy

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

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

## **MARKET AREA AND COMPETITION**

Puerto Rico, where the banking market is highly competitive, is the main geographic service area of the Corporation. As of December 31, 2016, the Corporation also had a presence in the state of Florida and in the USVI and BVI. Puerto Rico banks are subject to the same federal laws, regulations and supervision that apply to similar institutions in the United States mainland.

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

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

other personnel, and on its reputation.

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

## **SUPERVISION AND REGULATION**

References herein to applicable statutes or regulations are brief summaries of portions thereof which do not purport to be complete and which are qualified in their entirety by reference to those statutes and regulations. Although most of the regulations required under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act") now have been adopted, numerous additional regulations and changes to regulations may be adopted as a result of the Dodd-Frank Act, and future legislation may increase the regulation and oversight of the Corporation and FirstBank. Any change in applicable laws or regulations may have a material adverse effect on the business of commercial banks and bank holding companies, including FirstBank and the Corporation.

### ***Dodd-Frank Act***

The Dodd-Frank Act significantly changed the regulation of financial institutions and the financial services industry. The Dodd-Frank Act includes numerous provisions that have affected and will affect large and small financial institutions alike, including banks and bank holding companies and how they will be regulated in the future. As a result of the Dodd-Frank Act, there has been and will be in the future additional regulatory oversight and supervision of the Corporation and its subsidiaries.

The Dodd-Frank Act, among other things, imposes new capital requirements on bank holding companies; provides that a bank holding company must serve as a source of financial and managerial strength to each of its subsidiary banks and stand ready to commit resources to support each of them; changes the base for FDIC insurance assessments to a bank's average consolidated total assets minus average tangible equity, rather than upon its deposit base, and permanently raises the current standard deposit insurance

limit to \$250,000; and expands the FDIC's authority to raise insurance premiums. The legislation also calls for the FDIC to raise the ratio of reserves to deposits from 1.15% to 1.35% for deposit insurance purposes by September 30, 2020 and to "offset the effect" of increased assessments on insured depository institutions with assets of less than \$10 billion.

The Dodd-Frank Act establishes as an independent entity, within the Federal Reserve, the Consumer Financial Protection Bureau (the "CFPB"), which has broad rulemaking, supervisory and enforcement authority over consumer financial products and services, including deposit products, residential mortgages, home-equity loans and credit cards, and contains provisions on mortgage-related matters such as steering incentives and determinations as to a borrower's ability to repay the principal amount and prepayment penalties.

The CFPB has primary examination and enforcement authority over FirstBank and other banks with over \$10 billion in assets with respect to consumer financial products and services.

The Dodd-Frank Act also limits interchange fees payable on debit card transactions. The Federal Reserve Board's current debit card interchange rule caps a debit card issuer's base fee at 21 cents per transaction and allows an additional 5 basis-point charge per transaction to help cover fraud losses. The debit card interchange rule has reduced our interchange fee revenue in line with industry-wide expectations since 2011.

The Dodd-Frank Act includes provisions that affect corporate governance and executive compensation at all publicly-traded companies and allows financial institutions to pay interest on business checking accounts. The legislation also restricts proprietary trading, places restrictions on the owning or sponsoring of hedge and private equity funds, and regulates the derivatives activities of banks and their affiliates.

Section 171 of the Dodd-Frank Act (the "Collins Amendment"), among other things, eliminates certain trust-preferred securities from Tier I capital. Preferred securities issued under the U.S. Treasury's Troubled Asset Relief Program ("TARP") are exempt from this treatment. Bank holding companies, such as the Corporation, were required to fully phase out these instruments from Tier 1 capital by January 1, 2016; however, these instruments may remain in Tier 2 capital until the instruments are redeemed or mature.

***Regulatory Capital and Liquidity Coverage Developments.*** The federal banking agencies adopted new rules for U.S. banks that revise important aspects of the minimum regulatory capital requirements, the components of regulatory capital, and the risk-based capital treatment of bank assets and off-balance sheet exposures. The final rules, which currently apply to the Corporation and FirstBank, generally are intended to align U.S. regulatory capital requirements with international regulatory capital standards adopted by the Basel Committee on Banking Supervision ("Basel Committee"), in particular the most recent international capital accord adopted in 2010 (and revised in 2011) known as "Basel III." The current rules increase the quantity and quality of capital required by, among other things, establishing a minimum common equity capital requirements and an additional common equity Tier 1 capital conservation buffer. In addition, the current rules revise and harmonize the bank regulators' rules for calculating risk-weighted assets to



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

Consistent with Basel III and the Collins Amendment, the current rules also establish a more conservative standard for including an instrument such as trust-preferred securities as Tier 1 capital for bank holding companies with total consolidated assets of \$15 billion or more as of December 31, 2009. Bank holding companies such as the Corporation were required to fully phase out these instruments from Tier I capital by January 1, 2016, although qualifying trust preferred securities may be included as Tier 2 capital until the instruments are redeemed or mature. As of December 31, 2016, the Corporation had \$210 million in trust preferred securities that are subject to a full phase-out from Tier 1 capital under the final regulatory capital rules discussed above. During the first quarter of 2016, the Corporation repurchased \$10.0 million in trust preferred securities that had been issued by FBP Statutory Trust II. This transaction is described in more detail in “Significant Events Since the Beginning of 2016” above for additional information.

These regulatory capital requirements are discussed in further detail in “Regulation and Supervision – Bank and Bank Holding Company Regulatory Capital Requirements.”

The current capital rules became effective for the Corporation and our subsidiary bank on a multi-year transitional basis starting on January 1, 2015, and in general will be fully effective as of January 1, 2019; the new general minimum regulatory capital requirements and the “standardized approach” for risk weighting of a banking organization’s assets, however, currently fully apply to us. The rules have increased our regulatory capital requirements and require us to hold more capital against certain of our assets and off-balance sheet exposures. The Corporation’s estimated pro-forma common equity Tier 1 ratio, Tier 1 capital ratio, total capital ratio, and the leverage ratio under the Basel III rules, giving effect as of December 31, 2016 to all the provisions that will be phased-in between January 1, 2015 and January 1, 2019, were 16.9%, 17.3%, 20.8%, and 13.6%, respectively. These ratios would exceed the fully phased-in minimum capital ratios under Basel III.

### ***International Regulatory Capital and Liquidity Coverage Developments***

International regulatory developments can affect the regulation and supervision of U.S. banking organizations, including the Corporation and FirstBank. Both the Basel Committee and the Financial Stability Board (established in April 2009 by the Group of Twenty (“G-20”) Finance Ministers and Central Bank Governors) have agreed to take action to strengthen regulation and supervision of the financial system with greater international consistency, cooperation and transparency, including the adoption of Basel III and a commitment to raise capital standards and liquidity buffers within the banking system under Basel III.

In late 2014, the Basel Committee issued its final requirements for a Net Stable Funding Ratio (“NSFR”). The NSFR compares the amount of an institution’s available stable funding (“ASF”, the ratio’s numerator) to its required stable funding (“RSF”, the ratio’s denominator) to measure how the institution’s asset base is funded. ASF is defined as the portion of capital and liabilities expected to be reliable over the time horizon considered by the NSFR, which extends to one year. While the NSFR is intended to be applied to large, internationally active banks, at the discretion of national supervisors it can be applied to other banking organizations or classes of banking organizations. As proposed by the U.S. federal banking agencies in May 2016, however, the NSFR requirements would not apply to the Corporation.

***Prudential Regulation Developments.*** U.S. banking organizations, including the Corporation and FirstBank, operate under the federal banking agencies’ rules and general supervisory guidance for stress testing practices applicable to banking organizations with more than \$10 billion in total consolidated assets. These regulatory actions require bank holding companies with total consolidated assets of between \$10 billion and \$50 billion, consistent with the Dodd-Frank Act, to comply with annual company-run stress testing requirements, and outlines broad principles for a satisfactory stress testing framework, including principles related to governance, controls and use of results, and describes various stress testing approaches and how stress testing should be used at various levels within an organization.

Under these requirements, the Corporation is subject to two stress testing rules that implement provisions of the Dodd-Frank Act, one issued by the Federal Reserve Board that applies to First BanCorp. on a consolidated basis and one issued by the FDIC that applies to the Bank. These Dodd-Frank Act stress tests are designed to require banking organizations to assess the potential impact of different economic scenarios on their earnings, losses, and capital over a set time period, with consideration given to certain relevant factors, including the organization's condition, risks, exposures, strategies, and activities. The Dodd-Frank Act stress tests require banking organizations with total consolidated assets of more than \$10 billion but less than \$50 billion, including the Corporation and the Bank, to conduct annual company-run stress tests using certain scenarios that the Federal Reserve Board publishes by February 15 of each year, report the results to their primary federal regulator and the Federal Reserve Board by July 31 of the same year, and publicly disclose a summary of the results by October 31 of that year.

The Federal Reserve Board and the other federal banking agencies have published final supervisory guidance describing their supervisory expectations for the Dodd-Frank Act stress tests to be conducted by financial institutions, including the Corporation and the Bank. The final guidance provides flexibility to accommodate different risk profiles, sizes, business lines, market areas, and complexity approaches for banking institutions in the \$10 billion to \$50 billion asset range, and provides examples of practices that would be consistent with supervisory expectations. This guidance now is fully applicable to the Corporation and the Bank. The final guidance also confirms that banking organizations with assets between \$10 billion and \$50 billion are not subject to the more extensive capital planning and stress-testing requirements that apply to bank holding companies with assets of at least \$50 billion, including the Federal Reserve capital plan rule, the annual Comprehensive Capital Analysis and Review, the Dodd-Frank Act supervisory stress tests, and related data collections. Targeted changes to the Federal Reserve capital planning and stress-testing regulations most recently were made in November 2015, and were effective as of January 1, 2016. In

addition, in February 2017, the federal banking agencies issued the economic scenarios (baseline, adverse and severely adverse) to be used by banking organizations with total consolidated assets of more than \$10 billion for the 2017 company-run stress tests under the Dodd-Frank Act.

The Federal Reserve's rules that govern the supervision and regulation of large U.S. bank holding companies and foreign banking organizations, as required by the Dodd-Frank Act, generally apply only to institutions with total consolidated assets of \$50 billion or more, which would not affect the Corporation. The Federal Reserve's rules, however, require publicly traded U.S. bank holding companies with total consolidated assets of \$10 billion or more, such as the Corporation, to establish enterprise-wide risk committees. These requirements complement the stress testing and resolution planning requirements for large bank holding companies that the Federal Reserve previously finalized. The current rules require the Corporation's risk management framework to be commensurate with the Corporation's structure, risk profile, complexity, activities and size, and must include policies and procedures establishing risk-management governance, risk-management policies, and risk control infrastructure for the Corporation's global operations and processes and systems for implementing and monitoring compliance with such policies and procedures. In addition, one independent director must chair the risk committee, with the banking organization determining the appropriate proportion of independent directors on the committee, based on its size, scope, and complexity, provided that it meets the minimum requirement of one independent director. Also, at least one director with risk-management experience must be appointed to the risk committee. The Corporation is in compliance with these requirements.

**Consumer Financial Protection Bureau.** CFPB regulations issued over the past few years implement the Dodd-Frank Act amendments to the Equal Credit Opportunity Act, the Truth in Lending Act (“TILA”), and the Real Estate Settlement Procedures Act (“RESPA”). In general, among other changes, these regulations collectively: (i) require lenders to make a reasonable good faith determination of a prospective residential mortgage borrower’s ability to repay based on specific underwriting criteria and set standards for mortgage lenders to determine whether a consumer has the ability to repay the mortgage, (ii) require stricter underwriting of “qualified mortgages,” discussed below, that presumptively satisfy the ability to pay requirement (thereby providing the lender a safe harbor from non-compliance claims), (iii) specify new limitations on loan originator compensation and establish criteria for the qualifications of, and registration or licensing of loan originators, (iv) further restrict certain high-cost mortgage loans by expanding the coverage of the Home Ownership and Equity Protections Act of 1994, (v) expand mandated loan escrow accounts for certain loans, (vi) revise existing appraisal requirements under the Equal Credit Opportunity Act and require provision of a free copy of all appraisals to applicants for first lien loans, (vii) establish new appraisal standards for most “higher-risk mortgages” under TILA, (viii) combine in a single, new form required loan disclosures under TILA and RESPA, (ix) define a “qualified mortgage” for purposes of the Dodd Frank Act, and (x) affords safe harbor legal protections for lenders making qualified loans that are not “higher priced.”

The CFPB also has issued a final regulation setting forth new mortgage servicing rules that now apply to the Bank.

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

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

In October 2016, the CFPB adopted further changes to these mortgage servicing rules. The new changes generally clarify and amend provisions regarding force-placed insurance notices, policies and procedures, early intervention, loss mitigation requirements and periodic statement requirements under the CFPB mortgage servicing rules. The amendments also address proper compliance regarding certain servicing requirements when a consumer is a potential or confirmed successor in interest, is in bankruptcy, or sends a cease communication request under the Fair Debt Collection Practices Act. These amendments variously become effective in October 2017 and April 2018. These new mortgage servicing standards are expected to add to our costs of conducting a mortgage servicing business.

Sections 1098 and 1100A of Dodd-Frank Act direct the Bureau to publish rules and forms that combine certain disclosures that consumers receive in connection with applying for and closing on a mortgage loan under the TILA and the RESPA. Consistent with this requirement, the Bureau has amended Regulation X (Real Estate Settlement Procedures Act) and Regulation Z (Truth in Lending) to establish new disclosure requirements and forms in Regulation Z for most closed-end consumer credit transactions secured by real property. In addition to combining the existing disclosure requirements and implementing new requirements imposed by the Dodd-Frank Act, the rule provides extensive guidance regarding compliance with those requirements.

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

Final regulations implementing the Volcker Rule have been adopted by the financial regulatory agencies and are now generally effective.

The Corporation and the Bank are not engaged in proprietary trading as defined in the Volcker Rule. In addition, a review of the Corporation's investments was undertaken to determine if any meet the Volcker Rule's definition of covered funds. Based on that review, the Corporation's investments are not considered covered funds under the Volcker Rule.

***Future Legislation and Regulation.*** While the federal agencies have adopted regulations that implement many requirements of the Dodd-Frank Act, important regulatory actions (e.g., the adoption of rules regarding the compensation of financial institutions executives) that could have an impact on the Corporation and the Bank remain to be taken. Additional consumer protection laws may be enacted, and the FDIC, Federal Reserve and CFPB have adopted and may adopt in the future new regulations that have addressed or may address, among other things, banks' credit card, overdraft, collection, privacy and mortgage lending practices. Additional consumer protection regulatory activity is possible in the near future.

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

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

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

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

The Bank Holding Company Act also permits a bank holding company to elect to become a financial holding company and engage in a broad range of activities that are financial in nature. The Corporation filed an election with the Federal Reserve Board and became a financial holding company under the Bank Holding Company Act. Financial holding companies may engage, directly or indirectly, in any activity that is determined to be (i) financial in nature, (ii) incidental to such financial activity, or (iii) complementary to a financial activity and does not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally. The Bank Holding Company Act specifically provides that the following activities have been determined to be “financial in nature”: (a) lending, trust and other banking activities; (b) insurance activities; (c) financial or economic advice or services; (d) pooled investments; (e) securities underwriting and dealing; (f) domestic activities permitted for existing bank holding company; (g) foreign activities permitted for existing bank holding company; and (h) merchant banking activities.

A financial holding company that ceases to meet certain standards is subject to a variety of restrictions, depending on the circumstances, including precluding the undertaking of new activities or the acquisition of shares or control of other companies. Until compliance is restored, the Federal Reserve Board has broad discretion to impose appropriate

limitations on the financial holding company's activities. If compliance is not restored within 180 days, the Federal Reserve Board may ultimately require the financial holding company to divest its depository institutions or, in the alternative, to discontinue or divest any activities that are permitted only to non-financial holding company bank holding companies. The Corporation and FirstBank must be well-capitalized and well-managed for regulatory purposes, and FirstBank must earn "satisfactory" or better ratings on its periodic Community Reinvestment Act (the "CRA") examinations to preserve the financial holding company status. The Corporation currently is restricted in its ability to undertake new financial activities.

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

Under provisions of the Dodd-Frank Act and Federal Reserve Board policy, a bank holding company such as the Corporation is expected to act as a source of financial and managerial strength to its banking subsidiaries and to commit support to them. This support may be required at times when, absent such policy, the bank holding company might not otherwise provide such support. In the event of a bank holding company's bankruptcy, any commitment by the bank holding company to a federal bank regulatory agency to maintain capital of a subsidiary bank will be assumed by the bankruptcy trustee and be entitled to a priority of payment.

In addition, any capital loans by a bank holding company to any of its subsidiary banks must be subordinated in right of payment to deposits and to certain other indebtedness of such subsidiary bank. As of December 31, 2016, and the date hereof, FirstBank was and is the only depository institution subsidiary of the Corporation. The Dodd-Frank Act directs the Federal Reserve Board to adopt regulations adopting the statutory source-of-strength requirements, but implementing regulations have not yet been proposed.

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

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

The Corporation includes in its annual report on Form 10-K its management’s assessment regarding the effectiveness of the Corporation’s internal control over financial reporting. The internal control report includes a statement of management’s responsibility for establishing and maintaining adequate internal control over financial reporting for the Corporation; management’s assessment as to the effectiveness of the Corporation’s internal control over financial reporting based on management’s evaluation, as of year-end; and the framework used by management as criteria for evaluating the effectiveness of the Corporation’s internal control over financial reporting.

As of December 31, 2016, First BanCorp’s management concluded that the Corporation’s internal control over financial reporting was effective. The Corporation’s independent registered public accounting firm reached the same conclusion.

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

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

The Corporation applied for, and the U.S. Treasury approved, a capital purchase in the amount of \$400,000,000. The Corporation entered into a Letter Agreement, dated as of January 16, 2009, including the Securities Purchase



Agreement Standard Terms (collectively the “Letter Agreement”) with the U.S. Treasury, pursuant to which the Corporation issued and sold to the Treasury for an aggregate purchase price of \$400,000,000 in cash (i) 400,000 shares of Fixed Rate Cumulative Perpetual Preferred Stock, Series F (the “Series F Preferred Stock”), and (ii) a warrant to purchase 389,483 shares of the Corporation’s common stock at an exercise price of \$154.05 per share, subject to certain anti-dilution and other adjustments (the “warrant”). The TARP transaction closed on January 16, 2009. On July 20, 2010, we exchanged the Series F Preferred Stock, plus accrued dividends on the Series F Preferred Stock, for 424,174 shares of a new series of preferred stock, fixed rate Cumulative Mandatorily Convertible Preferred Stock, Series G (the “Series G Preferred Stock”), and amended the warrant. On October 7, 2011, we exercised our right to convert the Series G Preferred Stock into 32,941,797 shares of common stock. As a result of the issuance of \$525 million of common stock in October 2011, the warrant was adjusted to provide for the issuance of approximately 1,285,899 shares of common stock at an exercise price of \$3.29 per share. On August 16, 2013, a secondary offering of the Corporation’s common stock was completed by certain of the Corporation’s existing stockholders, which included the sale by the U.S. Treasury of 13 million shares in such secondary offering. In the fourth quarter of 2014, the U.S. Treasury sold an additional 4.4 million shares in accordance with its first pre-defined written trading plan. On March 9, 2015, the U.S. Treasury announced the sale of an additional 5 million shares of First BanCorp.’s common stock through its second pre-defined written trading plan. As of December 31, 2016, the U.S. Treasury owned approximately 4.7% of the Corporation’s outstanding common stock, excluding the shares underlying the warrant.

Under the terms of the amended Letter Agreement with the U.S. Treasury dated as of July 7, 2010 (i) the Corporation amended its compensation, bonus, incentive and other benefit plans, arrangements and agreements (including severance and employment agreements) to the extent necessary to be in compliance with the executive compensation and corporate governance requirements of Section 111(b) of the EESA and applicable guidance or regulations issued by the U.S. Treasury on or prior to January 16, 2009 and (ii) each Senior Executive Officer, as defined in the amended Letter Agreement, executed a written waiver releasing the U.S. Treasury and the Corporation from any claims that such officers may otherwise have as a result of the Corporation’s amendment of such arrangements and agreements to be in compliance with Section 111(b). Until such time as the U.S. Treasury ceases to own any debt or equity securities of the Corporation acquired pursuant to the amended Letter Agreement, the Corporation must remain in compliance with these requirements.

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

On February 17, 2009, the Congress enacted the American Recovery and Reinvestment Act of 2009 (“ARRA”). The ARRA includes federal tax cuts, expansion of unemployment benefits and other social welfare provisions, and domestic spending on education, health care, and infrastructure, including the energy sector.

The ARRA includes provisions relating to compensation paid by institutions that receive government assistance under TARP, including institutions that had already received such assistance, effectively amending the existing compensation and corporate governance requirements of Section 111(b) of the EESA. The provisions include restrictions on the amounts and forms of compensation payable, provisions for possible reimbursement of previously paid compensation and a requirement that compensation be submitted to a non-binding “say on pay” shareholder vote.

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

***USA PATRIOT Act and Other Anti-Money Laundering Requirements.***

As a regulated depository institution, FirstBank is subject to the Bank Secrecy Act, which imposes a variety of reporting and other requirements, including the requirement to file suspicious activity and currency transaction reports that are designed to assist in the detection and prevention of money laundering and other criminal activities. In addition, under Title III of the USA PATRIOT Act of 2001, also known as the International Money Laundering Abatement and Anti-Terrorism Financing Act of 2001, all financial institutions are required to, among other things, identify their customers, adopt formal and comprehensive anti-money laundering programs, scrutinize or prohibit altogether certain transactions of special concern, and be prepared to respond to inquiries from U.S. law enforcement agencies concerning their customers and their transactions. Presently, only certain types of financial institutions (including banks, savings associations and money services businesses) are subject to final rules implementing the anti-money laundering program requirements of the USA PATRIOT Act.

Regulations implementing the Bank Secrecy Act and the USA PATRIOT Act are published and primarily enforced by the Financial Crimes Enforcement Network, a bureau of the U.S. Treasury. Failure of a financial institution to comply with the requirement of the Bank Secrecy Act or the USA PATRIOT Act could have serious legal and reputational consequences for the institution, including the possibility of regulatory enforcement or other legal action, including significant civil money penalties, against the Corporation or the Bank. The Corporation also is required to comply with federal economic and trade sanctions requirements enforced by the Office of Foreign Assets Control (“OFAC”), a bureau of the U.S. Treasury. The Corporation has adopted appropriate policies, procedures and controls to address compliance with the Bank Secrecy Act, USA PATRIOT Act and economic/trade sanctions requirements, and to implement banking agency, U.S. Treasury and OFAC regulations.

### ***Community Reinvestment***

The CRA encourages banks to help meet the credit needs of the local communities in which the banks offer their services, including low- and moderate-income individuals, consistent with the safe and sound operation of the bank.

The CRA requires the federal supervisory agencies, as part of the general examination of supervised banks, to assess the bank's record of meeting the credit needs of its community, assign a performance rating, and take such record and rating into account in their evaluation of certain applications by such bank. The CRA also requires all institutions to make public disclosure of their CRA ratings. FirstBank received a "satisfactory" CRA rating in its most recent examination by the FDIC.

Failure to adequately serve the communities could result in the denial by the regulators to merge, consolidate or acquire new assets, as well as expand or relocate branches.

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

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

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

failure to act may provide the basis for enforcement action, including the filing of misleading or untimely reports with regulatory authorities.

### ***Written Agreement***

FirstBank was notified by the FDIC that the Consent Order under which the Bank had been operating since June 2, 2010 was terminated effective April 29, 2015. FirstBank is required to maintain capital at specified levels pursuant to applicable law and its agreement with its regulators and currently exceeds all minimum capital requirements. Although the Consent Order has been terminated, First BanCorp. is still subject to the Written Agreement that the Corporation entered into with the Federal Reserve Bank of New York on June 3, 2010.

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

The Corporation submitted its Capital Plan under the Written Agreement setting forth its plans for how to improve capital positions to comply with the Written Agreement over time. In addition to the Capital Plan, the Corporation submitted to its regulators a liquidity and brokered CD plan, including a contingency funding plan, a non-performing asset reduction plan, a budget and profit plan, a strategic plan, and a plan for the reduction of classified and special mention assets. As of December 31, 2016, the Corporation had

completed all of the items included in the Capital Plan and is continuing to work on reducing non-performing loans. The Written Agreement also requires the submission to the regulators of quarterly progress reports.

### ***Dividend Restrictions***

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

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

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

We suspended dividend payments on our common stock and preferred dividends commencing with the preferred dividend payments for the month of August 2009. We must obtain the regulators' approval before we declare, set apart or pay any dividends on any of our common stock or preferred stock. During the fourth quarter of 2016, following

receipt of the requisite regulatory approval, the Corporation announced the declaration of a cash dividend on its outstanding shares of Series A through E Noncumulative Perpetual Monthly Income Preferred Stock for the month of December 2016. The Corporation has to date received approval to pay the monthly dividends on the Corporation's Series A through E Preferred Stock through March 2017, although there is no assurance that such approvals for future periods will be forthcoming. Although there is no assurance that any dividends will be declared on the Corporation's Series A through E Preferred Stock in any future periods, the Corporation intends to continue to request the Federal Reserve's approval pursuant to the requirements of the Written Agreement to enable it to continue to pay the monthly dividends on its Series A through E Preferred Stock. Furthermore, so long as any shares of preferred stock remain outstanding, we cannot declare, set apart or pay any dividends on shares of our common stock unless any accrued and unpaid dividends on our preferred stock for the twelve monthly dividend periods ending on the immediately preceding dividend payment date have been paid or are paid contemporaneously and the full monthly dividend on our preferred stock for the then current month has been or is contemporaneously declared and paid or declared and set apart for payment.

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

Certain transactions between financial institutions such as FirstBank and its affiliates are governed by Sections 23A and 23B of the Federal Reserve Act and by Federal Reserve Regulation W. An affiliate of a financial institution in general is any corporation or entity that controls, is controlled by, or is under common control with the financial institution.

In a holding company context, the parent bank holding company and any companies that are controlled by such parent bank holding company are affiliates of the financial institution. Generally, Sections 23A and 23B of the Federal Reserve Act (i) limit the extent to which the financial institution or its subsidiaries may engage in "covered transactions" (defined below) with any one affiliate to an amount equal to 10% of such financial institution's capital stock and surplus, and contain an aggregate limit on all such transactions with all affiliates to an amount equal to 20% of such financial institution's capital stock and surplus and (ii) require that all "covered

transactions” be on terms substantially the same, or at least as favorable to the financial institution or affiliate, as those provided to a non-affiliate. The term “covered transaction” includes the making of loans, purchase of assets, issuance of a guarantee and other similar transactions. In addition, loans or other extensions of credit by the financial institution to the affiliate are required to be collateralized in accordance with the requirements set forth in Section 23A of the Federal Reserve Act. The Dodd-Frank Act added derivatives and securities lending and borrowing transactions to the list of “covered transactions” subject to Section 23A restrictions.

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

### *Executive Compensation*

In 2010, the federal banking agencies adopted interagency guidance governing incentive-based compensation programs, which applies to all banking organizations regardless of asset size. This guidance uses a principles-based approach to ensure that incentive-based compensation arrangements appropriately tie rewards to longer-term performance and do not undermine the safety and soundness of banking organizations or create undue risks to the financial system. The interagency guidance is based on three major principles: (i) balanced risk-taking incentives; (ii) compatibility with effective controls and risk management; and (iii) strong corporate governance. The guidance further provides that, where appropriate, the banking agencies will take supervisory or enforcement action to ensure that material deficiencies that pose a threat to the safety and soundness of the organization are promptly addressed.

In May 2016, as required under section 956 of the Dodd-Frank Act, the federal banking agencies, along with other federal regulatory agencies, proposed regulations (first proposed in 2011) governing incentive-based compensation practices at covered banking institutions, which would include, among others, all banking organizations with assets of \$1 billion or greater. These proposed rules are intended to better align the financial rewards for covered employees with an institution’s long-term safety and soundness. Portions of these proposed rules would apply to the Corporation and FirstBank. Those applicable provisions would generally (i) prohibit types and features of incentive-based compensation arrangements that encourage inappropriate risk because they are “excessive” or “could lead to material financial loss” at the banking institution; (ii) require incentive-based compensation arrangements to adhere to three basic principles: (1) a balance between risk and reward; (2) effective risk management and controls; and (3) effective governance; and (iii) require appropriate board of directors (or committee) oversight and recordkeeping and disclosures to the banking institution’s primary regulatory agency. The nature and substance of any final action to adopt these proposed rules, and the timing of any such action, are not known at this time.



***Bank and Bank Holding Company Regulatory Capital Requirements***

The Federal Reserve Board has adopted risk-based and leverage capital adequacy guidelines pursuant to which it assesses the adequacy of capital in examining and supervising a bank holding company and in analyzing applications to it under the Bank Holding Company Act. The Federal Reserve Board's historical risk-based capital guidelines were based upon the 1988 capital accord ("Basel I") of the Basel Committee. These historical requirements, however, which included a legacy simplified risk-weighting system for the calculations of risk-based assets, as well as lower leverage capital requirements, were superseded by new risk-based and leverage capital requirements that went into effect, on a multi-year transitional basis, on January 1, 2015. The FDIC has adopted substantively identical requirements that apply to insured banks under its regulation and supervision. These requirements are part of a revised regulatory capital framework for U.S. banking organizations (the "Basel III rules") adopted by the banking agencies that is based on international regulatory capital requirements adopted by the Basel Committee on Banking Supervision over the past several years.

The Basel III rules introduced new minimum capital ratios and capital conservation buffer requirements, change the composition of regulatory capital, require a number of new adjustments to and deductions from regulatory capital, and introduced a new "Standardized Approach" for the calculation of risk-weighted assets that replaced the risk-weighting requirements under prior U.S. regulatory capital rules. The new minimum regulatory capital requirements and the Standardized Approach for the calculation of risk-weighted assets became effective for the Corporation on January 1, 2015. The capital conservation buffer requirements, and the regulatory capital adjustments and deductions under the Basel III rules are being phased-in over several years ending on December 31, 2018.

The Basel III rules introduced a new and separate ratio of Common Equity Tier 1 capital ("CET1") to risk-weighted assets. CET1, a narrower subcomponent of total Tier 1 capital, generally consists of common stock and related surplus, retained earnings, accumulated other comprehensive income ("AOCI"), and qualifying minority interests. Certain banking organizations, however, including the

Corporation and FirstBank, were allowed to make a one-time permanent election in early 2015 to continue to exclude AOCI items. The Corporation and FirstBank elected to permanently exclude capital in AOCI in order to avoid significant variations in the level of capital depending upon the impact of interest rate fluctuations on the fair value of the securities portfolio. In addition, the Basel III rules require the Corporation to maintain an additional CET1 capital conservation buffer of 2.5%. The capital conservation buffer must be maintained to avoid limitations on both (i) capital distributions (e.g. repurchases of capital instruments or dividend or interest payments on capital instruments) and (ii) discretionary bonus payments to executive officers and heads of major business lines. Under the fully phased-in rules, the Corporation will be required to maintain: (i) a minimum CET1 to risk-weighted assets ratio of at least 4.5%, plus the 2.5% “capital conservation buffer,” resulting in a required minimum CET1 ratio of at least 7%, (ii) a minimum ratio of total Tier 1 capital to risk-weighted assets of at least 6.0%, plus the 2.5% capital conservation buffer, resulting in a required minimum Tier 1 capital ratio of 8.5%, (iii) a minimum ratio of total Tier 1 plus Tier 2 capital to risk-weighted assets of at least 8.0%, plus the 2.5% capital conservation buffer, resulting in a required minimum total capital ratio of 10.5%, and (iv) a required minimum leverage ratio of 4%, calculated as the ratio of Tier 1 capital to average on-balance sheet (non-risk adjusted) assets. The phase-in of the capital conservation buffer began on January 1, 2016 with a first year requirement of 0.625% of additional CET1, which will be progressively increased over a four-year period, increasing by that same percentage amount on each subsequent January 1 until it reaches the fully phased-in 2.5% CET1 requirement on January 1, 2019.

In addition, the Basel III rules require a number of new deductions from and adjustments to CET1, including deductions from CET1 for certain intangible assets, and deferred tax assets dependent upon future taxable income; the four-year phase-in period for these adjustments generally began on January 1, 2015. Mortgage servicing assets and deferred tax assets attributable to temporary differences, among others, are required to be deducted to the extent that any one such category exceeds 10% of CET1 or all such categories in the aggregate exceed 15% of CET1.

In addition, the Basel III rules require that certain non-qualifying capital instruments, including cumulative preferred stock and trust preferred securities (“TRuPs”), be excluded from Tier 1 capital. In general, banking organizations such as the Corporation began to phase out TRuPs from Tier 1 capital on January 1, 2015. The outstanding balance owed on the Corporation’s TRuPs were fully phased out from Tier 1 capital as of January 1, 2016. However, the Corporation’s TRuPs may continue to be included in Tier 2 capital until the instruments are redeemed or mature.

The Corporation and FirstBank compute risk weighted assets using the Standardized Approach required by the Basel III rules. The Standardized Approach for risk-weightings has expanded the risk-weighting categories from the four major risk-weighting categories under the previous regulatory capital rules (0%, 20%, 50%, and 100%) to a much larger and more risk-sensitive number of categories, depending on the nature of the assets. In a number of cases, the Standardized Approach results in higher risk weights for a variety of asset categories. Specific changes to the risk-weightings of assets include, among other things: (i) applying a 150% risk weight instead of a 100% risk weight for high volatility commercial real estate acquisition, development and construction loans, (ii) assigning a 150% risk weight to exposures that are 90 days past due (other than qualifying residential mortgage exposures, which remain at an assigned risk-weighting of 100%), (iii) establishing a 20% credit conversion factor for the unused portion of a commitment with an original maturity of one year or less that is not unconditionally cancellable, in contrast to the 0% risk-weighting under the prior rules and (iv) requiring capital to be maintained against on-balance-sheet and off-balance-sheet exposures that result from certain cleared transactions, guarantees and credit derivatives, and collateralized transactions (such as repurchase agreement transactions).

**Prompt Corrective Action.** The Prompt Corrective Action (“PCA”) provisions of the FDIA require the federal bank regulatory agencies to take prompt corrective action against any undercapitalized insured depository institution. The FDIA establishes five capital categories: well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. Well-capitalized insured depository institutions (“institutions”) significantly exceed the required minimum level for each relevant capital measure. Adequately capitalized institutions include institutions that meet but do not significantly exceed the required minimum level for each relevant capital measure. Undercapitalized institutions consist of those that fail to meet the required minimum level for one or more relevant capital measures. Significantly undercapitalized institutions are those with capital levels significantly below the minimum requirements for any relevant capital measure. Critically undercapitalized institutions have minimal capital and are at serious risk for government seizure.

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

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

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

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

The banking agencies' Basel III rules, discussed above, revise the PCA requirements by (i) introducing a separate CET1 ratio requirement for each PCA capital category (other than critically undercapitalized) with the required CET1 ratio being 6.5% for well-capitalized status; (ii) increasing the minimum Tier 1 capital ratio requirement for each PCA capital category with the minimum Tier 1 capital ratio for well-capitalized status being 8% (as compared to the previous 6%); and (iii) eliminating the previous provision that allows a bank with a composite supervisory rating of 1 to have a 3% leverage ratio and still be adequately capitalized and maintaining the minimum leverage ratio for well-capitalized status at 5%. The Basel III rules do not change the total risk-based capital requirement (10% for well-capitalized status) for any PCA capital category. The new PCA requirements became effective on January 1, 2015.

A bank's capital category, as determined by applying the prompt corrective action provisions of the law, may not constitute an accurate representation of the overall financial condition or prospects of a bank, such as the Bank, and should be considered in conjunction with other available information regarding the financial condition and results of operations of the bank.

Set forth below are the Corporation's and FirstBank's capital ratios as of December 31, 2016 based on Federal Reserve and FDIC guidelines:

	<b>First BanCorp.</b>	<b>Banking Subsidiary FirstBank</b>	<b>General Well-Capitalized Minimum</b>
<b>As of December 31, 2016</b>			
Total capital (Total capital to			

risk-weighted assets)	21.34%	20.80%	10.00%
Common Equity Tier 1 Capital (Common Equity Tier 1 capital to risk-weighted assets)	17.74%	16.92%	6.50%
Tier 1 capital ratio (Tier 1 capital to risk-weighted assets)	17.74%	19.53%	8.00%
Leverage ratio (1)	13.70%	15.10%	5.00%

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(1) Tier 1 capital to average assets.

### ***Deposit Insurance***

The increase in deposit insurance coverage to up to \$250,000 per customer, the FDIC's expanded authority to increase insurance premiums, as well as the increase in the number of bank failures after the 2008 financial crisis resulted in an increase in deposit insurance assessments for all banks, including FirstBank. The Dodd-Frank Act changed the requirements for the Deposit Insurance Fund by requiring that the designated reserve ratio for the Deposit Insurance Fund for any year not be less than 1.35 percent of estimated insured deposits or the comparable percentage of the new deposit assessment base. In addition, the FDIC must take steps as necessary for the reserve ratio to reach 1.35 percent of estimated insured deposits by September 30, 2020. If the reserve ratio exceeds 1.5 percent, the FDIC must dividend to Deposit Insurance Fund members the amount above the amount necessary to maintain the Deposit Insurance Fund at 1.5 percent, but the FDIC Board of Directors may, in its sole discretion, suspend or limit the declaration of payment of dividends. The FDIC has adopted a Deposit Reserve Fund restoration plan that projects that the designated reserve ratio will reach 1.35 percent by the 2020 deadline. The FDIC has also adopted a final rule raising its industry target ratio of reserves to

insured deposits to 2 percent, 65 basis points above the statutory minimum, but the FDIC does not project that goal to be met for several years.

The FDIC assessment rules currently define the assessment base for deposit insurance as required by the Dodd-Frank Act, specify assessment rates, implement the Dodd-Frank Act's Deposit Insurance Fund dividend provisions, and revise the risk-based assessment system for all large insured depository institutions (institutions with at least \$10 billion in total assets), such as FirstBank. In March 2016, the FDIC adopted a rule, which became effective on July 1, 2016, to increase the Deposit Insurance Fund to the statutorily required minimum level of 1.35 percent. Among other things, the rule imposes on banks with at least \$10 billion in assets (which would include the Bank) a surcharge of 4.5 cents per \$100 of their assessment base, after making certain adjustments. The FDIC has stated that it expects the reserve ratio will reach 1.35 percent before the end of 2018. If the reserve ratio does not reach 1.35 percent by the end of 2018, however, the FDIC will impose a shortfall assessment on March 31, 2019, on insured depository institutions with total consolidated assets of \$10 billion or more.

### ***FDIC Insolvency Authority***

Under Puerto Rico banking laws (discussed below), the OCIF may appoint the FDIC as conservator or receiver of a failed or failing FDIC-insured Puerto Rican bank such as the Bank, and the FDIA authorizes the FDIC to accept such an appointment. In addition, the FDIC has broad authority under the FDIA to appoint itself as conservator or receiver of a failed or failing state bank, including a Puerto Rican bank. If the FDIC is appointed conservator or receiver of a bank upon the bank's insolvency or the occurrence of other events, the FDIC may sell or transfer some, part or all of a bank's assets and liabilities to another bank, or liquidate the bank and pay out insured depositors, as well as uninsured depositors and other creditors to the extent of the closed bank's available assets. As part of its insolvency authority, the FDIC has the authority, among other things, to take possession of and administer the receivership estate, pay out estate claims, and repudiate or disaffirm certain types of contracts to which the bank was a party if the FDIC believes such contract is burdensome and its disaffirmance will aid in the administration of the receivership. In resolving the estate of a failed bank, the FDIC as receiver will first satisfy its own administrative expenses, and the claims of holders of U.S. deposit liabilities also have priority over those of other general unsecured creditors.

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

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

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

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

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

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

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

are presumed to be acting in concert with each other and their businesses. The regulations of the FDIC implementing the CBCA are generally similar to those described above.

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

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

The FDIA requires the FDIC and the other federal bank regulatory agencies to prescribe standards of safety and soundness, by regulations or guidelines, relating generally to operations and management, asset growth, asset quality, earnings, stock valuation, and compensation. The implementing regulations and guidelines of the FDIC and the other federal bank regulatory agencies establish general standards relating to internal controls and information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth and compensation, fees and benefits. In general, the regulations and guidelines require, among other things, appropriate systems and practices to identify and manage the risks and exposures specified in the guidelines. The regulations and guidelines prohibit excessive compensation as an unsafe and unsound practice and describe compensation as excessive when the amounts paid are unreasonable or disproportionate to the services performed by an executive officer, employee, director or principal shareholder. Failure to comply with these standards can result in administrative enforcement or other adverse actions against the bank.

### ***Brokered Deposits***

FDIC regulations adopted under the FDIA govern the receipt of brokered deposits by banks. Well-capitalized institutions are not subject to limitations on brokered deposits, while adequately-capitalized institutions are able to accept, renew or rollover brokered deposits only with a waiver from the FDIC and subject to certain restrictions on the interest paid on such deposits. Undercapitalized institutions are not permitted to accept brokered deposits.

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

As a commercial bank organized under the laws of the Commonwealth of Puerto Rico, FirstBank is subject to supervision, examination and regulation by OCIF pursuant to the Puerto Rico Banking Law of 1933, as amended (the “Banking Law”).

The Banking Law contains various provisions relating to FirstBank and its affairs, including its incorporation and organization, the rights and responsibilities of its directors, officers and stockholders and its corporate powers, lending limitations, capital requirements, and investment requirements. In addition, the Commissioner is given extensive rule-making power and administrative discretion under the Banking Law.

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

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



asset that the Commissioner identifies from time to time.

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

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

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

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

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

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

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

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

The business and operations of FirstBank International Branch (“FirstBank IBE” or the “IBE division of FirstBank”) and FirstBank Overseas Corporation (the IBE subsidiary of FirstBank) are subject to supervision and regulation by the Commissioner. FirstBank and FirstBank Overseas Corporation were created under the IBE Act 52, which provides for total Puerto Rico tax exemption on net income derived by IBEs operating in Puerto Rico on the specific activities identified in the IBE Act. An IBE that operates as a unit of a bank pays income taxes at the corporate standard rates to the extent that the IBE’s net income exceeds 20% of the bank’s total net taxable income. Under the IBE Act 52, certain sales, encumbrances, assignments, mergers, exchanges or transfers of shares, interests or participation(s) in the capital of an international banking entity (an “IBE”) may not be initiated without the prior approval of the Commissioner. The

IBE Act 52 and the regulations issued thereunder by the Commissioner (the “IBE Regulations”) limit the business activities that may be carried out by an IBE. Such activities are limited in part to persons and assets located outside of Puerto Rico.

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

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

In 2012, the Puerto Rico government approved Act Number 273 (“Act 273”). Act 273 replaces, prospectively, IBE Act 52 with the objective of improving the conditions for conducting international financial transactions in Puerto Rico. An IBE existing on the date of approval of Act 273, such as FirstBank IBE and FirstBank Overseas Corporation, can continue operating under IBE Act 52, or, it can voluntarily convert to an International Financial Entity (“IFE”) under Act 273 so it may broaden its scope of Eligible IFE Activities, as defined below, and obtain a grant of tax exemption under Act 273.

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

(i) to the IFE:

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

(ii) to its shareholders:

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

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

Act 187, as amended, enacted on November 17, 2015 requires the Commissioner to issue a Certificate of Compliance every two years in order to certify the compliance with law of companies organized under IBE Act 52.

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

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

Under the Puerto Rico Internal Revenue Code of 2011, as amended (the “2011 PR Code”), the Corporation and its subsidiaries are treated as separate taxable entities and are not entitled to file consolidated tax returns and, thus, the

Corporation is not able to utilize losses from one subsidiary to offset gains in another subsidiary. Accordingly, in order to obtain a tax benefit from a net operating loss (“NOL”), a particular subsidiary must be able to demonstrate sufficient taxable income within the applicable NOL carry forward period. The 2011 PR Code provides a dividend received deduction of 100% on dividends received from “controlled” subsidiaries subject to taxation in Puerto Rico and 85% on dividends received from other taxable domestic corporations.

Under the 2011 PR Code, First BanCorp. is subject to a maximum statutory tax rate of 39%. The 2011 PR Code also includes an alternative minimum tax of 30% that applies if the Corporation’s regular income tax liability is less than the alternative minimum tax requirements.

The Corporation has maintained an effective tax rate lower than the maximum statutory rate in Puerto Rico mainly by investing in government obligations and mortgage-backed securities exempt from U.S. and Puerto Rico income taxes and by doing business through FirstBank IBE, and through the Bank’s subsidiary, FirstBank Overseas Corporation, whose interest income and gain on sales is exempt from Puerto Rico income taxation.

On May 28 and September 30, 2015, the Puerto Rico legislature approved Act 72-2015 and Act 159-2015, respectively, which enacted amendments to the 2011 PR Code. The amendments related to the income tax provision include changes to the alternative minimum tax computation, and changes to the use limitation on NOLs and capital losses for 2015 and future taxable years. The change in the tax law affected the Corporation’s income tax computation by limiting the NOL deduction to 80% of taxable income, compared to a 90% limitation in prior years.

Act 72-2015, as amended, also introduced a value added tax (the “VAT”) on consumption, effective April 1, 2016, to replace the current sales and use tax (“SUT”), and certain temporary changes on SUT for the transition into the VAT. However, Act 54-2016, enacted on May 26, 2016, repealed the VAT sections of Act 72-2015 and made permanent the changes to SUT. The still in force changes in SUT include: an increase in tax rate from 7% to 11.5% on taxable goods and services, effective since July 1, 2015, and a 4% SUT on business to business services, and professional services, with certain exceptions, effective since October 1, 2015.

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

The Corporation is also subject to federal income tax on its income from sources within the United States and on any item of income that is, or is considered to be, effectively connected with the active conduct of a trade or business within the United States. The U.S. Internal Revenue Code provides for tax exemption of any portfolio interest received by a foreign corporation from sources within

the United States; therefore, the Corporation is not subject to federal income tax on certain U.S. investments that qualify under the term “portfolio interest.”

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

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

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

In addition to FDIC and CFPB regulation, FirstBank is subject to the rules and regulations of the FHA, VA, FNMA, FHLMC, GNMA, and the U.S. Department of Housing and Urban Development (the “HUD”) with respect to originating, processing, selling and servicing mortgage loans and the issuance and sale of mortgage-backed securities. Those rules and regulations, among other things, prohibit discrimination and establish underwriting guidelines that include provisions for inspections and appraisals, require credit reports on prospective borrowers and fix maximum loan amounts, and, with respect to VA loans, fix maximum interest rates. Moreover, lenders such as FirstBank are required annually to submit audited financial statements to the FHA, VA, FNMA, FHLMC, GNMA and HUD and each regulatory entity has its own financial requirements. FirstBank’s affairs are also subject to supervision and examination by the FHA, VA, FNMA, FHLMC, GNMA and HUD at all times to assure compliance with applicable regulations, policies and procedures. Mortgage origination activities are subject to, among other requirements, the Equal Credit Opportunity Act, Federal Truth-in-Lending Act, and the Real Estate Settlement Procedures Act and the regulations promulgated thereunder that, among other things, prohibit discrimination and require the disclosure of certain basic information to mortgagors concerning credit terms and settlement costs. FirstBank is licensed by the Commissioner under the Puerto Rico Mortgage Banking Law, and, as such, is subject to regulation by the Commissioner, with respect to, among other things, licensing requirements and the establishment of maximum origination fees on certain types of mortgage loan products.

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

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

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

*We are operating under an agreement with our regulators.*

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

As a financial holding company, we are permitted to engage in a broader range of “financial” activities than those permitted to bank holding companies that are not financial holding companies. At this time, we currently are not able to engage in new financial activities, and we may not be able to acquire shares or control of other companies.

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

If we fail to comply with the Written Agreement and other requirements from our regulators, we may become subject to additional regulatory enforcement action and other adverse regulatory actions that might have a material and adverse effect on our operations.

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

We continue to have a high level of non-performing loans as of December 31, 2016, which increased \$117.3 million to \$568.2 million as of December 31, 2016, or 26%, from \$450.9 million as of December 31, 2015. Our non-performing loans represent

approximately 6% of our \$8.9 billion loan portfolio as of December 31, 2016. In addition, we have a high level of total non-performing assets, which increased \$124.6 million to \$734.5 million as of December 31, 2016, or 20%, from \$609.9 million as of December 31, 2015. The increase in total non-performing assets was related, among other things, to the placement in non-accrual status of the Corporation's \$111.8 million exposure to commercial loans guaranteed by the TDF and bonds of the GDB and the Puerto Rico Public Buildings Authority with an aggregate fair value of \$20.5 million as of December 31, 2016. If we are unable to effectively maintain the quality of our loan portfolio, our financial condition and results of operations may be materially and adversely affected.

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

FirstBank relies primarily on customer deposits, the issuance of brokered CDs, and advances from the FHLB of New York to maintain its lending activities and to replace certain maturing liabilities. As of December 31, 2016, we had \$1.4 billion in brokered CDs outstanding, representing approximately 16% of our total deposits, and a reduction of \$657.8 million from the year ended December 31, 2015. Approximately \$798.8 million in brokered CDs mature over the next twelve months, and the average term to maturity of the retail brokered CDs outstanding as of December 31, 2016 was approximately 1.2 years. None of these CDs are callable at the Corporation's option.

Although FirstBank has historically been able to replace maturing deposits and advances, we may not be able to replace these funds in the future if our financial condition or general market conditions change. The use of brokered deposits has been particularly important for the funding of our operations. If we are unable to issue brokered deposits, or are unable to maintain access to other funding sources, our results of operations and liquidity would be adversely affected.

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

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

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

The Banking Law of the Commonwealth of Puerto Rico requires that a minimum of 10% of FirstBank's net income for the year be transferred to legal surplus until such surplus equals the total of paid-in-capital on common and preferred stock. Amounts transferred to the legal surplus account from the retained earnings account are not available for distribution to the stockholders without the prior consent of the Puerto Rico Commissioner of Financial



Institutions. The Puerto Rico Banking Law provides that when the expenditures of a Puerto Rico commercial bank are greater than receipts, the excess of the expenditures over receipts shall be charged against the undistributed profits of the bank, and the balance, if any, shall be charged against the reserve fund, as a reduction thereof. If there is no reserve fund sufficient to cover such balance in whole or in part, the outstanding amount shall be charged against the capital account and the Bank cannot pay dividends until it can replenish the reserve fund to an amount of at least 20% of the original capital contributed. During 2016 and 2015, \$9.6 million and \$2.8 million, respectively, were transferred to the legal surplus reserve. FirstBank's legal surplus reserve amounted to \$52.4 million and \$42.8 million as of December 31, 2016 and 2015, respectively.

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

The Written Agreement provides that we cannot declare or pay any dividends or make any distributions of interest, principal or other sums on subordinated debentures or trust-preferred securities without prior written approval of the Federal Reserve. With respect to our outstanding subordinated debentures, we had elected to defer the interest payments that were due in quarterly periods since March 2012. However, during the second quarter of 2016, the Corporation received approval from the Federal Reserve that enabled it to pay \$31.2 million for all the accrued but deferred interest payments plus the interest for the second quarter on the Corporation's subordinated debentures associated with its trust preferred securities. Subsequently, the Corporation received approval that enabled it to pay interest for the third quarter and fourth quarters of 2016. Future interest payments are subject to Federal Reserve approval. It is the intent of the Corporation to request approvals in future periods to continue regularly scheduled quarterly interest payments, although there is no assurance that such approvals will be granted.

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

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

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

We have a commercial and construction loan portfolio held for investment in the amount of \$3.9 billion as of December 31, 2016. Due to their nature, these loans entail a higher credit risk than consumer and residential mortgage loans, since they are larger in size, concentrate more risk in a single borrower and are generally more sensitive to economic downturns. Furthermore, given the slowdown in the real estate market, the properties securing these loans may be difficult to dispose of if they are foreclosed. As of December 31, 2016, we had \$375.1 million in non-performing commercial and construction loans held for investment. During 2015, the Corporation increased the reserve for loan losses by approximately \$35 million related to commercial loans extended to or guaranteed by the Puerto Rico government (excluding municipalities). In addition, the Corporation recorded other-than-temporary impairment charges totaling \$22.2 million in the last two years, on Puerto Rico government debt securities as a result of the Puerto Rico government's fiscal situation, including an OTTI charge of \$6.3 million in 2016. See "Risks Relating to the Business Environment and Our Industry – The Corporation's credit quality and the value of our portfolio of Puerto Rico government securities has been and in the future may be adversely affected by Puerto Rico's economic condition and may be affected by actions taken by the Puerto Rico government or the PROMESA oversight board to address the ongoing fiscal and economic crisis in Puerto Rico." We may incur additional credit losses over the near term, either because of continued deterioration of the quality of the loans or because of sales of such loans, which would likely accelerate the recognition of losses. Any such losses would adversely impact our overall financial performance and results of operations.

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

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

charge-offs, based on judgments different than those of management.

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

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

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

Further deterioration of the value of real estate collateral securing our construction, commercial and residential mortgage loan portfolios would result in increased credit losses. As of December 31, 2016, approximately 1%, 18% and 37% of our loan portfolio consisted of construction, commercial mortgage and residential real estate loans, respectively.

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

Construction and commercial loans, mostly secured by commercial and residential real estate properties, entail a higher credit risk than consumer and residential mortgage loans since they are larger in size, may have less collateral coverage, concentrate more risk in a single borrower and are generally more sensitive to economic downturns. As of December 31, 2016, commercial mortgage and construction real estate loans amounted to \$1.7 billion or 19% of the total loan portfolio.

We measure the impairment of a loan based on the fair value of the collateral, if collateral dependent, which is generally obtained from appraisals. Updated appraisals are obtained when we determine that loans are impaired and are updated annually thereafter. In addition, appraisals are also obtained for certain residential mortgage loans on a spot basis based on specific characteristics such as delinquency levels, age of the appraisal and loan-to-value ratios. The appraised value of the collateral may decrease or we may not be able to recover collateral at its appraised value. A significant decline in collateral valuations for collateral dependent loans may require increases in our specific provision for loan losses and an increase in the general valuation allowance. Any such increase would have an adverse effect on our future financial condition and results of operations. During the year ended December 31, 2016, net charge-offs on construction, commercial mortgage and residential mortgage loan portfolios totaled \$1.5 million, \$19.6 million and \$30.7 million, respectively.

***The acquisition of certain assets and deposits of Doral Bank through an alliance with another financial institution has magnified certain of the Corporation's risks and presented new risks.***

On February 27, 2015, the Corporation, through an alliance with another local financial institution that was the successful lead bidder with the FDIC on the failed Doral Bank, acquired certain assets and deposits of Doral Bank. The transaction presents new risks and magnifies certain of the risks the Corporation already faces that are described in these "Risk Factors", including the following:

- risks associated with weak economic conditions in the economy and in the real estate market in Puerto Rico, which adversely affect real estate prices, the job market, consumer confidence and spending habits, which may affect, among other things, the continued status of the loans acquired as performing loans, charge-offs and provision expense;
- changes in interest rates and market liquidity, which may reduce interest margins;
- changes in market rates and prices that may adversely impact the value of financial assets and liabilities; and
- failure to realize the anticipated acquisition benefits in the amounts and within the time frames expected.

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

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

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

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

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

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

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

In general, fixed-income portfolio yields would decrease if the re-investment of pre-payment amounts is at lower rates. Net interest income could also be affected by prepayments of mortgage-backed securities. Acceleration in the prepayments of mortgage-backed securities would lower yields on these securities, as the amortization of premiums paid upon the acquisition of these securities would accelerate. Conversely, acceleration in the prepayments of mortgage-backed securities would increase yields on securities purchased at a discount, as the accretion of the discount would accelerate. These risks are directly linked to future period market interest rate fluctuations. Also, net interest income in future periods might be affected by our investment in callable securities because decreases in interest rates might prompt the early redemption of such securities.

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

Basis risk is the risk of adverse consequences resulting from unequal changes in the difference, also referred to as the “spread” or basis, between the rates for two or more different instruments with the same maturity and occurs when market rates for different financial instruments or the indices used to price assets and liabilities change at different times or by different amounts. For example, the interest expense for liability instruments such as brokered CDs might not change by the same amount as interest income received from loans or investments. To the extent that the interest rates on loans and borrowings change at different rates and by different amounts, the margin between our LIBOR-based assets and the higher cost of the brokered CDs might be compressed and adversely affect net interest income.

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

For the years ended December 31, 2014, 2015 and 2016, we recognized a total of \$0.4 million, \$16.5 million and \$6.7 million, respectively, in other-than-temporary impairments. The 2015 and 2016 impairments were primarily related to Puerto Rico government debt securities held by the Corporation, which may continue to be adversely affected by the Puerto Rico government financial difficulties. See “Risks Relating to the Business Environment and Our Industry – The Corporation’s credit quality and the value of our portfolio of Puerto Rico government securities has been and in the future may be adversely affected by Puerto Rico’s economic condition and may be affected by actions taken by the Puerto Rico government or the PROMESA oversight board to address the ongoing fiscal and economic crisis in Puerto Rico.” To the extent that any portion of the unrealized losses in our investment securities portfolio of

\$66.6 million as of December 31, 2016 is determined to be other-than-temporary and, in the case of debt securities, the loss is related to credit factors, we would recognize a charge to earnings in the quarter during which such determination is made and capital ratios could be adversely affected. Even if we do not determine that the unrealized losses associated with this portfolio require an impairment charge, increases in unrealized losses on available-for-sale securities adversely affect our tangible common equity ratio, which may adversely affect credit rating agency and investor sentiment towards us. Any negative perception also may adversely affect our ability to access the capital markets or might increase our cost of capital. Valuation and other-than-temporary impairment determinations will continue to be affected by external market factors including default rates, severity rates and macro-economic factors.

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

The Corporation's ability to access new non-deposit sources of funding, even if approved by the Federal Reserve, could be adversely affected by downgrades in our credit ratings. The Corporation's liquidity is to a certain extent contingent upon its ability to obtain external sources of funding to finance its operations. The Corporation's current credit ratings and any downgrades in such credit ratings can hinder the Corporation's access to new forms of external funding and/or cause external funding to be more expensive, which could in turn adversely affect results of operations. Also, changes in credit ratings may further affect the fair value of unsecured derivatives that consider the Corporation's own credit risk as part of the valuation.

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

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

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

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

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

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

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

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

First BanCorp. is under continuous threat of cyber-attacks especially as we continue to expand customer services via the internet and other remote service channels. Three of the most significant cyber-attack risks that we face are e-fraud, denial-of-service and computer intrusion that might result in loss of sensitive customer data. Loss from



e-fraud occurs when cybercriminals breach and extract funds from customer bank accounts. Denial-of-service disrupts services available to our customers through our on-line banking system. Computer intrusion attempts might result in the breach of sensitive customer data, such as account numbers and social security numbers, and any cyber-attacks could present significant reputational, legal and/or regulatory costs to the Corporation if successful. Our risk and exposure to these matters remains heightened because of the evolving nature and complexity of the threats from organized cybercriminals and hackers, and our plans to continue to provide electronic banking services to our customers.

If personal, non-public, confidential or proprietary information of our customers in our possession were to be mishandled or misused, we could suffer significant regulatory consequences, reputational damage and financial loss. Such mishandling or misuse could include, for example, the erroneous provision of information to parties who are not permitted to have the information, either by fault of our systems, employees, or counterparties, or the interception or other inappropriate use of such information by third parties.

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

Third parties perform key aspects of our business operations such as data processing, information security, recording and monitoring transactions, online banking interfaces and services, internet connections and network access. While we believe that we have selected these third party vendors carefully, we do not control their actions. Any problems caused by these third parties, including those resulting from disruptions in communication services provided by a vendor, failure of a vendor to handle current or higher volumes, failure of a vendor to provide services for any reason, the provision by a vendor of poor performance of services, or failure of a vendor to notify us of a reportable event, could adversely affect our ability to deliver products and services to our customers and otherwise conduct our business. Financial or operational difficulties of a third party vendor could also hurt our

operations if those difficulties interfere with the vendor's ability to serve us. Replacing these third party vendors could also create significant delay and expense. Accordingly, use of such third parties creates an inherent risk to our business operations.

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

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

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

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

As a TARP recipient, we are subject to the executive compensation provisions of the EESA, including amendments to such provisions implemented under the American Recovery and Reinvestment Act of 2009, which limit the types of compensation arrangements that the Corporation may enter into with our most senior leaders. Our competitors may be in an advantageous position to retain and attract senior leaders since we are the only institution in Puerto Rico that is currently subject to TARP-related compensation provisions. Our compensation practices are subject to review and oversight by the Federal Reserve Board. We also may be subject to limitations on compensation practices by the FDIC or other regulators, which may or may not affect our competitors. Limitations on our compensation practices could have a negative impact on our ability to attract and retain talented senior leaders in support of our long term strategy.

***Our compensation practices are subject to oversight by the Federal Reserve Board and the FDIC. Any deficiencies in our compensation practices may be incorporated into our supervisory ratings, which can affect our ability to make acquisitions or perform other actions. In addition, the regulation of our compensation practices may change in the future.***

Our compensation practices are subject to oversight by the Federal Reserve Board and the FDIC. As discussed above, the Corporation currently is subject to the executive compensation restrictions as a TARP recipient and the 2010 interagency guidance governing the incentive compensation activities of regulated banks and bank holding

companies. Our failure to satisfy these restrictions and guidelines could expose us to adverse regulatory criticism, lowered supervisory ratings, and restrictions on our operations and acquisition activities. In addition, the federal banking agencies have proposed new regulations under the Dodd-Frank Act that place restrictions on the incentive compensation practices of banking organizations with \$1 billion or more in assets.

The scope and content of the U.S. banking regulators' policies on executive compensation are continuing to develop and are likely to continue evolving in the near future. It cannot be determined at this time whether compliance with such policies will adversely affect the ability of the Corporation and its subsidiaries to hire, retain and motivate their key employees.

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

The FDIC insures deposits at FDIC-insured depository institutions up to certain limits (currently, \$250,000 per depositor account). The FDIC charges insured depository institutions premiums to maintain the Deposit Insurance Fund (the "DIF"). In the event of a bank failure, the FDIC takes control of a failed bank and, if necessary, pays all insured deposits up to the statutory deposit insurance limits using the resources of the DIF. The FDIC is required by law to maintain adequate funding of the DIF, and the FDIC may increase premium assessments to maintain such funding.

The Dodd-Frank Act requires the FDIC to increase the DIF's reserves against future losses, which will require institutions with assets greater than \$10 billion, such as FirstBank, to bear an increased responsibility for funding the prescribed reserve to support the DIF. Among other things, the Dodd-Frank Act requires the FDIC to bolster the DIF by increasing the required reserve ratio for the industry to 1.35 percent (ratio of reserves to insured deposits) by September 30, 2020.

The FDIC's revised rule on deposit insurance assessments implements a provision in the Dodd-Frank Act that changes the assessment base for deposit insurance premiums from one based on domestic deposits to one based on average consolidated total assets minus average Tier 1 capital. The rule changes the assessment rate schedules for insured depository institutions so that approximately the same amount of revenue would be collected under the new assessment base as would be collected under the previous rate schedule and the schedules previously proposed by the FDIC. The rule also revises the risk-based assessment system for all large insured depository institutions (generally, institutions with at least \$10 billion in total assets, such as FirstBank). Under the rule, the FDIC uses a scorecard method to calculate assessment rates for all such institutions.

In March 2016, the FDIC adopted a final rule imposing a quarterly deposit insurance assessment surcharge on banks with at least \$10 billion in assets of 4.5 cents per \$100 of their assessment base, after making certain adjustments once the Deposit Insurance Fund Reserve Ratio reaches or exceeds 1.15 percent. For purposes of this surcharge, the first \$10 billion of assets are subtracted from the regular insurance assessment base to determine the surcharge base. The assessment surcharge became effective on July 1, 2016, is assessed as of the third quarter of 2016 and subsequent periods, and applies to FirstBank. The Bank's current surcharge base is slightly higher than the \$10 billion threshold. The surcharge assessments will continue through December 31, 2018 or until the Deposit Insurance Fund Reserve Ratio reaches or exceeds 1.35 percent. In addition, under existing regulations, the FDIC reduced the initial base assessment rate, which reduces the standard risk-based assessment rate. This resulted in a decrease in the total FDIC insurance premium expense (standard risk-based assessment plus assessment surcharge expense) of approximately \$1.6 million in the second half of 2016, as the benefit of the reduction in the initial base assessment rate exceeded the surcharge amount. In addition, under the Final Rule, if the Deposit Insurance Fund Reserve Ratio does not reach 1.35 percent by December 31, 2018, a shortfall assessment may be assessed on large banks in the first quarter of 2019 and collected by the FDIC on June 30, 2019. The FDIC also adopted a final rule raising its industry target ratio of reserves to insured deposits to 2 percent, 65 basis points above the statutory minimum, but the FDIC does not project that goal to be met for several years.

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

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

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

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

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

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

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

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

***Changes in accounting standards issued by the Financial Accounting Standards Board may adversely affect our financial statements.***

Our financial statements are subject to the application of U.S. Generally Accepted Accounting Principles (“GAAP”), which are periodically revised and expanded. Accordingly, from time to time, we are required to adopt new or revised accounting standards issued by the Financial Accounting Standards Board (“FASB”). The FASB has issued several financial accounting and reporting

standards that will govern key aspects of the Corporation's financial statements or interpretations thereof when those standards become effective, including those areas where the Corporation is required to make assumptions or estimates. For example, the FASB's new accounting standard on credit losses, which will become effective for the Corporation on January 1, 2020, will require earlier recognition of credit losses on financial assets. The new accounting model requires that lifetime "expected credit losses" of financial assets not recorded at fair value through net income, such as loans and held-to-maturity securities, be recorded at inception of the financial asset, replacing the multiple existing impairment model under GAAP which generally require that a loss be "incurred" before it is recognized. For additional information on this and other accounting standards, see Note 1 to the Consolidated Financial Statements.

Changes to financial accounting or reporting standards or interpretations, whether promulgated or required by the FASB or other regulators, could present operational challenges and could require the Corporation to change certain of the assumptions or estimates it previously used in preparing its financial statements, which could negatively impact how it records and reports its financial condition and results of operations generally and/or with respect to particular businesses. For additional information on the key areas for which assumption and estimates are used in preparing the Corporation's financial statements, see Note 1 to the Consolidated Financial Statements.

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

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

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

The goodwill impairment evaluation process requires us to make estimates and assumptions with regards to the fair value of our reporting units. Actual values may differ significantly from these estimates. Such differences could result in future impairment of goodwill that would, in turn, negatively impact our results of operations and the reporting unit where the goodwill is recorded. We conducted our most recent evaluation of goodwill during the fourth quarter of 2016.

The Step 1 evaluation of goodwill allocated to the Florida reporting unit under our valuation approaches (market and discounted cash flow analyses) indicated that the fair value of the unit was above the carrying amount of its equity book value as of the valuation date (October 1), which meant that Step 2 was not undertaken. Goodwill with a carrying value of \$28.1 million was not impaired as of December 31, 2016 or 2015, nor was any goodwill written off due to impairment during 2016, 2015, and 2014. If we are required to record a charge to earnings in our consolidated financial statements because an impairment of the goodwill or amortizable intangible assets is determined, our results of operations could be adversely affected.

***Recognition of deferred tax assets is dependent upon the generation of future taxable income by the Bank.***

As of December 31, 2016, the Corporation had a deferred tax asset of \$281.7 million (net of a valuation allowance of \$207.2 million), including \$171.5 million associated with FirstBank's Net Operating Losses ("NOLs"). Under Puerto Rico law, the Corporation and its subsidiaries, including FirstBank, are treated as separate taxable entities and are not entitled to file consolidated tax returns. To obtain the full benefit of the applicable deferred tax asset attributable to NOLs, FirstBank must have sufficient taxable income within the applicable carry forward period (7 years for taxable years beginning before January 1, 2005, 12 years for taxable years beginning after December 31, 2004 and before January 1, 2013, and 10 years for taxable years beginning after December 31, 2012). The Bank incurred all of its

NOLs on or after 2009. Accounting for income taxes requires that companies assess whether a valuation allowance should be recorded against their deferred tax asset based on an assessment of the amount of the deferred tax asset that is more likely than not to be realized.

The Corporation recorded a partial reversal of its valuation allowance in the amount of \$302.9 million in the fourth quarter of 2014. The Corporation's valuation allowance as of December 31, 2016 amounted to \$207.2 million. Due to significant estimates utilized in determining the valuation allowance and the potential for changes in facts and circumstances, it is reasonably possible that, in the future, the Corporation will not be able to reverse the remaining valuation allowance or that the Corporation will need to increase its current deferred tax asset valuation allowance.

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

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

Fluctuations in federal, state, local and foreign taxes or a change to uncertain tax positions, including related interest and penalties, may impact the Corporation's effective tax rate. When particular tax matters arise, a number of years may elapse before such matters are audited and finally resolved. In addition, tax positions may be challenged by the Puerto Rico Department of Treasury ("PRTD"),

the United States Internal Revenue Service (“IRS”) and the tax authorities in the jurisdictions in which we operate and we may estimate and provide for potential liabilities that may arise out of tax audits to the extent that uncertain tax positions fail to meet the recognition standard under applicable GAAP. Unfavorable resolution of any tax matter could increase the effective tax rate and could result in a material increase in our tax expense. Resolution of a tax issue may require the use of cash in the year of resolution.

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

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

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

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

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

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

***The Corporation’s credit quality and the value of our portfolio of Puerto Rico government securities has been and in the future may be adversely affected by Puerto Rico’s economic condition and may be affected by actions taken by the Puerto Rico government or the PROMESA oversight board to address the ongoing fiscal and economic crisis in Puerto Rico.***

A significant portion of our financial activities and credit exposure is concentrated in the Commonwealth of Puerto Rico, which has been in an economic recession since 2006. Based on the most recent information available, the main economic indicators suggest that the Puerto Rico economy remains weak. For fiscal years 2017 and 2018, the Puerto



Rico government projects a continued economic contraction in the Commonwealth's GNP of 2.2% and 2.8%, respectively, while the GDB-EAI in December 2016 decreased 2.9% on a year-over-year basis to 121.1, the lowest number in 25 years. The GDB-EAI is a coincident index of economic activity for Puerto Rico made up of four indicators (non-farm payroll employment, electric power generation, cement sales and gasoline consumption). The seasonally adjusted unemployment rate in Puerto Rico was 12.4% in December 2016, which is higher than in any U.S. state. Puerto Rico population decreased by an estimated 6.8% from 2010-2015, driven primarily by falling birth rate, a rising death rate, and migration to the United States mainland, according to the U.S. census data.

Based on information published by the Puerto Rico government, General Fund net revenues for the fiscal year 2015-2016 totaled approximately \$9.175 billion, a year-over-year increase of \$214.4 million. Fiscal year revenues were \$116.7 million below revised estimates. General Fund net revenues for the first semester of fiscal year 2017 were \$3.97 billion, an increase of \$75 million year-over-year, and exceeded estimates by approximately \$77 million.

On April 6, 2016, the Puerto Rico Emergency Moratorium and Financial Rehabilitation Act was enacted, which gives Puerto Rico's governor emergency powers to deal with the challenging fiscal situation, including the ability to declare a moratorium on any debt payment. Puerto Rico's governor also issued an executive order intended to protect the GDB's liquidity by allowing withdrawals only to fund necessary costs for essential services such as health, public safety and education services.

On June 30, 2016, pursuant to the debt moratorium law, the Puerto Rico governor ordered a moratorium on the payment of \$780 million of the Puerto Rico government's general obligations and guaranteed debt, along with the payment obligations of certain other issuers. The Puerto Rico government has continued to default on general obligation bonds, including the payment due on January 1, 2017. This followed a default on the principal payment of \$367 million of GDB notes due on May 1, 2016. On August 1, 2016, the GDB defaulted on a \$28 million payment of interest due to its creditors, including interest due on GDB bonds held by the Corporation. The GDB

default marked the first time the GDB, or any other Puerto Rico agency or instrumentality, failed to pay interest on Puerto Rico government bonds held by the Corporation. On October 1, 2016, the Puerto Rico Public Buildings Authority failed to make a full payment of interest due on its obligation bonds, including bonds held by the Corporation. Generally, based on specific facts and circumstances of the issuer, a default event requires us to classify the defaulted bonds as a non-performing asset. Accordingly, during the third quarter of 2016, bonds of the GDB and the Puerto Rico Public Buildings Authority with an aggregate fair value as of December 31, 2016 of \$20.5 million (\$35.6 million- amortized cost, including accrued interest of \$0.9 million) were classified as non-performing and placed in non-accrual status by the Corporation. These bonds are held as part of the available-for-sale securities portfolio. In the first quarter of 2016, the Corporation recorded a \$6.3 million OTTI charge on the aforementioned bonds of the GDB and the Puerto Rico Public Buildings Authority. This was the third OTTI charge on these securities recorded since June 30, 2015, as OTTI charges of \$12.9 million and \$3.0 million were booked in the second and fourth quarters of 2015. The credit-related impairment loss estimates were based on the probability of default and loss severity in the event of default in consideration of the latest available information about the Puerto Rico government's financial condition, including the enactment of a debt moratorium law and the declaration of a state of emergency at the GDB, the issuance of the GDB and the Commonwealth's audited financial statements for the fiscal year ended June 30, 2014, as well as issuance of exchange proposals with the Commonwealth's creditors related to its outstanding bond obligations. In addition to bonds of the GDB and the Puerto Rico Public Buildings Authority, the Corporation owns bonds of the Puerto Rico Housing Finance Authority in the aggregate amount of \$7.9 million carried on the Corporation's books at the aggregate fair value of \$6.3 million, which are current as to contractual payments as of December 31, 2016.

On June 30, 2016, President Obama signed HR5278 Bill, PROMESA, which established an oversight board, a process for restructuring debt, and expedited procedures for approving critical infrastructure projects in order to address the Puerto Rico government fiscal situation. The independent seven-member oversight board that was appointed by the House of Representatives, Senate and President Obama pursuant to PROMESA has fiscal oversight over Puerto Rico's finances for an initial term of five years. This marks the largest federal intervention ever into the U.S. municipal bond market. PROMESA enables Puerto Rico to restructure its debt. The PROMESA oversight board had its first meeting on September 30, 2016, and its term will expire once Puerto Rico has posted four structurally balanced budgets in a row and is deemed to have adequate access to the capital markets. The PROMESA oversight board has the power to approve or reject the general government's proposed budgets until the oversight board is satisfied that the budgets are structurally responsible and based on reasonable expectations and accounting standards.

During their first meeting, the PROMESA oversight board announced the designation of a number of entities as covered entities under PROMESA, including the Commonwealth, all of its public corporations and retirement systems, the University of Puerto Rico and all affiliates and subsidiaries of the foregoing. The designation of an entity as a covered entity has various implications under PROMESA. First, it means that the Governor will have to submit such entity's annual budgets and, if the PROMESA oversight board so requests, its fiscal plans, to the PROMESA oversight board for its review and approval. Second, covered territorial instrumentalities may not issue debt or guarantee, exchange, modify, repurchase, redeem, or enter into similar transactions with respect to their debts without the prior approval of the PROMESA oversight board. Third, pursuant to certain contracting guidelines approved by the PROMESA oversight board, prior PROMESA oversight board approval is required in connection with any transaction undertaken by a covered entity that (i) is outside the ordinary course of business or (ii) has a material financial impact. Finally, covered entities could also potentially be eligible to use the restructuring procedures provided by PROMESA. The first, Title VI, is a largely out-of-court process through which a government entity and its financial creditors can agree on terms to restructure such entity's debt. If a supermajority of creditors of a certain

category agree, that agreement can bind all other creditors in such category. The second, Title III, draws on the federal bankruptcy code and provides a court-supervised process for a comprehensive restructuring led by the PROMESA oversight board.

PROMESA contains many provisions that, although similar to the provisions of Chapter 9 or other chapters of the United States Bankruptcy Code, are not identical and may not be interpreted in the same manner. Puerto Rico's economy may be adversely affected by expenditures cuts or revenue raising measures implemented as a result of PROMESA. An increase in the tax burden of Puerto Rico residents may aggravate the population decline and economic recession. Additionally austerity measures that further reduce governmental expenditures or services, may also increase the rate at which residents leave and reduce the disposable income of residents of Puerto Rico. This decline may, in turn, lead to a decrease in economy activity that will affect the government's ability to collect revenues as projected. Holders of bonds issued by the Commonwealth and its instrumentalities may be subject to voluntary or involuntary haircuts of interest or principal or both on their bonds as a result of one of the two methods to restructure Puerto Rico's debt contained in PROMESA.

PROMESA also created a bipartisan Congressional Task Force on Economic Growth in Puerto Rico. The Task Force consists of an eight-member panel of Congressional members that will review federal laws and programs to improve Puerto Rico's economy. The Task Force submitted a report during December 2016 with over 75 recommendations to Congress to jump start Puerto Rico's economy that included dealing with Medicaid, competitive tax treatment for U.S. subsidiaries, granting child tax credits and increasing loans for small businesses and the rum cover-over tax. They also stated that if the government conducts a plebiscite authorized by Congress, they would analyze and take any appropriate legislative action. As of the date of submission of this Form 10-K, the U.S. Congress has not taken action on any of the recommendations in the report.

On November 8, 2016, a new governor of Puerto Rico was elected and assumed office in January 2017. In addition a new Resident Commissioner was designated to represent Puerto Rico in the U.S. House of Representatives. Since taking office, Puerto Rico's governor signed an executive order reducing spending by 10%, created an expedited process for infrastructure projects, implemented a zero-based budgeting methodology, introduced several bills to promote economic development and outlined several labor reforms aimed at reducing the cost of doing business in Puerto Rico. Puerto Rico's governor also signed an extension to an excise tax on foreign manufacturers which contributes a significant amount of revenue to the general fund. Furthermore, Puerto Rico's governor signed the "Financial Emergency and Fiscal Responsibility Act," which replaces the prior administration's debt moratorium with a new approach that segregates revenues available after the payment of essential services to pay debt service.

In January 2017, the PROMESA oversight board sent a letter to the Puerto Rico governor outlining a minimum of \$4.5 billion in fiscal measures that would need to be included in the government's next fiscal plan in order for the PROMESA oversight board to certify the fiscal plan, which is the first step before negotiations with creditors can occur. In response to the Puerto Rico governor's request for more time to develop a fiscal plan, the PROMESA oversight board established a number of milestones and conditions it would require if the then-current deadlines were extended. On January 28, 2017, the PROMESA oversight board officially extended various deadlines including moving to (i) February 28, 2017 the deadline for the updated fiscal plan, (ii) March 15, 2017 for the PROMESA oversight board to certify the fiscal plan and (iii) May 1, 2017 for the stay on debt-related litigation. On February 28, 2017, the Puerto Rico governor submitted to the PROMESA oversight board the Puerto Rico government fiscal plan which, among other initiatives, calls for significant reductions in operational expenses and subsidies for municipalities and the University of Puerto Rico. The plan, which relies on significant change in economic assumptions vis a vis the baseline, projects a surplus before debt service of \$11.6 billion in the aggregate during the ten year projection period (against \$35.1 billion in contractual debt service). Estimated savings under the fiscal plan of \$3.8 billion fall short of the \$4.5 billion figure the PROMESA oversight board recommended. This initial fiscal plan was rejected by the PROMESA oversight board, which claimed the proposal relied on overly optimistic baseline revenue assumptions, economic projections and forecasted savings resulting from measures to reduce public expenditures. A revised fiscal plan was submitted by the Puerto Rico governor on March 11, 2017, including \$262 million in additional revenue and changes to healthcare funding. On March 13, 2017, the PROMESA oversight board certified the revised fiscal plan, provided that two amendments are made. One amendment would institute the PROMESA oversight board's earlier proposal for furloughing most government employees four days a month, with two days for teachers and none for law enforcement officers, by July 1st, 2017 (the beginning of fiscal year 2018), and eliminate the annual Christmas bonus for government workers if the Puerto Rico government does not come up with plans to increase liquidity by \$200 million and implement its plan to "right-size" its operations in a fiscal year 2018 budget proposal by April 30th. If it does, the cost-savings measures would be delayed until September 1st. A further determination would then be made as to whether the savings measures are needed or to what extent needed. The other amendment would require an agreement between the Puerto Rico government and the PROMESA oversight board to reduce pension costs 10% by 2020 to be reached within 30 days and finalized by June 30th.

With respect to the PREPA, on December 23, 2015, PREPA and more than 70% of its creditors reached an agreement on an RSA that would provide, among other things, for a restructuring of some of PREPA's outstanding debt at 85 cents on the dollar. The RSA also included a BPA whereby certain of those creditors would purchase new bonds to be issued by PREPA. The implementation of the RSA would provide the basis for PREPA to provide more reliable and lower-cost service, fund its capital needs for the medium term, help ensure environmental compliance, diversify generation resources to include more natural gas, and provide jobs.

Legislation to establish the necessary securitization framework for the new PREPA debt was passed on February 16, 2016. In June 2016, the Puerto Rico Energy Commission approved a "transition" charge to PREPA customers that will secure the new debt that will be issued to facilitate the PREPA restructuring. In May and June of 2016, certain bondholders purchased \$115 million of bonds pursuant to the BPA. The BPA was amended in late June and

bondholders purchased another \$264 million on June 30, 2016. Following the BPA amendment, PREPA made the full principal and interest payment due on July 1, 2016. On January 1, 2017, PREPA made its full interest payment and did so without requiring any type of BPA

On January 27, 2017, the AAFAF notified all creditors involved that it was extending the January 31, 2017 expiration date of the RSA until March 31, 2017. In addition, AAFAF also notified the parties together with its financial advisors Rothchild, that it would lead negotiations with PREPA creditors.

As of December 31, 2016, the Corporation had \$323.3 million of direct exposure to the Puerto Rico government, its municipalities and public corporations, compared to \$360.7 million as of December 31, 2015. Approximately \$191.9 million of the exposure consisted of loans and obligations of municipalities in Puerto Rico that are supported by assigned property tax revenues and for which, in most cases, the good faith, credit and unlimited taxing power of the applicable municipality have been pledged to their repayment. Approximately 89% of the Corporation's municipality exposure consists primarily of senior priority obligations concentrated in five of the largest municipalities in Puerto Rico (San Juan, Carolina, Bayamon, Mayaguez and Guaynabo). These municipalities are required by law to levy special property taxes in such amounts as shall be required for the payment of all of their respective general obligation bonds and loans. Although the PROMESA oversight board has not designated any of the Commonwealth's 78 municipalities as covered entities under PROMESA, it may decide to do so in the future. While the fiscal plan submitted by the Puerto Rico governor to the PROMESA oversight board on February 28, 2017 did not contemplate a restructuring of the debt of Puerto

Rico's municipalities, the plan did call for the gradual elimination of budgetary subsidies provided to municipalities, which constitute a material portion of the operating revenues of certain municipalities. The PROMESA oversight board had previously expressly called for the elimination of these budgetary subsidies as part of any certified fiscal plan. Furthermore, municipalities are also likely to be affected by the negative economic and other effects resulting from expense, revenue or cash management measures taken to address the Puerto Rico government's fiscal and liquidity shortfalls. In addition to municipalities, the total exposure to the Puerto Rico government entities covered by PROMESA included \$6.9 million of loans to units of the Puerto Rico central government, and approximately \$81.9 million consisted of loans to public corporations (entities covered by PROMESA), including the direct exposure to PREPA with a book value of \$65.5 million as of December 31, 2016 that was sold in the first quarter of 2017 as described above. See "Significant Events Since the Beginning of 2016 – Sale of the Puerto Rico Electric Power Authority Loan". The PREPA credit facility was placed in non-accrual status in the first quarter of 2015, and interest payments recorded on a cost-recovery basis. The Corporation's total direct exposure also includes obligations of the Puerto Rico government with an amortized cost of \$42.7 million as part of its available-for-sale investment securities portfolio, net of \$22.2 million in cumulative OTTI charges, and recorded at a fair value of \$26.8 million as of December 31, 2016.

Furthermore, as of December 31, 2016, the Corporation had \$127.7 million outstanding (book value of \$111.8 million) in credit facilities extended to the hotel industry in Puerto Rico under which the borrower and the operations of the underlying collateral are the primary sources of repayment and the TDF provides a secondary guarantee for payment performance, compared to \$129.4 million outstanding as of December 31, 2015. The TDF is a subsidiary of the GDB that facilitates private sector financings to Puerto Rico's hotel industry. Adverse developments related to the Puerto Rico government's fiscal situation introduced additional uncertainty regarding the TDF's ability to honor its guarantee, including the enactment of Act 21. These facilities were placed in non-accrual status and classified as impaired in the first quarter of 2016, and interest payments are now applied against principal. The Corporation has been receiving payments on the largest of these three facilities sufficient to cover the monthly contractual payments. This facility matured on February 1, 2017 and is currently under renegotiation. In addition, the borrowers' cash flows related to the other two facilities are insufficient to cover debt service and the Corporation is not receiving collections from the TDF guarantee. As such, these two facilities are collateral dependent loans and charge-offs amounting to \$13.9 million were recorded during the second half of 2016, of which \$13.0 million was charged against reserves established in prior periods. These loans have been adversely classified since the third quarter of 2015. As of December 31, 2016, the loans guaranteed by the TDF are being carried at 72% of unpaid principal balance, net of reserves and accumulated charge-offs. The Corporation measures impairment on these loans based on the fair value of the collateral and the existence of the government guarantee. Developments of the Puerto Rico government debt restructuring process, with the automatic stay on litigations under PROMESA set to expire on May 1, 2017, and actions taken or those that may have to be taken by the Commonwealth or the PROMESA oversight board to address Puerto Rico's fiscal and economic crisis could ultimately adversely affect the value of the Puerto Rico government guarantees, including the TDF guarantee. If as a result of developments, including discussions with regulators, loan rating downgrades, progress in the debt restructuring process, or for other reasons, the Corporation determines that additional impairment charges are necessary, such an action would adversely affect the Corporation's results of operations in the period in which such determination is taken.

In addition, the Corporation had \$119.9 million in exposure to residential mortgage loans that are guaranteed by the Puerto Rico Housing Finance Authority. Residential mortgage loans guaranteed by the Puerto Rico Housing Finance Authority are secured by the underlying properties and the guarantees serve to cover shortfalls in collateral in the event of a borrower default. The Puerto Rico government guarantees up to \$75 million of the principal guaranteed

under the mortgage loans insurance program. According to the most recently released audited financial statements of the Puerto Rico Housing Financing Authority, as of June 30, 2015, the Puerto Rico Housing Finance Authority's mortgage loans insurance program covered loans aggregating approximately \$552 million. The regulations adopted by the Puerto Rico Housing Finance Authority require the establishment of adequate reserves to guarantee the solvency of the mortgage loans insurance fund. As of June 30, 2015, the most recent date as to which information is available, the Puerto Rico Housing Finance Authority had a restricted net position for such purposes of approximately \$77.4 million.

Furthermore, as of December 31, 2016, the Corporation had \$408.8 million of public sector deposits in Puerto Rico. Approximately 28% is from municipalities and municipal agencies in Puerto Rico and 72% is from public corporations and the central government and agencies in Puerto Rico.

The decline in Puerto Rico's economy since 2006 has resulted in, among other things, a decline in our loan originations, an increase in the level of our non-performing assets, higher loan loss provisions and charge-offs, and an increase in the rate of foreclosure loss on mortgage loans, all of which adversely affected our profitability. During the next four fiscal years, the Commonwealth expects to confront various events that may significantly reduce its revenues or increase its expenditures. To the extent the Commonwealth is unable to address these events, its ability to continue operating and providing essential services to its population may be severely compromised. Any further potential deterioration of economic activity could result in further adverse effects on our profitability and credit quality.

***Continuation of the economic slowdown and decline in the U.S. Virgin Islands could continue to harm our results of operations.***

The fiscal health of the government of the USVI over the past 10 years has shown signs of deterioration evidenced by persistent budgetary deficits and projected future revenue shortfalls. The accumulated deficit position in the general fund at the end of the fiscal

year 2015 was in excess of \$74 million and the annual deficit for fiscal year 2016 is projected to be nearly \$14 million. In addition to the general fund situation, the USVI is also experiencing growth in its unfunded actuarial accrued liability.

The government of the USVI has developed a five-year financial plan, designed to return the general fund to fiscal stability. The fiscal stabilization plan includes a number of revenue enhancement initiatives as well as reductions to government operating expenses. Many of the USVI government's revenue enhancement initiatives are subject to legislative approval and are in the form of tax increases which could potentially have an adverse effect on the economy. The fiscal stabilization plan is also predicated on access of the government to the financial markets in order to issue deficit financing to cover the operating deficits for 2017 and 2018, which is uncertain.

As of December 31, 2016, the Corporation has total exposure to the USVI government and its instrumentalities of \$84.7 million. All loans are currently performing and up to date with its principal and interest payments.

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

Given that most of our business is in Puerto Rico and the United States and given the degree of interrelation between Puerto Rico's economy and that of the United States, we are exposed to downturns in the U.S. economy, including factors such as unemployment and underemployment levels in the United States and real estate valuations. The deterioration of these conditions could adversely affect the credit performance of mortgage loans, credit default swaps and other derivatives, and result in significant write-downs of asset values by financial institutions, including government-sponsored entities as well as major commercial banks and investment banks.

Despite improving labor markets in the U.S. in the past year, an elevated amount of underemployment and household debt, the volatile interest rate environment, along with a continued sluggish recovery in the consumer real estate market and certain commercial real estate markets in the U.S., pose challenges for the U.S. economic performance and the financial services industry.

In particular, we may face the following risks:

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



- There may be downward pressure on our stock price.

The deterioration of economic conditions in the U.S. and disruptions in the financial markets could adversely affect our ability to access capital, our business, financial condition and results of operations and our ability to comply with the Written Agreement, which could result in further regulatory enforcement actions.

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

Our ability to engage in routine funding transactions could be adversely affected by future failures of financial institutions and the actions and commercial soundness of other financial institutions. Financial institutions are interrelated as a result of trading, clearing, counterparty and other relationships. We have exposure to different industries and counterparties and routinely execute transactions with counterparties in the financial services industry, including brokers and dealers, commercial banks, investment banks, investment companies and other institutional clients. In certain of these transactions, we are required to post collateral to secure the obligations to the counterparties. In the event of a bankruptcy or insolvency proceeding involving one of such counterparties, we may experience delays in recovering the assets posted as collateral, or we may incur a loss to the extent that the counterparty was holding collateral in excess of the obligation to such counterparty, such as the loss of our assets that we pledged to Lehman Brothers, Inc., which we have been trying to recover, so far unsuccessfully.

In addition, many of these transactions expose us to credit risk in the event of a default by our counterparty or client. In addition, the credit risk may be exacerbated when the collateral held by us cannot be realized or is liquidated at prices not sufficient to recover

the full amount of the loan or derivative exposure due to us. Any losses resulting from our routine funding transactions may materially and adversely affect our financial condition and results of operations.

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

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

The financial crisis of 2008 resulted in government regulatory agencies and political bodies placing increased focus and scrutiny on the financial services industry. The U.S. government intervened on an unprecedented scale, responding by temporarily enhancing the liquidity support available to financial institutions, establishing a commercial paper funding facility, temporarily guaranteeing money market funds and certain types of debt issuances and increasing insurance on bank deposits.

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

***Financial deregulation measures proposed by the Trump administration and members of the U.S. Congress may create regulatory uncertainty for the financial sector, increase competition in certain of our investment strategies and adversely affect our business, financial condition and results of operations.***

The Trump administration's short-term legislative agenda may include certain deregulatory measures for the U.S. financial services industry including changes to the Volcker Rule, the U.S. Risk Retention Rules, Basel III capital requirements, the FSOC's authority and other aspects of the Dodd-Frank Act. On February 3, 2017, President Trump signed an executive order calling for the administration to review U.S. financial laws and regulations in order to determine their consistency with a set of core principles identified in the order. One bill, the Financial CHOICE Act (the "CHOICE Act"), which was sponsored by Rep. Jeb Hensarling last year but was not enacted, is being discussed as an avenue for amending the Dodd-Frank Act and may be subject to revisions and reintroduction in the current session of Congress. The most recent version of the CHOICE Act would eliminate the power of the FSOC to designate non-bank financial institutions as systematically important, repeal the Volcker Rule and change the structure and powers of the Consumer Financial Protection Bureau. In addition, the CHOICE Act would allow certain qualifying banking organizations with a satisfactory composite supervisory rating and a non-risk weighted leverage ratio of at least 10% to elect to be exempt from enhanced risk-weighted capital ratios, liquidity requirements and other regulations currently applicable to large banking organizations, and would revise the U.S. Risk Retention Rules to remove the risk retention requirement for all asset-backed securitizations other than for certain non-qualifying residential mortgage securitizations. The CHOICE Act also would significantly alter stress testing, possibly exempting qualifying banking organizations from stress tests altogether and eliminating the Federal Reserve Board's

ability to make “qualitative” objections to capital plans submitted by other banking organizations. In addition, the CHOICE Act would also significantly enhance the SEC’s enforcement capabilities and increase the maximum civil penalties and criminal sanctions under federal securities laws, including under the Investment Company Act of 1940 and the Investment Advisers Act of 1940.

Whether the CHOICE Act will be enacted, and, if so, whether additional amendments would be added during the legislative process remains unclear. However, the results of the recent elections have increased the likelihood that the CHOICE Act or similar financial reform legislation will be enacted. In addition, in the absence of legislative change, the Trump administration may influence the substance of regulatory supervision through, among other things, the appointment of individuals to the Federal Reserve Board. As a result of the recent notice of resignation by one member of the Federal Reserve Board, President Trump is expected to soon be able to nominate persons to fill three of the Federal Reserve Board’s seven seats, including a Vice Chairman for Supervision. In turn, the nomination of new Federal Reserve Board members by Mr. Trump may increase the likelihood that the Federal Reserve Board will depart from adopting capital and liquidity requirements for U.S. banking organizations that are more stringent than those that have been agreed upon at the international level, including the Basel Committee on Banking Supervision’s Basel III framework.

Measures focused on deregulation of the U.S. financial services industry may have the effect of increasing competition for our credit-focused businesses or otherwise reducing investment opportunities. Increased competition from banks and other financial institutions in the credit markets could have the effect of reducing credit spreads, which may adversely affect the revenues of our credit and other businesses whose strategies including the provision of credit to borrowers.

Determining the full extent of the impact on us of any such potential financial reform legislation, or whether any such particular proposal will become law, at this point in time is highly speculative. However, any such changes may impose additional costs on us, require the attention of our senior management or result in limitations on the manner in which business is conducted.

***We could be adversely affected by changes in tax laws and regulations or the interpretation of such laws and regulations.***

The Corporation and its subsidiaries are subject to Puerto Rico income tax laws on their income from all sources. As Puerto Rico corporations, First BanCorp. and its subsidiaries are treated as foreign corporations for U.S. and USVI income tax purposes and are generally subject to U.S. and USVI income tax only on their income from sources within the U.S. and USVI or income effectively connected with the conduct of a trade or business in those regions. These tax laws are complex and subject to different interpretations. We must make judgments and interpretations about the application of these inherently complex tax laws when determining our provision for income taxes, our deferred tax assets and liabilities, and our valuation allowance. In addition, legislative changes, particularly changes in tax laws, could adversely impact our results of operations.

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

The Corporation faces increased regulation and regulatory scrutiny as a result of, among other things, its participation in the Troubled Assets Relief Program. The U.S. Treasury acquired shares of common stock from the Corporation in October 2011 in exchange for shares of preferred stock that it owned because of the Corporation's issuance of preferred stock to U.S. Treasury in January 2009 pursuant to the TARP. In July 2010, the Corporation issued to U.S. Treasury a warrant, which amends, restates and replaces the original warrant that it issued to U.S. Treasury in January 2009 under the TARP. The Corporation's participation in the TARP also imposes limitations on the payments it may make to its senior leaders. For more details on the implications of TARP please refer to the risks factors titled as follow: "Competition for our executives and other key employees is intense, and we may not be able to attract and retain the highly skilled people we need to support our business" above.

As discussed above, the Dodd-Frank Act significantly changed the regulation of financial institutions and the financial services industry. The Dodd-Frank Act includes, and the regulations developed and to be developed thereunder include or will include, provisions affecting large and small financial institutions alike. In addition, U.S. banking organizations, including the Corporation and FirstBank, are subject to new and more stringent regulatory capital requirements that generally increase the amounts of capital that we need to hold.

As of December 31, 2016, the Corporation had \$210 million in trust preferred securities that are now subject to the full phase-out from Tier 1 capital under the final regulatory capital rules discussed above.

Although First BanCorp. and FirstBank were able to meet well-capitalized capital ratios upon implementation of the requirements, and we expect both companies will continue to exceed the minimum risk-based and leverage capital ratio requirements for well-capitalized status under the new capital rules, we may not remain well capitalized.

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

***We are subject to regulatory capital adequacy guidelines, and if we fail to meet these guidelines our business and financial condition will be adversely affected.***

Under regulatory capital adequacy guidelines, and other regulatory requirements, the Corporation and our banking subsidiary must meet guidelines that include quantitative measures of assets, liabilities and certain off balance sheet items, subject to qualitative judgments by regulators regarding components, risk weightings and other factors. If we fail to meet these minimum capital guidelines and other regulatory requirements, our business and financial condition will be materially and adversely affected. If we fail to maintain certain capital levels, or are deemed not well managed under regulatory exam procedures, or if we experience certain regulatory violations, our status as a financial holding company, and our ability to offer certain financial products will be compromised and our financial condition and results of operations could be adversely affected.

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

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

New regulations implement the Dodd-Frank Act amendments to the Equal Credit Opportunity Act, the Truth in Lending Act, and the Real Estate Settlement Procedures Act. See “Regulation and Supervision – Consumer Financial Protection Bureau.”

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

These and other changes required by the Dodd-Frank Act have required substantial modifications to the entire mortgage lending and servicing industry. Their impact may involve changes to our operations and increased compliance costs in making single-family residential mortgage loans. There are new laws and regulations that come into effect in 2017 and 2018 affecting the residential mortgage business and commercial business which may cause us to incur additional increased regulatory and compliance costs. Notwithstanding the above, the new administration has expressed its disagreement with the burden of new regulations and requirements. In addition, House Financial Services Committee Chairman Jeb Hensarling issued a press release on January 26, 2017 stating that replacing the Dodd-Frank Act is a top administration and congressional priority. At this point, however, it is uncertain whether any of these regulatory burdens will be relaxed.

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

The Corporation is currently subject to supervisory guidance for stress testing practices issued by the federal banking agencies. The current guidance outlines broad principles for a satisfactory stress testing framework and describes various stress testing approaches and how stress testing should be used at various levels within an organization. As previously discussed, the Corporation is also subject to two new stress testing rules that implement provisions of the Dodd-Frank Act, one issued by the Federal Reserve Board that applies to First BanCorp. on a consolidated basis and one issued by the FDIC that applies to the Bank.

The Corporation submitted its second annual company-run stress test to regulators in July 2016, which was published in October 2016.

Future public disclosure of stress test results could result in reputational harm if the Corporation’s results are worse than those of its competitors or otherwise indicate that the Corporation’s risk profile is excessive or elevated. Furthermore, given that the Corporation will be subject to multiple stress testing requirements that are administered at different levels by more than one federal banking agency, and compliance with such requirements will be

complicated, if the Corporation fails to fully comply with these requirements, it may be subject to regulatory action.

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

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

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

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

The Community Reinvestment Act, the Equal Credit Opportunity Act, the Fair Housing Act and other fair lending laws and regulations impose nondiscriminatory lending requirements on financial institutions. The Department of Justice and other federal agencies are responsible for enforcing these laws and regulations. A successful regulatory challenge to an institution's performance under the Community Reinvestment Act or fair lending laws and regulations could result in a wide variety of sanctions, including damages and civil money penalties, injunctive relief, restrictions on mergers and acquisitions activity, restrictions on expansion and

restrictions on entering new business lines. Private parties may also have the ability to challenge an institution's performance under fair lending laws in private class action litigation. Such actions could have a material adverse effect on our business, financial condition and results of operations.

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

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

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

***Sales in the public market of the approximately 23% of our outstanding shares of common stock that are held by a small group of large stockholders could adversely affect the trading price of our common stock.***

The following stockholders own an aggregate of approximately 23.2% of our outstanding shares of common stock: funds affiliated with Thomas H. Lee Partners, L.P. ("THL"), which own approximately 9.2%, and funds managed by Oaktree Capital Management, L.P. ("Oaktree"), which own approximately 9.2%, and the U.S. Treasury, which owns approximately 4.7%, excluding shares of common stock issuable upon exercise of the U.S. Treasury's warrant. We have registered these securities for resale under the Securities Act of 1933 and are obligated to keep the prospectus, which is part of the resale registration statement filed with the SEC, current so that the securities can be sold in the public market at any time. The resale of the securities in the public market, or the perception that these sales might occur, could cause the market price of our common stock to decline.

***Issuance of additional equity securities in the public markets and other capital management or business strategies that we may pursue could depress the market price of our common stock and could result in dilution of holders of our common stock, including purchasers of our common stock under the resale registration statement.***

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



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

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

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

The stock markets have frequently experienced high levels of volatility since 2008. These market fluctuations have adversely affected, and may continue to adversely affect, the trading price of our common stock. In addition, the market price of our common stock has been subject to significant fluctuations and volatility because of factors specifically related to our businesses and may continue to fluctuate or decline.

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

- uncertainties and developments related to the resolution of the Puerto Rico government's fiscal problems;
- our ability to continue to comply with the Written Agreement;

- any additional regulatory actions against us;
- changes or perceived changes in the condition, operations, results or prospects of our businesses and market assessments of these changes or perceived changes;
- announcements of strategic developments, acquisitions and other material events by us or our competitors, including any failures of banks;
- changes in governmental regulations or proposals, or new governmental regulations or proposals, affecting us;
- a continuing recession in the Puerto Rico market and a lack of growth in our other principal markets in the USVI, BVI and U.S.;
- the departure of key employees;
- changes in the credit, mortgage and real estate markets;
- operating results that vary from the expectations of management, securities analysts and investors;
- operating and stock price performance of companies that investors deem comparable to us; and
- the public perception of the banking industry and its safety and soundness.

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

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

In consideration of the financial results reported for the second quarter ended June 30, 2009, we decided, as a matter of prudent fiscal management and following applicable Federal Reserve Board's guidance, to suspend the payment of dividends. The Corporation's ability to declare and pay dividends is dependent on certain Federal regulatory considerations, including the guidelines of the Federal Reserve Board regarding capital adequacy and dividends and on the requirements of the Written Agreement which requires prior written approval of the Federal Reserve to declare or pay dividends. During the fourth quarter of 2016, following the requisite regulatory approval, the Corporation announced the declaration of a cash dividend on its outstanding shares of Series A through E Noncumulative Perpetual Monthly Income Preferred Stock for the month of December 2016. Dividends on our Series A through E Preferred Stock had not been paid since July 2009. The Corporation has to date receive approval to pay the monthly dividends on the Corporation's Series A through E Preferred Stock through March 2017. Although there is no assurance that any dividends will be declared on the Corporation's Series A through E Preferred Stock in any future periods, the Corporation intends to continue to request the Federal Reserve's approval pursuant to the requirements of the Written Agreement to enable it to continue to pay the monthly dividends on its Series A through E Preferred

Stock.

The holders of the preferred stock have the right to appoint two additional members to our Board of Directors. Any member of the Board of Directors appointed by the holders of Series A through E Preferred Stock is required to vacate his or her office if the Corporation resumes the payment of dividends in full for twelve consecutive monthly dividend periods.

#### **Item 1B. Unresolved Staff Comments**

None.

#### **Item 2. Properties**

As of March 1, 2017, First BanCorp owned the following three main offices located in Puerto Rico:

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

- Consumer Lending Center – A three-story building with a three-level parking garage located at 876 Muñoz Rivera Avenue, Hato Rey, Puerto Rico. This facility is fully occupied by the Corporation.

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

### **Item 3. Legal Proceedings**

Reference is made to Note 30, "Regulatory Matters, Commitments and Contingencies," included in the Notes to Consolidated Financial Statements in Item 8 of this Report, which is incorporated herein by reference.

### **Item 4. Mine Safety Disclosure.**

Not applicable.

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

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

The Corporation's common stock is traded on the NYSE under the symbol FBP. On March 3, 2017, there were 388 holders of record of the Corporation's common stock, not including beneficial owners whose shares are held in the name of brokers or other nominees. The last sales price for the common stock on that date was \$6.30.

In December 2016, January 2017, and February 2017 the Corporation paid dividends on the non-cumulative perpetual monthly income preferred stocks which, along with common stock dividend payments, were suspended during the third quarter of 2009. The common stock ranks junior to all series of preferred stock as to dividend rights and as to rights on liquidation, dissolution or winding up of the Corporation.

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

<b><u>Quarter Ended</u></b>	<b>High</b>	<b>Low</b>	<b>Last</b>	<b>Dividends per Common Share</b>
<b>2016:</b>				
Fourth Quarter Ended December 31, 2016	\$ 7.05	\$ 4.78	\$ 6.61	\$ -
Third Quarter Ended September 30, 2016	5.26	3.82	5.20	-
Second Quarter Ended June 30, 2016	4.62	2.52	3.97	-
First Quarter Ended March 31, 2016	3.23	2.06	2.92	-
<b>2015:</b>				
Fourth Quarter Ended December 31, 2015	\$ 4.49	\$ 3.06	\$ 3.25	\$ -
Third Quarter Ended September 30, 2015	4.89	3.15	3.56	-
Second Quarter Ended June 30, 2015	6.74	4.82	4.82	-
First Quarter Ended March 31, 2015	6.74	5.27	6.20	-

During the fourth quarter of 2014, the U.S. Treasury sold approximately 4.4 million shares of First BanCorp.'s common stock through its first pre-defined written trading plan. On March 9, 2015, the U.S. Treasury announced the sale of an additional 5 million shares of First BanCorp.'s common stock through its second pre-defined written trading plan

On December 5, 2016, THL and Oaktree completed a secondary offering of the Corporation's common stock. THL and Oaktree sold an aggregate of 18 million shares (9 million shares each) of common stock at a price of \$5.60 per share. In addition, the underwriters exercised their option to purchase an additional 2.7 million shares of common stock from the selling stockholders. Also, on February 7, 2017, THL and Oaktree participated in another secondary offering in which they sold an additional aggregate amount of 20 million shares (10 million shares each) of common stock at a price of \$6.36 per share. Subsequently, the underwriters exercised their option to purchase an additional 3 million shares of common stock from the selling stockholders. The Corporation did not receive any proceeds from these offering.

As of March 3, 2017, each of THL and Oaktree owned approximately 9.2% of the Corporation's outstanding common stock and the U.S. Treasury owned approximately 4.7%, excluding the 1.3 million common shares underlying the warrant owned by the Treasury, which is exercisable for \$3.29 per share.

Effective April 1, 2013, the Board determined to increase the salary amounts paid to certain executive officers primarily by paying the increased salary amounts in the form of shares of the Corporation's common stock, instead of cash. The Corporation issued 755,223 shares of common stock with a weighted average market value of \$3.96 in 2016 as such additional salary amounts (2015 – 483,053 shares with a weighted average market value of \$4.67). The Corporation withheld 226,261 shares from the common stock paid to the officers as additional compensation to cover employee payroll and income tax withholding liabilities in 2016 (2015 – 149,463 shares); these shares are held as treasury shares. The Corporation paid any fractional share of salary stock that the officer was entitled to in cash.

In 2016, the Corporation granted 1,925,575 shares of restricted stock to certain executive officers, other employees, and independent directors (2015 – 1,013,495 shares). In connection with the vesting of restricted stock in 2016, the Corporation withheld 65,498 shares of restricted stock (2015 – 72,918 shares) to cover employee payroll and income tax withholding liabilities; these shares are also held as treasury shares.

As of December 31, 2016 and December 31, 2015, the Corporation had 1,254,189 and 962,430 shares held as treasury stock, respectively.

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

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

The terms of the Corporation's Series A through E Preferred Stock do not permit the Corporation to declare, set apart or pay any dividend or make any other distribution of assets on, or redeem, purchase, set apart or otherwise acquire

shares of common stock or of any other class of stock of First BanCorp. ranking junior to the preferred stock, unless all accrued and unpaid dividends on the preferred stock and any parity stock for the twelve monthly dividend periods ending on the immediately preceding dividend payment date shall have been paid or are paid contemporaneously; the full monthly dividend on the preferred stock and any parity stock for the then current month has been or is contemporaneously declared and paid or declared and set apart for payment; and the Corporation has not defaulted in the payment of the redemption price of any shares of the preferred stock and any parity stock called for redemption. If the Corporation is unable to pay in full the dividends on the preferred stock and on any other shares of stock of equal rank as to the payment of dividends, all dividends declared upon the preferred stock and any such other shares of stock will be declared pro rata.

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

#### *2014 Exchange*

In 2014, the Corporation issued an aggregate of 4,597,121 shares of its common stock in exchange for an aggregate 1,077,726 shares of the Corporation's Series A through E Preferred Stock, having an aggregate liquidation value of \$26.9 million. The shares of common stock were issued to holders of the Series A through E Preferred Stock in separate and unrelated transactions in reliance upon the exemption set forth in Section 3(a)(9) of the Securities Act, for securities exchanged by an issuer with existing security holders where no commission or other remuneration is paid or given directly or indirectly by the issuer for soliciting such exchange.

### *2015 Exchange*

During the second quarter of 2015, the Corporation exchanged trust-preferred securities with a liquidation value of \$5.3 million for 852,831 shares of the Corporation's common stock in reliance upon the exemption set forth in Section 3(a)(9) of the Securities Act.

### **Dividends**

The Corporation had a policy of paying quarterly cash dividends on its outstanding shares of common stock subject to its earnings and financial condition. For the first time since July 2009, following the requisite regulatory approval, on December 8, 2016, the Corporation announced the declaration of a cash dividend on its outstanding shares of Series A through E Noncumulative Perpetual Monthly Income Preferred Stock for the month of December 2016. The Corporation has to date received approval to pay the monthly dividends on the Corporation's Series A through E Preferred Stock through March 2017. The Corporation's ability to pay future dividends will necessarily depend upon its earnings and financial condition as well as its receipt of approval from the Federal Reserve to pay dividends. The Corporation intends to continue to request the Federal Reserve's approval pursuant to the requirements of the Written Agreement to enable it to continue to pay the monthly dividends on its Series A through E Preferred Stock. See the discussion under "Dividend Restrictions" under Item 1 for additional information concerning restrictions on the payment of dividends that apply to the Corporation and FirstBank.

The 2011 PR Code requires the withholding of income tax from dividend income sourced within Puerto Rico to be received by any individual, resident of Puerto Rico or not, trusts and estates and by non-resident custodians, partnerships, and corporations.

#### *Resident U.S. Citizens*

A special tax of 15% withheld at source is imposed, in lieu of regular tax, on any eligible dividends paid to individuals, trusts, and estates. Eligible dividends include dividends paid by a domestic Puerto Rico corporation. However, the taxpayer can perform an election to be excluded from the 15% special tax. Once this election is made it is irrevocable. The election allows the taxpayer to include in gross income the eligible dividends received and take a credit for the amount of tax withheld in excess, if any. If the taxpayer does not make this election on the tax return, then he can exclude from gross income the eligible dividends received and reported without claiming the credit for the tax withheld.

#### *Nonresident U.S. Citizens*



Nonresident U.S. citizens have the right to certain exemptions when a Withholding Tax Exemption Certificate (Form 2732) is properly completed and filed with the Corporation. The Corporation, as withholding agent, is authorized to withhold a tax of 15% only from the excess of the income paid over the applicable tax-exempt amount.

*U.S. Corporations and Partnerships*

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

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

The following table summarizes equity compensation plans approved by security holders and equity compensation plans that were not approved by security holders as of December 31, 2016:

<b><u>Plan category</u></b>	<b>(a)</b>	<b>(b)</b>	<b>(c)</b>
	<b>Number of Securities to be Issued Upon Exercise of Outstanding Options, warrants and rights</b>	<b>Weighted Average Exercise Price of Outstanding Options, warrants and rights</b>	<b>Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a))</b>
Equity compensation plans, approved by stockholders (1)	34,989 <sup>(1)</sup>	\$ 138.00	6,846,986 <sup>(2)</sup>
Equity compensation plans not approved by stockholders	N/A	N/A	N/A
<b>Total</b>	<b>34,989</b>	<b>\$ 138.00</b>	<b>6,846,986</b>

(1) The 1997 stock option plan expired on January 21, 2007. All outstanding awards under the stock option plan continue in full force and effect, subject to their original terms and the shares of common stock underlying the options are subject to adjustments for stock splits, reorganization and other similar events. Stock options granted under the 1997 stock options plan expired in January 2017.

(2) Securities available for future issuance under the First BanCorp. 2008 Omnibus Incentive Plan (the "Omnibus Plan"), which was initially approved by stockholders on April 29, 2008. The Omnibus Plan was first amended with stockholder approval on December 9, 2011 to increase the number of shares reserved for issuance under the Omnibus plan. Then, on May 24, 2016, the Omnibus plan was amended again to, among other things, increase the number of shares of common stock reserved for issuance under the Omnibus Plan, to extend the term of the Omnibus Plan to May 24, 2026 and to re-approve the material terms of the performance goals under the Omnibus Plan for purpose of Section 162 (m) of the U.S. Internal Revenue Code of 1986, as amended. The Omnibus Plan provides for equity-based compensation incentives through the grant of stock options, stock appreciation rights, restricted stock, restricted stock units, performance shares, and other stock-based awards. As amended, this plan provides for the issuance of up to 14,169,807 shares of common stock, subject to adjustments for stock splits, reorganization and other similar events. As of December 31, 2016, 6,846,986 shares of Common Stock were available for future issuance under the Omnibus Plan.

**Purchase of equity securities by the issuer and affiliated purchasers**

The following table provides relating to the Corporation's purchases of shares of its common stock in the three-month period ended December 31, 2016:

<b><u>Period</u></b>	<b>Total number of shares purchased <sup>(1)</sup></b>	<b>Average Price Paid</b>	<b>Total Number of Shares Purchased as Part of Publicly Announced Plans Or Programs</b>	<b>Maximum Number of Shares That May Yet be Purchased Under These Plans or Programs</b>
October, 2016	13,283	\$ 5.34	-	-
November, 2016	12,290	5.77	-	-
December, 2016	11,084	6.40	-	-
Total	36,657	\$ 5.80	-	-

(1) Reflects shares of common stock withheld from the common stock paid to certain senior officers.

## STOCK PERFORMANCE GRAPH

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

The graph below compares the cumulative total stockholder return of First BanCorp. during the measurement period with the cumulative total return, assuming reinvestment of dividends, of the S&P 500 Index and the S&P Supercom Banks Index (the “Peer Group”). The Performance Graph assumes that \$100 was invested on December 31, 2011 in a share of, or interest in, each of First BanCorp. common stock, the S&P 500 Index and the Peer Group. The comparisons in this table are set forth in response to SEC disclosure requirements, and are therefore not intended to forecast or be indicative of future performance of First BanCorp.’s common stock.

The cumulative total stockholder return was obtained by dividing (i) the cumulative amount of dividends per share, assuming dividend reinvestment since the measurement point, December 31, 2011 plus (ii) the change in the per share price since the measurement date, by the share price at the measurement date.

**Item 6. Selected Financial Data**

The following table sets forth certain selected consolidated financial data for each of the five years in the period ended December 31, 2016. This information should be read in conjunction with the audited consolidated financial statements and the related notes thereto.

**SELECTED FINANCIAL DATA**

(In thousands, except for per share and financial ratios)	<b>Year Ended December 31,</b>				
	<b>2016</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>
<b>Condensed Income Statements:</b>					
Total interest income	\$ 585,292	\$ 605,569	\$ 633,949	\$ 645,788	\$ 637,771
Total interest expense	101,174	103,303	115,876	130,843	176,071
Net interest income	484,118	502,266	518,073	514,945	461,700
Provision for loan and lease losses	86,733	172,045	109,530	243,751	120,487
Non-interest income (loss)	87,954	81,325	61,348	(15,489)	49,396
Non-interest expenses	355,080	383,830	378,253	415,028	354,880
Income (loss) before income taxes	130,259	27,716	91,638	(159,323)	35,716
Income tax (expense) benefit	(37,030)	(6,419)	300,649	(5,164)	(5,933)
Net income (loss)	93,229	21,297	392,287	(164,487)	29,783
Net income (loss) attributable to common stockholders - basic	93,006	21,297	393,946	(164,487)	29,783
Net income (loss) attributable to common stockholders - diluted	93,006	21,297	393,946	(164,487)	29,783
<b>Per Common Share Results:</b>					
Net earnings (loss) per common share - basic	\$ 0.44	\$ 0.10	\$ 1.89	\$ (0.80)	\$ 0.10
Net earnings (loss) per common share - diluted	\$ 0.43	\$ 0.10	\$ 1.87	\$ (0.80)	\$ 0.10
Cash dividends declared	-	-	-	-	-
Average shares outstanding	212,818	211,457	208,752	205,542	205,360
Average shares outstanding diluted	215,794	212,971	210,540	205,542	205,820
Book value per common share	\$ 8.05	\$ 7.71	\$ 7.68	\$ 5.57	\$ 6.88
Tangible book value per common share <sup>(1)</sup>	\$ 7.83	\$ 7.47	\$ 7.45	\$ 5.30	\$ 6.60
<b>Balance Sheet Data:</b>					
Total loans, including loans held for sale	\$ 8,936,879	\$ 9,148,251	\$ 9,177,371	\$ 9,545,501	\$ 10,022,631
Allowance for loan and lease losses	205,603	240,710	222,395	285,858	435,410
Money market and investment securities	2,091,196	2,299,520	2,170,401	2,374,980	2,103,540
Intangible assets	46,754	50,583	49,907	54,866	60,940
Deferred tax asset, net	281,657	311,263	313,045	7,644	4,800
Total assets	11,922,455	12,573,019	12,727,835	12,656,925	13,099,741
Deposits	8,831,205	9,338,124	9,483,945	9,879,924	9,864,540
Borrowings	1,186,187	1,381,492	1,456,959	1,431,959	1,640,350
Total preferred equity	36,104	36,104	36,104	63,047	63,047
Total common equity	1,784,529	1,685,779	1,653,990	1,231,547	1,393,540
Accumulated other comprehensive (loss) income, net of tax	(34,390)	(27,749)	(18,351)	(78,736)	28,400
Total equity	1,786,243	1,694,134	1,671,743	1,215,858	1,485,020



	Year Ended December 31,				
	2016	2015	2014	2013	2012
<b>Selected Financial Ratios (In Percent):</b>					
<b>Profitability:</b>					
Return on Average Assets	0.75	0.17	3.10	(1.28)	0.23
Return on Average Total Equity	5.28	1.26	30.25	(12.39)	2.04
Return on Average Common Equity	5.39	1.29	31.38	(13.01)	2.14
Average Total Equity to Average Total Assets	14.25	13.23	10.25	10.36	11.24
Interest Rate Spread	3.88	3.94	4.02	3.92	3.37
Interest Rate Margin	4.14	4.15	4.20	4.11	3.64
Interest Rate Spread- tax equivalent basis (2)	3.99	4.08	4.16	4.01	3.41
Interest Rate Margin- tax equivalent basis (2)	4.25	4.30	4.34	4.21	3.68
Tangible common equity ratio (1)	14.34	12.84	12.51	8.71	10.44
Dividend payout ratio	-	-	-	-	-
Efficiency ratio (3)	62.07	65.77	65.28	83.10	69.44
<b>Asset Quality:</b>					
Allowance for loan and lease losses to loans held for investment	2.31	2.64	2.44	3.02	4.38
Net charge-offs to average loans (4)	1.37	1.68	1.84	4.07	1.76
Provision for loan and lease losses to net charge-offs	0.71x	1.12x	0.63x	0.69x	0.67x
Non-performing assets to total assets (4)	6.16	4.85	5.63	5.73	9.45
Non-performing loans held for investment to total loans held for investment (4)	6.30	4.86	5.76	5.23	9.82
Allowance to total non-performing loans held for investment	36.71	54.36	42.45	57.69	44.63
Allowance to total non-performing loans held for investment, excluding residential real estate loans	51.50	87.92	64.80	85.56	65.78
<b>Other Information:</b>					
Common stock price: End of period	\$ 6.61	\$ 3.25	\$ 5.87	\$ 6.19	\$ 4.58

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

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

(3) Non-interest expenses to the sum of net interest income and non-interest income.

(4) Loans used in the denominator in calculating each of these ratios include purchased credit-impaired loans.

However, the Corporation separately tracks and reports purchased credit-impaired loans and excludes these from non-performing loan and non-performing asset amounts.

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

The following Management’s Discussion and Analysis of Financial Condition and Results of Operations relates to the accompanying consolidated audited financial statements of First BanCorp. and should be read in conjunction with such financial statements and the notes thereto. This section also presents certain non-GAAP financial measures. Refer to “Basis of Presentation” below for information about why the non-GAAP financial measures are being presented and the reconciliation of the non-GAAP financial measures for which the reconciliation is not presented earlier.

### **Description of Business**

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

### **The Puerto Rico economy**

See “Puerto Rico Government Fiscal Situation, Government Actions, enactment of PROMESA and Exposure” above and “Exposure to Puerto Rico Government” below for a discussion about the Puerto Rico government’s difficult economic situation, which has a significant impact on the operations of the Corporation.

### **EXECUTIVE Overview of Results of Operations**

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



The Corporation had net income of \$93.2 million, or \$0.43 per diluted share, for the year ended December 31, 2016, compared to \$21.3 million, or \$0.10 per diluted share, for 2015 and \$392.3 million, or \$1.87 per diluted share, for 2014. The financial results for 2016, 2015, and 2014 included the following items that management believes are not reflective of core operating performance, are not expected to reoccur with any regularity or may reoccur at uncertain times and in uncertain amounts:

Year ended December 31, 2016

- Charge to the provision for loan and lease losses of \$1.8 million (\$1.1 million after-tax) related to the sale of a \$16.3 million pool of non-performing assets in the fourth quarter of 2016, mostly comprised of non-performing commercial loans.
- Gain of \$1.5 million (\$1.2 million after-tax) from recovery of a residual collateralized mortgage obligation (“CMO”) previously written off once the trust was liquidated in the fourth quarter of 2016.
- Gain of \$6.1 million (\$5.9 million after-tax) on sales of \$198.7 million of U.S. agency MBS that carried an average yield of 2.36% recorded in the third quarter of 2016.
- OTTI charges on debt securities, primarily on Puerto Rico government debt securities, of \$6.7 million recorded in the first quarter of 2016. No tax benefit was recognized for the OTTI charges.
- Brokerage and insurance commissions of \$1.7 million (\$1.0 million after-tax) net of incentive costs, recorded in the fourth quarter of 2016, primarily from the sale of large fixed annuities contracts.
- Adjustment of \$2.7 million (\$1.7 million after tax) recorded in the fourth quarter of 2016 to reduce the credit card rewards program liability due to the expiration of reward points earned by customers up to September 2013 (the conversion date of the credit card portfolio acquired from FIA in May 2012). Most of these points had been accrued at acquisition date and ultimately experienced a redemption pattern materially different from those points accrued after conversion.

- Costs of \$0.6 million recorded in the fourth quarter of 2016 associated with the secondary offering of the Corporation's common stock by certain of the existing stockholders. The costs, incurred at the holding company level, had no effect on the income tax expense in 2016.
- Severance payments of \$0.3 million (\$0.2 million after-tax) related to permanent job discontinuance recorded in the third quarter of 2016.
- Gain of \$4.2 million on the repurchase and cancellation of \$10 million in trust preferred securities recorded in the first quarter of 2016, reflected in the statement of income as "Gain on early extinguishment of debt." The gain, realized at the holding company level, had no effect on the income tax expense in 2016.

Year ended December 31, 2015

- Charges of \$48.7 million (\$29.7 million after-tax) related to a bulk sale of assets with a carrying value of \$150.4 million (the "bulk sale of assets") completed in the second quarter of 2015, mostly comprised of non-performing commercial loans.
- OTTI charges on debt securities, primarily on Puerto Rico government debt securities, of \$16.5 million in 2015. No tax benefit was recognized for the OTTI charges.
- Gain of \$7.0 million (\$4.3 million after-tax) associated with a long-term strategic marketing alliance entered into during the fourth quarter of 2015 as part of the sale of the FirstBank Puerto Rico merchant contracts portfolio.
- Bargain purchase gain of \$13.4 million (\$8.2 million after-tax) on assets acquired and liabilities assumed from Doral Bank recorded in the first quarter of 2015.
- Costs of \$2.2 million (\$1.4 million after-tax) related to a voluntary early retirement program recorded in the fourth quarter of 2015.

- Costs of \$4.6 million (\$2.8 million after-tax) in 2015 related to the conversion of loan and deposit accounts acquired from Doral Bank to the FirstBank systems.

Year ended December 31, 2014

- Prepayment penalty income of \$2.5 million (\$1.6 million after-tax) on a commercial mortgage loan paid off in the fourth quarter of 2014. The \$2.5 million contractual prepayment penalty collected was paid by the borrower to compensate for the economic loss sustained by the Corporation in the early termination of an interest rate swap agreement that provided an economic hedge of the cash flows associated with this loan. Such loss equaled the mark-to-market unrealized losses recorded by the Corporation in prior periods for the terminated interest rate swap.
- Charge to the provision for loan and lease losses of \$1.4 million (\$0.9 million after-tax) recorded in the second quarter of 2014 related to the acquisition of residential mortgage loans from Doral Financial in full satisfaction of secured borrowings owed by such entity to FirstBank.
- OTTI charges on debt securities of \$0.4 million in 2014. No tax benefit was recognized for the OTTI charges.
- Gain of \$0.3 million on the sale of a \$4.6 million Puerto Rico government agency bond in the second quarter of 2014. The gain had no income tax effect in 2014.
- Equity in loss of unconsolidated entity of \$7.3 million in 2014. No tax effect was reflected in 2014 related to the equity in loss of unconsolidated entity, as the related deferred tax asset was fully reserved with a valuation allowance. Refer to “Non-interest income” below for additional information.
- Costs of \$1.2 million (\$0.8 million after-tax) recorded in 2014 related to the acquisition of residential mortgage loans from Doral Financial.
- Income tax benefit of \$302.9 million associated with the partial reversal of the valuation allowance recorded in the fourth quarter of 2014 against the deferred tax assets of the Corporation’s banking subsidiary, FirstBank.

The following table reconciles for 2016, 2015, and 2014 the reported net income to adjusted net income, a non-GAAP financial measure that excludes the items identified above, which are items that management believes are not reflective of core operating performance, are not expected to reoccur with any regularity or may reoccur at uncertain times and in uncertain amounts:

	<b>Year Ended December 31,</b>		
	<b>2016</b>	<b>2015</b>	<b>2014</b>
(In thousands)			
Net income, as reported	\$ 93,229	\$ 21,297	\$ 392,287
Adjustments:			
Charge related to the sale of the \$16.3 million pool of non-performing assets	1,799	-	-
Charges related to the bulk sale of assets, including transaction expenses	-	48,667	-
Gain from recovery of investments previously written off	(1,547)	-	-
Brokerage and insurance commissions, primarily from the sale of large fixed annuities contracts, net of incentive costs	(1,692)	-	-
Adjustment to reduce the credit cards rewards liability due to unusually large customer forfeitures	(2,732)	-	-
Secondary offering costs	590	-	-
Gain on sale of investment securities	(6,104)	-	(262)
Severance payments on jobs discontinuance	281	-	-
Other-than-temporary impairment on debt securities	6,687	16,517	388
Gain on early extinguishment of debt	(4,217)	-	-
Gain on sale of merchant contracts	-	(7,000)	-
Voluntary early retirement program expenses	-	2,238	-
Bargain purchase gain on assets acquired and liabilities assumed from Doral Bank	-	(13,443)	-
Acquisition and conversion costs of assets acquired and liabilities assumed from Doral Bank	-	4,646	-
Equity in loss of unconsolidated entity	-	-	7,279
Partial reversal of the deferred tax assets valuation allowance	-	-	(302,898)
Prepayment penalty collected on a commercial loan tied to interest rate swaps	-	-	(2,546)
Charges related to the acquisition of loans from Doral Financial, including associated expenses	-	-	2,663
Income tax impact of adjustments (1)	1,409	(13,691)	(45)
Adjusted net income	\$ 87,703	\$ 59,231	\$ 96,866

(1) See "Basis of Presentation" for the individual tax impact for each reconciling item.

The key drivers of the Corporation's GAAP financial results include the following:

- Net interest income for the year ended December 31, 2016 was \$484.1 million compared to \$502.3 million and \$518.1 million for the years ended December 31, 2015 and 2014, respectively. The decrease for 2016 compared to 2015 was primarily driven by: (i) a \$15.2 million decrease in interest income on consumer loans and finance leases mainly attributable to a decrease of \$142.8 million in the average balance of this portfolio, primarily auto loans, (ii) a \$3.9 million decrease in interest income on investment securities, primarily reflecting the gradual reinvestment of MBS prepayments in lower yielding securities given the low interest rate environment that prevailed in 2016 and an adverse impact of approximately \$1.0 million related to the discontinuance of interest income recognition on bonds of the GDB and the Puerto Rico Public Buildings Authority that were placed in non-performing status in the third quarter of 2016, (iii) a \$1.2 million decrease in interest income on commercial and construction loans, reflecting a decline of \$153.4 million in the average balance of these portfolios that resulted in a decrease of approximately \$3.6 million in interest income and the adverse impact of large commercial relationships classified as non-performing during 2016, partially offset by an increase of approximately \$1.4 million in prepayment penalties and deferred fees amortization, recovery of interest income on

certain non-performing loans that were fully paid off, and the upward repricing of variable commercial loans tied to higher short-term interest rates, and (iv) a \$1.2 million decrease in interest income on residential mortgage loans primarily due to lower cash collections on residential non-performing loans.

These variances were partially offset by: (i) a \$2.1 million decrease in interest expense, including a decrease of \$3.0 million in interest expense on brokered CDs primarily related to a \$622.7 million decrease in the average volume of brokered CDs that offset higher costs on new issuances, and a \$2.2 million decrease in interest expense on repurchase agreements primarily reflecting the effect of the repayment of \$400 million of repurchase agreements that matured in 2016 and carried an average cost of 3.35%, partially offset by increases of \$1.8 million and \$1.0 million in interest expense on FHLB advances and non-brokered deposits, respectively, and (ii) a \$1.2 million increase in interest income on interest-bearing cash and cash equivalent balances due to increases in fed fund rates late in 2015 and 2016. The net interest margin decreased slightly to 4.14% for the year ended December 31, 2016 compared to 4.15% for 2015.

The decrease for 2015 compared to 2014 was primarily driven by: (i) a \$30.1 million decrease in interest income on commercial and construction loans, including a decrease of approximately \$24.1 million attributable to a \$592.2 million decline in the average volume of these portfolios and the adverse impact of \$3.8 million in interest payments received in 2015 from the credit facility to PREPA, accounted for on a cost-recovery basis, (ii) a \$20.4 million decrease in interest income on consumer loans, including a decrease of approximately \$16.2 million related to a \$148.0 million decrease in the average volume of such loans and a \$3.8 million adverse variance due to the fact that the remaining discount on the credit card portfolio acquired in 2012 was fully accreted into income in the first half of 2014, and (iii) a \$7.6 million decrease in interest income on MBS, including a decrease of approximately \$4.6 million attributable to a \$180.0 million decline in the average volume of MBS and a \$3.0 million decrease related to lower yields reflecting, among other things, the gradual reinvestment of MBS prepayments in lower-yielding investments given the low interest rate environment.

These variances were partially offset by: (i) a \$28.6 million increase in interest income on residential mortgage loans primarily related to the acquisition of several loan portfolios from Doral Bank completed in the first quarter of 2015 and fourth quarter of 2014 and from Doral Financial in the second quarter of 2014, (ii) an \$8.9 million decrease in interest expense on deposits, including a decrease of \$5.0 million in interest expense on brokered CDs primarily related to a \$670.5 million decrease in the average volume of brokered CDs, and a \$3.9 million decrease in interest expense on non-brokered deposits mainly due to lower deposit pricing that resulted in an 8 basis points reduction in the average cost of such deposits, and (iii) a \$4.6 million decrease in interest expense on repurchase agreements mainly related to the restructuring of \$400 million of repurchase agreements early in 2015 and the interest income earned on reverse repurchase agreements entered into in 2015 that qualifies for offsetting accounting. The net interest margin decreased 5 basis points to 4.15% for the year ended December 31, 2015 compared to 4.20% for 2014.

- The provision for loan and lease losses for 2016 was \$86.7 million compared to \$172.0 million and \$109.5 million for 2015 and 2014, respectively. The provision for the year ended December 31, 2016 includes a charge of \$1.8 million associated with the sale of a \$16.3 million pool of non-performing assets in the fourth quarter of 2016, for 2015 included a charge of \$46.9 million associated with the bulk sale of assets completed during the second quarter of

2015, and for 2014 included a charge of \$1.4 million related to the acquisition of residential mortgage loans from Doral Financial in the second quarter of 2014 in full satisfaction of secured borrowings owed by such entity to FirstBank, as further discussed below. Excluding the impact of the aforementioned items, the adjusted provision for loan and lease losses of \$84.9 million for 2016 decreased by \$40.2 million compared to the adjusted provision for loan and lease losses of \$125.1 million for 2015 reflecting, among other things, (i) a \$23.2 million decrease in the adjusted provision for commercial and construction loans reflecting, among other things, the impact in 2015 of the \$35 million increase in the general reserve for commercial loans extended to or guaranteed by the Puerto Rico government (excluding municipalities) reflecting the impact of both the migration of certain of these loans to adverse classification categories and a \$19.2 million charge related to qualitative factor adjustments that stressed the historical loss rates applied to these loans, partially offset by lower loan loss recoveries and the impact in 2015 of an \$8.1 million reserve release adjustment for construction loans that reflected adjustments to the general reserve given the stabilization in the asset quality of land loans, (ii) an \$11.7 million decrease in the provision for consumer loans, driven by lower charge-offs and loss severity rates and the overall decrease in the size of this portfolio, and (iii) a \$5.3 million decrease in the adjusted provision for residential mortgage loans mainly related to lower delinquency levels, lower charges to the reserve for PCI loans, and the overall decrease in the size of this portfolio.

During the fourth quarter of 2016, the Corporation completed the sale of a pool of non-performing assets, primarily comprised of non-performing commercial loans, with a book value of \$16.3 million (principal balance of \$20.1 million), in a cash transaction. The proceeds from this sale were \$11.3 million, net of \$0.4 million of escrow and principal and interest collected on behalf of the purchaser subsequent to the effective date of the transaction. Approximately \$2.8 million of reserves had been allocated to the loans. This transaction resulted in total net charge-offs of \$4.6 million and an incremental pre-tax loss of \$1.8 million recorded as a charge to the provision for loan and lease losses. The following table shows the impact of the sale of the \$16.3 million pool of non-performing assets on net charge-offs and the provision for loan and lease losses for the year ended December 31, 2016 as well as on a non-GAAP basis excluding the impact of such sale:

(Dollars in thousands)

2016	As Reported (GAAP)	Impact of the Sale of a \$16.3 Million Pool of Non-Performing Assets	Adjusted (Non-GAAP)
<b>Total net charge-offs</b>	<b>\$ 121,840</b>	<b>\$ 4,631</b>	<b>\$ 117,209</b>
Total net charge-offs to average loans	1.37%		1.32%
Commercial mortgage	\$ 19,638	\$ 3,026	\$ 16,612
Commercial mortgage loans net charge-offs to average loans	1.28%		1.09%
Commercial and Industrial	\$ 23,890	\$ 1,593	\$ 22,297
Commercial and Industrial loans net charge-offs to average loans	1.11%		1.04%
Residential mortgage	\$ 30,680	\$ 12	\$ 30,668
Residential mortgage loans net charge-offs to average loans	0.93%		0.93%
<b>Provision for loan and lease losses</b>	<b>\$ 86,733</b>	<b>\$ 1,799</b>	<b>\$ 84,934</b>
Commercial mortgage	8,688	1,787	6,901
Commercial and Industrial	17,075	2	17,073
Residential mortgage	25,090	10	25,080

During the second quarter of 2015, the Corporation completed the sale of commercial and construction loans with a book value of \$147.5 million (principal balance of \$196.5 million), comprised mostly of non-performing and adversely classified loans, as well as OREO properties with a book value of \$2.9 million in a cash transaction. The sale price of this bulk sale was \$87.3 million. Approximately \$15.3 million of reserves had been allocated to the loans. This transaction resulted in total net charge-offs of \$61.4 million and an incremental pre-tax loss of \$48.7 million, including \$0.9 million in professional service fees directly attributable to this bulk sale. The following table shows the impact of the bulk sale on net charge-offs and the provision for loan and lease losses for the year ended December 31, 2015 on a GAAP basis as well as on a non-GAAP basis excluding the impact of the bulk sale of assets:



(Dollars in thousands)

2015	As Reported (GAAP)	Impact of the Bulk Sale Transaction	Adjusted (Non-GAAP)
<b>Total net charge-offs</b>	<b>\$ 153,730</b>	<b>\$ 61,435</b>	<b>\$ 92,295</b>
Total net charge-offs to average loans	1.68%		1.01%
Commercial mortgage	\$ 49,567	\$ 37,590	\$ 11,977
Commercial mortgage loans net charge-offs to average loans	3.12%		0.77%
Commercial and Industrial	\$ 29,528	\$ 20,570	\$ 8,958
Commercial and Industrial loans net charge-offs to average loans	1.32%		0.40%
Construction	\$ 2,412	\$ 3,275	\$ (863)
Construction loans net charge-offs to average loans	1.42%		(0.52)%
<b>Provision for loan and lease losses</b>	<b>\$ 172,045</b>	<b>\$ 46,947</b>	<b>\$ 125,098</b>
Commercial mortgage	66,884	33,807	33,077
Commercial and Industrial	34,575	10,765	23,810
Construction	(6,891)	2,375	(9,266)

The provision for loan and lease losses for the year ended December 31, 2014 includes a charge of \$1.4 million related to the acquisition of residential mortgage loans from Doral Financial in the second quarter of 2014 in full satisfaction of secured borrowings owed by such entity to FirstBank. On May 30, 2014, FirstBank purchased from Doral Financial all of its rights, title and interest in first and second mortgage loans having an unpaid principal balance of approximately \$241.7 million for

an aggregate purchase price of approximately \$232.9 million. Doral Financial had pledged the mortgage loans to FirstBank as collateral for secured borrowings pursuant to a series of credit agreements between the parties entered into in 2006. As consideration for the purchase of the mortgage loans, FirstBank credited approximately \$232.9 million as full satisfaction of the outstanding balance of the Doral Financial secured borrowings plus interest owed to FirstBank. The estimated fair value of the mortgage loans at acquisition was \$226.0 million. This transaction resulted in a loss of \$6.9 million derived from the difference between the fair value of the mortgage loans acquired, \$226.0 million, and the book value of the secured borrowings of \$232.9 million. Approximately \$5.5 million of the loss was part of the general allowance for loan losses established for commercial loans in prior periods; thus, an additional charge to the provision of \$1.4 million was recorded in 2014. The following table shows the impact of this transaction on net charge-offs and the provision for loan and lease losses for the year ended December 31, 2014 on a GAAP basis as well as on a non-GAAP basis excluding the impact of the transaction.

2014	As Reported (GAAP)	Loss on Acquisition of Mortgage Loans from Doral Financial	Adjusted (Non-GAAP)
(in thousands)			
<b>Total net charge-offs</b>	\$ 172,993	\$ 6,908	\$ 166,085
Total net charge-offs to average loans	1.84%		1.77%
Commercial and Industrial	58,255	6,908	51,347
Commercial and Industrial loans net charge-offs to average loans	2.27%		2.08%
<b>Provision for loan and lease losses</b>	\$ 109,530	\$ 1,428	\$ 108,102
Commercial and Industrial	36,681	1,428	35,253

The adjusted provision for loan and lease losses of \$125.1 million for the year ended December 31, 2015 increased by \$17.0 million compared to the adjusted provision of \$108.1 million in 2014 reflecting, among other things, (i) a \$35 million increase in the general reserve for commercial loans extended to or guaranteed by the Puerto Rico government (excluding municipalities), reflecting the migration of certain loans to adverse classification categories, and a \$19.2 million charge to the provision related to qualitative factor adjustments that stressed the historical loss rates applied to these loans, and (ii) a \$12.9 million increase in the provision for residential mortgage loans reflecting higher reserve requirements for loans in the late stage of delinquencies and the establishment of a \$4.0 million reserve for purchased-credit impaired loans acquired in May 2014. These variances were partially offset by a \$32.8 million decrease in the provision for consumer loans that reflects improvements in charge-off rates, declining loss severity rates on auto loans and the overall decrease in the size of this portfolio.

Net charge-offs totaled \$121.8 million for the year ended December 31, 2016, or 1.37% of average loans, including \$4.6 million of net charge-offs related to the sale of the \$16.3 million pool of non-performing assets in 2016. Net charge-offs for the year ended December 31, 2015 totaled \$153.7 million, or 1.68% of average loans, including \$61.4 million of net charge-offs related to the bulk sale of assets in 2015. Net charge-offs for the year ended December 31, 2014 totaled \$173.0 million, including \$6.9 million of charge-offs resulting from the difference between the fair value of mortgage loans acquired from Doral Financial Corporation in the second quarter of 2014 of \$226.0 million, and the book value of the secured borrowings that such institution owed to FirstBank. Adjusted net charge-offs that exclude from net charge-offs for 2016 the impact of the sale of the \$16.3 million of non-performing assets, for 2015 the impact of the bulk sale of assets, and for 2014 the impact of charge-offs resulting from the mortgage loans acquired in satisfaction of secured borrowings are non-GAAP financial measures. Non-GAAP adjusted net charge-offs for 2016

amounted to \$117.2 million, or 1.32% of average loans, an increase of \$24.9 million compared to non-GAAP adjusted net charge-offs of \$92.3 million for 2015. The increase reflects the impact of four large commercial loan charge-offs totaling \$28.0 million in the Puerto Rico region, including \$13.9 million associated with two of the three facilities guaranteed by the TDF. Refer to “Basis of Presentation” below for additional information about these non-GAAP financial measures. Also refer to the discussions under “Provision for loan and lease losses” and “Risk Management” below for an analysis of the allowance for loan and lease losses and non-performing assets and related ratios.

- The Corporation recorded non-interest income of \$88.0 million for the year ended December 31, 2016 compared to \$81.3 million and \$61.3 million for the years ended December 31, 2015 and 2014, respectively. The increase for 2016 compared to 2015 was primarily driven by: (i) a \$9.8 million decrease in OTTI charges on debt securities, primarily related to lower charges on bonds of GDB and the Puerto Rico Public Buildings Authority held by the Corporation as part of the available-for-sale securities portfolio, with respect to which the Corporation had already recognized OTTI charges of \$22.2 million, (ii) a \$6.1 million gain on sales of \$198.7 million of U.S. agency MBS in 2016, (iii) a \$4.2 million gain on the repurchase and cancellation of \$10 million in trust preferred securities in 2016, (iv) a \$3.2 million increase in revenues from the mortgage banking business driven by higher gains on sales of residential mortgage loans in the secondary market associated with both a
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higher volume of sales and higher gain margins, (v) a \$2.6 million increase in service charges on deposits primarily related to the implementation of new service and transactional fees on certain products in November 2015, (vi) a \$2.2 million increase in insurance and broker-dealer commissions, primarily related to the sale of large fixed annuities contracts, and (viii) a \$1.5 million gain from the recovery of a residual CMO previously written off. These increases were partially offset by the impact in 2015 of the \$13.4 million bargain purchase gain on assets acquired and liabilities assumed from Doral Bank and the impact in 2015 of a \$7.0 million gain on the sale of merchant contracts. Adjusted non-interest income for 2016 was \$81.0 million, excluding items that management believes are not reflective of core operating performance, are not expected to reoccur with any regularity or may reoccur at uncertain times and in uncertain amounts, compared to adjusted non-interest income of \$78.0 million in 2015. Refer to “Basis of Presentation” below for additional information and reconciliation of this non-GAAP financial measure.

The increase in non-interest income of \$20.0 million in 2015, as compared to 2014, was mainly due to: (i) the \$13.4 million bargain purchase gain on assets acquired and liabilities assumed from Doral Bank in 2015, (ii) the \$7.0 million gain on the sale of merchant contracts, (iii) the impact in 2014 of the \$7.3 million equity in loss of unconsolidated entity related to the Bank’s investment in CPG/GS PR NPL, LLC (“CPG/GS”), since the value of the investment in this unconsolidated entity became zero in the second quarter of 2014, (iv) a \$3.6 million increase in service charges on deposits primarily associated with the deposits assumed from Doral in late February 2015 as well as the implementation of new service and transactional fees on certain products beginning in the fourth quarter of 2015, (v) a \$2.5 million increase in revenues from the mortgage banking business, and (vi) an increase of \$1.3 million in merchant-related income despite the sale of merchant contracts completed early in the fourth quarter of 2015. These variances were partially offset by a \$16.1 million increase in OTTI charges on debt securities, primarily related to OTTI charges of \$15.9 million on Puerto Rico government debt securities, specifically bonds of the GDB and the Puerto Rico Public Buildings Authority held by the Corporation as part of the available-for-sale securities portfolio. Adjusted non-interest income for 2015 was \$78.0 million, excluding items that management believes are not reflective of core operating performance, are not expected to reoccur with any regularity or may reoccur at uncertain times and in uncertain amounts, compared to adjusted non-interest income of \$68.8 million in 2014. Refer to “Basis of Presentation” below for additional information and reconciliation of this non-GAAP financial measure.

- Non-interest expenses for 2016 were \$355.1 million compared to \$383.8 million and \$378.3 million for 2015 and 2014, respectively. The decrease for 2016 compared to 2015 was primarily due to: (i) an \$11.5 million decrease in total professional service fees mainly driven by the impact in 2015 of several items, including, professional services fees of \$3.7 million related to the acquisition and conversion of loan and deposit accounts acquired from Doral Bank to the FirstBank systems, \$3.6 million of interim servicing costs related to loans and deposits acquired from Doral Bank, costs of \$1.3 million related to special projects and strategic, stress testing and capital planning matters, professional service fees of \$0.9 million directly related to the bulk sale of assets, and a \$2.9 million decrease in collections, appraisals and other credit related professional service fees associated with lower costs on troubled loans resolution efforts, (ii) a \$4.3 million decrease in losses on OREO operations primarily reflecting decreases in write downs to the value of OREO properties and in OREO-operating expenses, including lower property taxes, and an increase in rental income, (iii) a \$4.1 million decrease in occupancy and equipment costs reflecting reductions in depreciation, electricity and repairs expenses, (iv) a \$3.9 million decrease in the FDIC insurance premium expense reflecting, among other things, a reduction in the initial base assessment rate, and reductions in brokered deposits and average assets, (v) a \$3.8 million decrease in business promotion expenses, primarily due to lower costs associated with credit card and deposit reward programs, including the effect of the \$2.7 million adjustment recorded during the fourth quarter of 2016 to reduce the credit card rewards liability due to the expiration of reward points earned by customers up to September 2013 (the conversion date of the credit card portfolio acquired from FIA in May 2012),

and (vi) a \$2.5 million decrease in processing expenses mainly due to the sale of merchant contracts in the fourth quarter of 2015. These variances were partially offset by a \$2.5 million increase in taxes, other than income taxes, primarily due to the increase in the sales tax rate from 7% to 11.5% effective in Puerto Rico since July 1, 2015 and the sales tax of 4% on designated professional services effective in Puerto Rico since October, 1, 2015. Adjusted non-interest expenses for 2016 were \$356.9 million, excluding items that management believes are not reflective of core operating performance, are not expected to reoccur with any regularity or may reoccur at uncertain times and in uncertain amounts, compared to adjusted non-interest expenses of \$375.8 million in 2015. Refer to “Basis of Presentation” below for additional information and reconciliation of this non-GAAP financial measure.

The increase in non-interest expense of \$5.6 million in 2015, as compared to 2014 was mainly due to: (i) a \$14.6 million increase in employees’ compensation and benefits, including costs of \$2.2 million associated with the voluntary early retirement program and higher costs associated with salary merit increases, the impact of personnel costs related to the branches acquired from Doral Bank in 2015, higher stock-based compensation expense and an increase in incentive and performance-based compensation, (ii) a \$7.7 million increase in total professional service fees driven by the aforementioned impact of \$3.7 million in professional service fees related to the acquisition and conversion of loan and deposit accounts acquired from Dora Bank to the FirstBank systems and the \$3.6 million incurred in interim servicing costs also related to loans and deposits acquired from Doral Bank, and (iii) a \$1.0 million increase in occupancy and equipment costs primarily related to rental, depreciation and maintenance expenses associated with the acquired Doral Bank branches. These variances

were partially offset by: (i) a \$10.5 million decrease in the FDIC deposit insurance premium expense reflecting, among other things, the decrease in brokered CDs, a strengthened capital position and an improved earnings to assets average ratio, (ii) a \$4.8 million decrease in OREO-related expenses, mainly due to a \$3.7 million increase in rental income from OREO income-producing properties and higher gains on sales, and (iii) a \$5.4 million decrease in taxes, other than income taxes, primarily reflecting the elimination of Puerto Rico's national gross receipts tax in 2015, partially offset by incremental costs related to the sales and use tax. Adjusted non-interest expenses for 2015 was \$375.8 million, excluding items that management believes are not reflective of core operating performance, are not expected to reoccur with any regularity or may reoccur at uncertain times and in uncertain amounts, compared to adjusted non-interest expenses of \$377.0 million in 2014. Refer to "Basis of Presentation" below for additional information and reconciliation of this non-GAAP financial measure.

- For 2016, the Corporation recorded an income tax expense of \$37.0 million compared to an income tax expense of \$6.4 million for 2015 and an income tax benefit of \$300.6 million for 2014. The increase in income tax expense for 2016, when compared to 2015, was mainly driven by higher taxable income, as the year 2015 was impacted by a pre-tax loss of \$48.7 million on the bulk sale of assets. The effective tax rate for the year ended December 31, 2016 was 28% compared to 23% for the year ended December 31, 2015. The income tax benefit for 2014 primarily reflects the \$302.9 million partial reversal of FirstBank's deferred tax assets valuation allowance. As of December 31, 2016, the Corporation had a net deferred tax asset of \$281.7 million (net of a valuation allowance of \$207.2 million, including a valuation allowance of \$171.0 million against the deferred tax assets of the Corporation's banking subsidiary, FirstBank). Refer to "Income Taxes" below for additional information.

- As of December 31, 2016, total assets were approximately \$11.9 billion, a decrease of \$650.6 million from December 31, 2015. The decrease was mainly due to a \$452.8 million decrease in cash and cash equivalents, associated with liquidity used to repay maturing brokered CDs and repurchase agreements. Total loans (before allowance) decreased \$211.4 million primarily due to a \$110.5 million reduction in consumer loans, primarily auto loans, a \$66.4 million reduction in commercial and construction loans, and a \$34.5 million reduction in residential mortgage loans primarily reflected in the Puerto Rico region. The decrease in commercial and construction loans includes a reduction of \$195.3 million in Puerto Rico driven by the repayment of several large commercial loans, the sale of a \$20.2 million commercial loans participation, the sale of the \$16.3 million pool of non-performing assets, and charge-offs, including the four large charge-offs totaling \$28.0 million noted above. The commercial and construction loan portfolio in the Virgin Islands decreased by \$49.7 million primarily related to facilities granted to government entities. In contrast, the commercial and construction loan portfolio in the Florida region increased by \$178.7 million during 2016. Refer to "Financial Condition and Operating Data" below for additional information.

- As of December 31, 2016, total liabilities were \$10.1 billion, a decrease of \$742.7 million, from December 31, 2015. The decrease was mainly related to a \$657.8 million decrease in brokered CDs, the repayment at maturity of \$400 million of repurchase agreements, a \$10 million decrease in junior subordinated debentures associated with the repurchase and cancellation of certain trust preferred securities, and the payment of interest on trust preferred securities deferred and accrued since March 2012. As of December 31, 2016, the Corporation is current on all interest payments related to its subordinated debt. These reductions were partially offset by a \$164.5 million increase in total deposits, excluding government deposits and brokered CDs, and a \$215.0 million increase in FHLB advances. Refer to "Risk Management – Liquidity and Capital Adequacy" below for additional information about the Corporation's funding sources.

- As of December 31, 2016, the Corporation's stockholders' equity was \$1.8 billion, an increase of \$92.1 million from December 31, 2015. The increase was mainly driven by the net income of \$93.2 million reported for 2016. The Corporation's Total Capital, Common equity Tier 1 Capital, Tier 1 Capital and Leverage ratios calculated under the Basel III rules were 21.34%, 17.74%, 17.74%, and 13.70%, respectively, as of December 31, 2016, compared to Total Capital, Common equity Tier 1 Capital, Tier 1 Capital and Leverage ratios of 20.01%, 16.92%, 16.92%, and 12.22%, respectively, as of December 31, 2015. The Corporation's tangible common equity ratio increased to 14.34% as of December 31, 2016, from 12.84% as of December 31, 2015. Refer to "Risk Management – Capital" below for additional information.
- Total loan production, including purchases, refinancings and draws from existing revolving and non-revolving commitments, was \$2.9 billion for the year ended December 31, 2016, excluding the utilization activity on outstanding credit cards, compared to \$3.0 billion, for 2015. The decrease consisted of reductions of \$103.7 million and \$45.8 million in the Puerto Rico and Virgin Islands regions, respectively, partially offset by the growth of \$70.0 million achieved in the Florida region primarily reflected in the commercial segment.
- Total non-performing assets were \$734.5 million as of December 31, 2016, an increase of \$124.6 million from December 31, 2015. The increase was primarily attributable to the inflow in the first quarter of 2016 of the Corporation's exposure to commercial mortgage loans guaranteed by the TDF with a book value of \$111.8 million as of December 31, 2016, and the inflow in 2016 of two commercial relationship in Puerto Rico, which together totaled \$68.7 million, and the placement in non-performing status of bonds of the GDB and the Puerto Rico Public Buildings Authority as these entities had defaulted on

interest due on bonds held by the Corporation as part of its available-for-sale securities portfolio. As of December 31, 2016, the amortized cost of these bonds, including accrued interest of \$0.9 million, was \$35.6 million (net of \$22.2 million in cumulative other-than-temporary impairment charges), and the bonds were recorded on the Corporation's books at their aggregate fair value of \$20.5 million. The increase resulting from the inflow of large commercial loans and investment securities was partially offset by charge-offs, the sale of the \$16.3 million pool of non-performing assets in the fourth quarter of 2016, mostly comprised of non-performing commercial loans, and reductions in non-performing residential, consumer and OREO balances. Refer to "Risk Management - Non-accruing and Non-performing Assets" below for additional information.

- Adversely classified commercial and construction loans held for investment decreased by \$32.7 million to \$489.4 million, or 6%, from \$522.1 million as of December 31, 2015, driven by certain loans paid off, charge offs, and the pool sale of non-performing assets completed in the fourth quarter of 2016. This decrease was partially offset by the aforementioned migration of certain commercial relationships to non-accrual status.

### **Critical Accounting Policies and Practices**

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

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

The Corporation maintains the allowance for loan and lease losses at a level considered adequate to absorb losses currently inherent in the loan and lease portfolio. The Corporation does not maintain an allowance for held-for-sale loans or PCI loans that are performing in accordance with or better than expectations as of the date of acquisition, as the fair values of these loans already reflect a credit component. The allowance for loan and lease losses does not include amounts related to accrued interest receivable, other than billed interest and fees on credit card loans, as accrued interest receivable is reversed when a loan is placed on nonaccrual status. The allowance for loan and lease losses provides for probable losses that have been identified with specific valuation allowances for individually evaluated impaired loans and for probable losses believed to be inherent in the loan portfolio that have not been specifically identified. The determination of the allowance for loan and lease losses requires significant estimates, including with respect to the timing and amounts of expected future cash flows on impaired loans, consideration of current economic conditions, and historical loss experience pertaining to the portfolios and pools of homogeneous



loans, all of which may be susceptible to change.

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

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

The allowance for loan and lease losses consists of specific reserves based upon valuations of loans considered to be impaired, including loans modified in a Troubled Debt Restructuring ("TDR"), and general reserves. A specific valuation allowance is established for individual impaired loans in the commercial mortgage, construction, and commercial and industrial portfolios and certain marine financings, residential mortgage loans, and home equity lines of credit, primarily when the collateral value of the loan

(if the impaired loan is determined to be collateral dependent) or the present value of the expected future cash flows discounted at the loan's effective rate is lower than the carrying amount of that loan. The loans within the commercial mortgage, construction, commercial and industrial and marine financings portfolios with a principal balance of \$1 million or more are individually evaluated for impairment. Also, certain residential mortgage loans and home equity lines of credit are individually evaluated for impairment purposes based on their delinquency and loan to value levels. When foreclosure of a collateral dependent loan is probable, the impairment measure is based on the fair value of the collateral. The fair value of the collateral is generally obtained from appraisals. Updated appraisals are obtained when the Corporation determines that loans are impaired and are generally updated annually thereafter according to the Corporation's appraisal policy. In addition, appraisals and/or appraiser price opinions are also obtained for residential mortgage loans based on specific characteristics such as delinquency levels, age of the appraisal, and loan-to-value ratios. The excess of the recorded investment in a collateral dependent loan over the resulting fair value of the collateral is charged-off when deemed uncollectible.

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

The Corporation uses a roll-rate methodology to estimate losses on its consumer loan portfolio based on delinquencies and considering credit bureau score bands. The Corporation tracks the historical portfolio performance to arrive at a weighted-average distribution in each subgroup of each delinquency bucket. Roll-to-loss rates (loss factors) are calculated by multiplying the roll rates from each subgroup within the delinquency buckets forward through loss. Once roll rates are calculated, the resulting loss factor is applied to the existing receivables in the applicable subgroups within the delinquency buckets and the end results are aggregated to arrive at the required allowance level. The Corporation's assessment also involves evaluating key qualitative and environmental factors, which include credit and macroeconomic indicators such as unemployment, bankruptcy trends, recent market transactions, and collateral values to account for current market conditions that are likely to cause estimated credit losses to differ from historical loss experience. The Corporation analyzes the expected delinquency migration to determine the future volume of delinquencies.

The cash flow analysis for each residential mortgage pool is performed at the individual loan level and then aggregated to the pool level in determining the overall expected loss ratio. The model applies risk-adjusted prepayment curves, default curves, and severity curves to each loan in the pool. For loan restructuring pools, the present value of expected future cash flows under new terms, at the loan's effective interest rate, is taken into consideration. Additionally, estimates of default risk and prepayments related to loan restructurings are based on, among other things, the historical experience of these loans. Loss severity is affected by the expected house price scenario, which is based in part on recent house price trends. Default curves are used in the model to determine expected delinquency levels. The attributes that are most significant to the probability of default include present collection status (current, delinquent, in bankruptcy, in foreclosure stage), vintage, loan-to-values, and geography (Puerto Rico, Florida or the Virgin Islands). The estimates of the risk-adjusted timing of liquidations and associated costs are used in the model, and are risk-adjusted for the geographic area in which each property is located.

For commercial loans, historical charge-off rates are calculated by the Corporation on a quarterly basis by tracking cumulative charge-offs experienced over a two-year loss period on loans according to their internal risk rating (referred to as “base rate” for the quarter). The allowance is calculated using the base rate average of the last 8 quarters. A qualitative factor adjustment is applied to the base rate average utilizing a resulting factor derived from a set of risk-based ratings and weights assigned to credit and economic indicators over a reasonable period applied to a developed expected range of historical losses. This factor may be stressed to reflect other elements not reflected in the historical data underlying the loss estimates, such as the prolonged uncertainty surrounding how the Puerto Rico government might restructure its debt and the effect of recent payment defaults and other unprecedented measures implemented by the Puerto Rico government to deal with its fiscal condition.

*Charge-off of Uncollectible Loans* - Net charge-offs consist of the unpaid principal balances of loans held for investment that the Corporation determines are uncollectible, net of recovered amounts. Charge-offs are recorded as a reduction to the allowance for loan and lease losses and subsequent recoveries of previously charged off amounts are credited to the allowance for loan and lease losses. Collateral dependent loans in the construction, commercial mortgage, and commercial and industrial loan portfolios are charged off to their net realizable value (fair value of collateral, less estimated costs to sell) when loans are considered to be uncollectible. Within the consumer loan portfolio, auto loans and finance leases are reserved once they are 120 days delinquent and are charged off to their estimated net realizable value when the collateral deficiency is deemed uncollectible (i.e., when foreclosure/repossession is probable) or when the loan is 365 days past due. Within the other consumer loans class, closed-end loans are charged off when payments are 120 days in arrears, except small personal loans. Open-end (revolving credit) consumer loans, including credit card loans, and small personal loans are charged off when payments are 180 days in arrears. On a quarterly basis, residential mortgage loans that are 180 days delinquent and have an original loan-to-value ratio that is higher than 60% are reviewed and charged-off, as needed, to the fair value of the underlying collateral. Generally, all loans may be charged off or written down to the fair value of the collateral prior to the policies described above if a loss-confirming event has occurred. Loss-confirming events include, but are not limited to, bankruptcy

(unsecured), continued delinquency, or receipt of an asset valuation indicating a collateral deficiency when the asset is the sole source of repayment. The Corporation does not record charge-offs on PCI loans that are performing in accordance with or better than expectations as of the date of acquisition, as the fair value of these loans already reflects a credit component. The Corporation records charge-offs on PCI loans only if actual losses exceed estimated losses incorporated into the fair value recorded at acquisition and the amount is deemed uncollectible.

### **Other-than-temporary impairments (“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 security is considered impaired if the fair value is less than its amortized cost basis.

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

The impairment analysis of debt securities places special emphasis on the analysis of the cash position of the issuer and its cash and capital generation capacity, which could increase or diminish the issuer’s ability to repay its bond obligations, the length of time and the extent to which the fair value has been less than the amortized cost basis, any adverse change to the credit conditions and liquidity of the issuer, taking into consideration the latest information available about the financial condition of the issuer, credit ratings, the failure of the issuer to make scheduled principal or interest payments, recent legislation and government actions affecting the issuer’s industry and actions taken by the issuer to deal with the economic climate. The Corporation also takes into consideration changes in the near-term prospects of the underlying collateral of a security, if any, such as changes in default rates, loss severity given default, and significant changes in prepayment assumptions and the level of cash flows generated from the underlying collateral, if any, supporting the principal and interest payments of the debt securities. OTTI must be recognized in earnings if the Corporation has the intent to sell the debt security or it is more likely than not that it will be required to sell the debt security before recovery of its amortized cost basis. However, even if the Corporation does not expect to sell a debt security, it must evaluate expected cash flows to be received and determine if a credit loss has occurred. An unrealized loss is generally deemed to be other-than-temporary and a credit loss is deemed to exist if the present value of the expected future cash flows is less than the amortized cost basis of the debt security. The credit loss component of an OTTI, if any, is recorded as net impairment losses on debt securities in the statements of income, while the remaining portion of the impairment loss is recognized in other comprehensive income (“OCI”), net of taxes, and included as a component of stockholders’ equity provided the Corporation does not intend to sell the underlying debt security and it is more likely than not that the Corporation will not have to sell the debt security prior to recovery. The previous amortized cost basis less the OTTI recognized in earnings is the new amortized cost basis of the investment. The new amortized cost basis is not adjusted for subsequent recoveries in fair value. However, for debt securities for which OTTI was recognized in earnings, the difference between the new amortized cost basis and the cash flows expected to be collected is accreted as interest income as long as the security is not placed in non-accrual status. Debt securities held by the Corporation at year-end primarily consisted of securities issued by U.S. government-sponsored entities, bonds issued by the Puerto Rico government and private label MBS. Given the

explicit and implicit guarantees provided by the U.S. Federal government, the Corporation believes the credit risk in securities issued by the U.S. government-sponsored entities is low. The Corporation's OTTI assessment is concentrated on Puerto Rico government debt securities, with an amortized cost of \$42.7 million as of December 31, 2016, and on private label MBS with an amortized cost of \$28.8 million as of December 31, 2016. The discounted cash flow analyses applied to the Puerto Rico government debt securities are calculated based on the probability of default and loss severity assumptions. The valuation for private label MBS is derived from a discounted cash flow analysis that considers relevant assumptions such as the prepayment rate, default rate, and loss severity on a loan level basis. For further information, refer to Note 5 - Investment Securities, of the Corporation's audited financial statements for the year ended December 31, 2016 included in Item 8 of this Form 10-K.

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

## **Income Taxes**

The Corporation is required to estimate income taxes in preparing its consolidated financial statements. This involves the estimation of current income tax expense together with an assessment of temporary differences resulting from differences in the

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

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

Under the Puerto Rico Internal Revenue Code of 2011, as amended (the "2011 PR Code"), the Corporation and its subsidiaries are treated as separate taxable entities and are not entitled to file consolidated tax returns and, thus, the Corporation is not able to utilize losses from one subsidiary to offset gains in another subsidiary. Accordingly, in order to obtain a tax benefit from a net operating loss ("NOL"), a particular subsidiary must be able to demonstrate sufficient taxable income within the applicable NOL carry-forward period. The 2011 PR Code provides a dividend received deduction of 100% on dividends received from "controlled" subsidiaries subject to taxation in Puerto Rico and 85% on dividends received from other taxable domestic corporations.

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

The determination of deferred tax expense or benefit is based on changes in the carrying amounts of assets and liabilities that generate temporary differences. The carrying value of the Corporation's net deferred tax asset assumes

that the Corporation will be able to generate sufficient future taxable income based on estimates and assumptions. If these estimates and related assumptions change, the Corporation may be required to record valuation allowances against its deferred tax asset resulting in additional income tax expense in the consolidated statements of income. Management evaluates its deferred tax asset on a quarterly basis and assesses the need for a valuation allowance, if any. A valuation allowance is established when management believes that it is more likely than not that some portion of its deferred tax asset will not be realized.

Changes in the valuation allowance from period to period are included in the Corporation's tax provision in the period of change. In 2010, the Corporation established a valuation allowance for substantially all of the deferred tax assets of its banking subsidiary, FirstBank, primarily due to significant operational losses driven by charges to the provision for loan losses, a three-year cumulative loss position as of the end of the year 2010, and uncertainty regarding the amount of future taxable income that the Bank could forecast. As of December 31, 2014, based upon the assessment of all positive and negative evidence, management concluded that it was more likely than not that FirstBank will generate sufficient taxable income within the applicable NOL carry-forward periods to realize \$308.2 million of its deferred tax assets and, therefore, reversed \$302.9 million of the valuation allowance

During 2016, management reassessed the need for a valuation allowance and concluded, based upon the assessment of all positive and negative evidence, that it is more likely than not that FirstBank will generate sufficient taxable income within the applicable NOL carry-forward periods to realize \$277.4 million of its deferred tax asset. The positive evidence considered by management to conclude on the adequacy of the valuation allowance as of December 31, 2016 includes factors such as: FirstBank's three-year cumulative gain position of \$206.7 million; forecasts of future profitability under several potential scenarios that support the partial utilization of NOLs prior to their expiration between 2021 through 2024; two consecutive years of taxable income (taxable year 2015 being the first year with taxable income since 2008); and sustained pre-tax pre-provision for loan losses income. These factors demonstrate demand for FirstBank's products and services and improvements in credit quality measures that have resulted in reduced credit exposures, when compared to the period that led to the full valuation allowance, and have resulted in improvements in both sustainability of

profitability and management's ability to forecast future losses. The negative evidence considered by management includes: Puerto Rico's current economic conditions, which resulted in the enactment of the Puerto Rico Oversight Management and Economic Stability Act ("PROMESA"), the uncertainty related to government loan concentration and the still elevated levels of non-performing assets.

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 on a two-step analysis: 1) a tax position must be more likely than not to be sustained based solely on its technical merits in order to be recognized, and 2) the benefit is measured at the largest dollar amount of that position that is more likely than not to be sustained upon settlement. The difference between the benefit recognized in accordance with this analysis and the tax benefit claimed on a tax return is referred to as UTB.

As of December 31, 2016, the Corporation did not have UTBs recorded on its books. During 2014, the Corporation reached a final settlement with the IRS in connection with the 2007-2009 examination periods. As a result, during 2014, the Corporation released a portion of its reserve for uncertain tax positions, resulting in a tax benefit of \$1.8 million, and paid \$2.5 million to settle the tax liability resulting from the audit

Refer to Note 26 – Income Taxes, of the Corporation's audited financial statements for the year ended December 31, 2016 included in Item 8 of this Form 10-K, for further information related to Income Taxes.

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

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

During the second quarter of 2016, the Corporation reviewed its historical accounting treatment as loans of its \$156.2 million of financing arrangements with Puerto Rico municipalities issued in bond form, but underwritten as loans with



features that are typically found in commercial loan transactions. This review came as a result of the determination of the Federal Reserve Board that the transactions must be treated for regulatory reporting purposes as investment securities. The Puerto Rico Municipal Finance Act (“the Act”) requires the designation of financing arrangements obtained by municipalities with maturities greater than 8 years as “special obligation bonds” subject to specific provisions under the Act. The Corporation concluded that the impact of accounting for the transaction as held-to-maturity investment securities rather than loans does not have a material effect on previously reported results of operations, financial condition, or cash flows and, accordingly, these financing arrangements have been accounted for and reported as held-to-maturity investment securities and not as loans since the second quarter of 2016. For purposes of comparability, prior period amounts have been reclassified to conform to the 2016 presentation.

### **Valuation of financial instruments**

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

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

#### *Investment securities available for sale*

The fair value of investment securities was the market value based on quoted market prices (as is the case with equity securities, Treasury notes, and non-callable U.S. Agency debt securities), when available (Level 1), or, when available, market prices for identical or comparable assets (as is the case with MBS and callable U.S. agency debt) that are based on observable market parameters, including benchmark yields, reported trades, quotes from brokers or dealers, issuer spreads, bids, offers and reference

data, including market research operations (Level 2). Observable prices in the market already consider the risk of nonperformance. During 2016, the Corporation recorded OTTI charges of \$6.3 million on certain Puerto Rico government debt securities, specifically bonds of the GDB and the Puerto Rico Public Buildings Authority. The credit impairment loss was based on the probability of default and loss severity in the event of default in consideration of the latest information available about the Puerto Rico government's financial condition. Refer to Note 5- Investment Securities, of the Corporation's audited financial statements for the year ended December 31, 2016 included in Item 8 of this Form 10-K, for significant assumptions used to determine the credit impairment portion, including default rates and recovery rates, which are unobservable inputs. If listed prices or quotes are not available, fair value is based upon models that use unobservable inputs due to the limited market activity of the instrument, as is the case with certain private label mortgage-backed securities held by the Corporation (Level 3).

Private label MBS are collateralized by fixed-rate mortgages on single-family residential properties in the United States; the interest rate on the securities is variable, tied to 3-month LIBOR and limited to the weighted-average coupon of the underlying collateral. The market valuation represents the estimated net cash flows over the projected life of the pool of underlying assets applying a discount rate that reflects market observed floating spreads over LIBOR, with a widening spread based on a nonrated security. The market valuation is derived from a model that utilizes relevant assumptions such as the prepayment rate, default rate, and loss severity on a loan level basis. The Corporation modeled the cash flow from the fixed-rate mortgage collateral using a static cash flow analysis according to collateral attributes of the underlying mortgage pool (i.e., loan term, current balance, note rate, rate adjustment type, rate adjustment frequency, rate caps, and others) in combination with prepayment forecasts based on historical portfolio performance. 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, using an asset-level risk assessment method taking into account loan credit characteristics (loan-to-value, state, delinquency, property type and pricing behavior, and other) to provide an estimate of default and loss severity.

#### *Derivative instruments*

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

A credit spread is considered for those derivative instruments that are not secured. The cumulative mark-to-market effect of credit risk in the valuation of derivative instruments in 2016, 2015 and 2014 was immaterial.

#### **Income Recognition on Loans and Impaired Loans**

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

*Non-Performing and Past-Due Loans* - Loans on which the recognition of interest income has been discontinued are designated as non-performing. Loans are classified as non-performing when they are 90 days past due for interest and principal, with the exception of residential mortgage loans guaranteed by the FHA or the VA and credit cards. It is the Corporation's policy to report delinquent mortgage loans insured by the FHA or guaranteed by the VA as loans past due 90 days and still accruing as opposed to non-performing loans since the principal repayment is insured. However, the Corporation discontinues the recognition of income for FHA/VA loans when such loans are over 15 months delinquent. As permitted by regulatory guidance issued by the Federal Financial Institutions Examination Council ("FFIEC"), credit card loans are generally charged off in the period in which the account becomes 180 days past due. Credit card loans continue to accrue finance charges and fees until charged off at 180 days. Loans generally may be placed on non-performing status prior to when required by the policies described above when the full and timely collection of interest or principal becomes uncertain (generally based on an assessment of the borrower's financial condition and the adequacy of collateral, if any). When a loan is placed on non-performing status, any accrued but uncollected interest income is reversed and charged against interest income and amortization of any net deferred fees is suspended. Interest income on non-performing loans is recognized only to the extent it is received in cash. However, when there is doubt regarding the ultimate collectability of loan principal, all cash thereafter received is applied to reduce the carrying value of such loans (i.e., the cost recovery method). Generally, the Corporation returns a loan to accrual status when all delinquent interest and principal becomes current under the terms of the loan agreement, or after a

sustained period of repayment performance (6 months) and the loan is well secured, is in the process of collection, and full repayment of the remaining contractual principal and interest is expected. PCI loans are not reported as non-performing as these loans were written down to fair value at the acquisition date and the accretable yield is recognized in interest income over the remaining life of the loans. Loans that are past due 30 days or more as to principal or interest are considered delinquent, with the exception of residential mortgage, commercial mortgage, and construction loans, which are considered past due when the borrower is in arrears on two or more monthly payments.

*Impaired Loans* - A loan is considered impaired when, based upon current information and events, it is probable that the Corporation will be unable to collect all amounts due (including principal and interest) according to the contractual terms of the loan agreement, or the loan has been modified in a TDR. Loans with insignificant delays or insignificant shortfalls in the amounts of payments expected to be collected are not considered to be impaired. The Corporation evaluates individually for impairment those loans in the construction, commercial mortgage, commercial and industrial and marine financing portfolios with a principal balance of \$1 million or more. Loans in the Construction, Commercial mortgage, and Commercial and Industrial portfolios that originally met the Corporation's threshold for impairment evaluation but due to charge-offs or payments are currently below the \$1 million threshold and are still 90 days past due, except TDR's, are accounted for under the Corporation's general reserve. Although the accounting authoritative guidance for a specific impairment of a loan excludes large groups of smaller balance homogeneous loans that are collectively evaluated for impairment (e.g. mortgage and consumer loans), it specifically requires that loan modifications considered TDR be analyzed under its provision. The Corporation also evaluates for impairment purposes certain residential mortgage loans and home equity lines of credit with high delinquency and loan to value levels. Held-for-sale loans are not reported as impaired, as these loans are recorded at the lower of cost or fair value.

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

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

the economic loss and to avoid foreclosure or repossession of collateral. Residential mortgage loans for which a binding offer to restructure has been extended are also classified as TDR loans. PCI loans are not classified as TDR.

TDR loans are classified as either accrual or nonaccrual. Loans in accrual status may remain in accrual status when their contractual terms have been modified in a TDR if the loans had demonstrated performance prior to the restructuring and payment in full under the restructured terms is expected. Otherwise, a loan on nonaccrual status and restructured as a TDR will remain on nonaccrual status until the borrower demonstrates a sustained period of performance (generally six consecutive months of payments, inclusive of consecutive payments made prior to the modification), and there is evidence that such payments can and are likely to continue as agreed. Refer to Note 8 – Loans Held for Investment, of the Corporation’s audited financial statements for the year ended December 31, 2016 included in Item 8 of this Form 10-K, for additional qualitative and quantitative information about TDR loans.

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

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

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

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

If both of the conditions are met, the loan can be removed from the TDR classification in calendar years after the year in which the restructuring took place. However, the loan continues to be individually evaluated for impairment. Loans classified as TDRs, including loans in trial payment periods (trial modifications), are considered impaired loans.

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

A loan that had previously been modified in a TDR and is subsequently refinanced under current underwriting standards at a market rate with no concessionary terms is accounted for as a new loan and is no longer reported as a TDR.

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

## **Loans Acquired**

All purchased loans are recorded at fair value at the date of acquisition. Loans acquired with evidence of credit deterioration since their origination and where it is probable at the date of acquisition that the Corporation will not collect all contractually required principal and interest payments are considered PCI loans. Evidence of credit quality deterioration as of the purchase date may include statistics such as past due and non-accrual status, credit scores, and revised loan terms. PCI loans have been aggregated into pools based on common risk characteristics. Each pool is accounted for as a single asset with a single composite interest rate and an aggregate expectation of cash flows. In accounting for PCI loans, the difference between contractually required payments and the cash flows expected to be collected at acquisition is referred to as the nonaccretable difference. The nonaccretable difference, which is neither accreted into income nor recorded on the consolidated statements of financial condition, reflects estimated future credit losses expected to be incurred over the life of the pool of loans. The excess of cash flows expected to be collected over the estimated fair value of PCI loans is referred to as the accretable yield. This amount is not recorded on the statements of financial condition, but is accreted into interest income over the remaining life of the pool of loans, using the effective-yield method.

Subsequent to acquisition, the Corporation continues to estimate cash flows expected to be collected over the life of the PCI loans using models that incorporate current key assumptions such as default rates, loss severity, and prepayment speeds. Decreases in expected cash flows will generally result in an impairment charge to the provision for loan and lease losses and the establishment of an allowance for loan and lease losses. Increases in expected cash flows will generally result in a reduction in any allowance for loan and lease losses established subsequent to acquisition and an increase in the accretable yield. The adjusted accretable yield is recognized in interest income over the remaining life of the pool of loans.

Resolutions of loans may include sales of loans to third parties, receipt of payments in settlement with the borrower, or foreclosure of the collateral. The Corporation's policy is to remove an individual loan from a pool at its relative carrying amount. The carrying amount is defined as the loan's current contractually required payments receivable less its remaining nonaccretable difference and accretable yield, but excluding any post-acquisition loan loss allowance. To determine the carrying value, the Corporation performs a pro-rata allocation of the pool's total remaining nonaccretable difference and accretable yield to an individual loan in proportion to the loan's current contractually required payments receivable compared to the pool's total contractually required payments receivable. This removal method assumes that the amount received from resolution approximates pool performance expectations. The remaining accretable yield balance is unaffected and any material change in the remaining effective yield caused by this removal method is addressed by the Corporation's quarterly cash flow evaluation process for each pool. Modified PCI loans are not removed from a pool even if those loans would otherwise be deemed TDRs.

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

For acquired loans that are not deemed impaired at acquisition, subsequent to acquisition, the Corporation recognizes the difference between the initial fair value at acquisition and the undiscounted expected cash flows in interest income over the period in which substantially all of the inherent losses associated with the non-PCI loans at the acquisition date are estimated to occur. Thus, such loans are accounted for consistently with other originated loans, potentially being classified as nonaccrual or impaired, as well as being classified under the Corporation's standard practice and procedures. In addition, these loans are considered in the determination of the allowance for loan losses.

### **Loans held for sale**

Loans that the Corporation intends to sell or that the Corporation does not have the ability and intent to hold for the foreseeable future are classified as held-for-sale loans. Loans held for sale are stated at the lower of aggregate cost or fair value. Generally, the loans held-for-sale portfolio consists of conforming residential mortgage loans that the Corporation intends to sell to the Government National Mortgage Association and government-sponsored entities such as the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation. Generally, residential mortgage loans held for sale are valued on an aggregate portfolio basis and the value is primarily derived from quotations based on the mortgage-backed securities market. The amount by which cost exceeds market value in the aggregate portfolio of loans held for sale, if any, is accounted for as a valuation allowance with changes therein included in the determination of net income and reported as part of mortgage banking activities in the consolidated statement of income. Loan costs and fees are deferred at origination and are recognized in income at the time of sale. The fair value of commercial loans held for sale is primarily derived from external appraisals with changes in the valuation allowance reported as part of other non-interest income in the consolidated statement of income.

In certain circumstances, the Corporation transfers loans from/to held for sale or held for investment based on a change in strategy. If such a change in holding strategy is made, significant adjustments to the loans' carrying values may be necessary. Reclassifications of loans held for sale to held for investment are made at fair value on the date of transfer. Any difference between the carrying value and the fair value of a reclassified loan is recorded as an adjustment to non-interest income. Meanwhile, reclassification of loans held for investment to held for sale are made at the lower of cost or fair value on the date of transfer and establish a new cost basis upon transfer. Write-downs of loans transferred from held for investment to held for sale are recorded as charge-offs at the time of transfer.

### **Results of Operations**

#### **Net Interest Income**



Net interest income is the excess of interest earned by First BanCorp. on its interest-earning assets over the interest incurred on its interest-bearing liabilities. First BanCorp.'s net interest income is subject to interest rate risk due to the repricing and maturity mismatch of the Corporation's assets and liabilities. Net interest income for the year ended December 31, 2016 was \$484.1 million, compared to \$502.3 million and \$518.1 million for 2015 and 2014, respectively. On a tax-equivalent basis and excluding the changes in the fair value of derivative instruments, net interest income for the year ended December 31, 2016 was \$497.4 million compared to \$520.0 million and \$535.0 million for 2015 and 2014, respectively.

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

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

**Part I**

Year Ended December 31, (Dollars in thousands)	Average volume			Interest income <sup>(1)</sup> / expense			Average rate <sup>(1)</sup>		
	2016	2015	2014	2016	2015	2014	2016	2015	2014
Interest-earning assets:									
Money market and other									
short-term investments	667,838	\$ 775,848	\$ 742,929	\$ 3,365	\$ 2,148	\$ 1,892	0.50%	0.28%	0.25%
Government obligations	(2) 746,890	636,734	514,626	20,849	20,560	15,749	2.79%	3.23%	3.06%
Mortgage-backed securities	1,357,518	1,489,423	1,669,406	38,072	44,909	54,291	2.80%	3.02%	3.25%
FHLB stock	31,449	26,522	27,155	1,454	1,075	1,169	4.62%	4.05%	4.30%
	1,963	777	320	8	-	-	0.41%	0.00%	0.00%

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Other investments										
Total investments										
(3)	2,805,658	2,929,304	2,954,436	63,748	68,692	73,101	2.27%	2.34%	2.47%	
Residential mortgage loans	3,302,519	3,272,464	2,751,366	180,051	181,400	153,373	5.45%	5.54%	5.57%	
Construction loans	143,095	169,666	198,450	5,225	6,357	7,304	3.65%	3.75%	3.68%	
C&I and commercial mortgage loans	3,694,988	3,821,843	4,385,281	160,329	162,496	192,296	4.34%	4.25%	4.39%	
Finance leases	229,632	228,709	240,268	17,349	18,259	19,530	7.56%	7.98%	8.13%	
Consumer loans	1,526,475	1,670,245	1,806,646	171,858	186,120	205,278	11.26%	11.14%	11.36%	
Total loans	(4)(5) 8,896,709	9,162,927	9,382,011	534,812	554,632	577,781	6.01%	6.05%	6.16%	
Total interest-earning assets	\$ 11,702,367	\$ 12,092,231	\$ 12,336,447	\$ 598,560	\$ 623,324	\$ 650,882	5.11%	5.15%	5.28%	
Interest-bearing liabilities:										
Interest-bearing checking accounts	\$ 1,073,821	\$ 1,096,087	\$ 1,075,513	\$ 4,914	\$ 5,440	\$ 6,446	0.46%	0.50%	0.60%	
Savings accounts	2,503,047	2,533,689	2,426,171	12,392	13,660	15,416	0.50%	0.54%	0.64%	
Certificates of deposit	2,367,874	2,294,939	2,296,314	28,068	25,246	26,371	1.19%	1.10%	1.15%	
Brokered CDs	1,805,443	2,428,185	3,098,724	21,928	24,904	29,894	1.21%	1.03%	0.96%	
Interest-bearing deposits	7,750,185	8,352,900	8,896,722	67,302	69,250	78,127	0.87%	0.83%	0.88%	
Other borrowed funds	833,283	997,615	1,131,959	27,908	29,882	34,188	3.35%	3.00%	3.02%	
FHLB advances	460,861	349,027	312,575	5,964	4,171	3,561	1.29%	1.20%	1.14%	
Total interest-bearing liabilities	\$ 9,044,329	\$ 9,699,542	\$ 10,341,256	\$ 101,174	\$ 103,303	\$ 115,876	1.12%	1.07%	1.12%	

Net interest income	\$ 497,386	\$ 520,021	\$ 535,006		
Interest rate spread				3.99%	4.08%
Net interest margin				4.25%	4.30%
				4.16%	4.34%

- (1) On an adjusted tax-equivalent basis. The adjusted tax-equivalent yield was estimated by dividing the interest rate spread on exempt assets by 1 less the Puerto Rico statutory tax rate of 39.0% and adding to it the cost of interest-bearing liabilities. The tax-equivalent adjustment recognizes the income tax savings when comparing taxable and tax-exempt assets. Management believes that it is a standard practice in the banking industry to present net interest income, interest rate spread and net interest margin on a fully tax-equivalent basis. Therefore, management believes these measures provide useful information to investors by allowing them to make peer comparisons. Changes in the fair value of derivatives are excluded from interest income and interest expense because the changes in valuation do not affect interest received or paid.
- (2) Government obligations include debt issued by government-sponsored agencies.
- (3) Unrealized gains and losses on available-for-sale securities are excluded from the average volumes.
- (4) Average loan balances include the average of non-performing loans.
- (5) Interest income on loans includes \$9.9 million, \$10.8 million and \$14.2 million for 2016, 2015 and 2014, respectively, of income from prepayment penalties and late fees related to the Corporation's loan portfolio.

## Part II

	2016 Compared to 2015			2015 Compared to 2014		
	Increase (decrease)			Increase (decrease)		
	Volume	Due to:		Volume	Due to:	
Rate		Total	Rate		Total	
<b>(In thousands)</b>						
Interest income on interest-earning assets:						
Money market and other short-term investments	\$ (422)	\$ 1,639	\$ 1,217	\$ 86	\$ 170	\$ 256
Government obligations	3,316	(3,027)	289	3,904	907	4,811
Mortgage-backed securities	(3,822)	(3,015)	(6,837)	(5,599)	(3,783)	(9,382)
FHLB stock	216	163	379	(27)	(67)	(94)
Other investments	-	8	8	-	-	-
Total investments	(712)	(4,232)	(4,944)	(1,636)	(2,773)	(4,409)
Residential mortgage loans	1,652	(3,001)	(1,349)	28,967	(940)	28,027
Construction loans	(974)	(158)	(1,132)	(1,069)	122	(947)
C&I and commercial mortgage loans	(5,449)	3,282	(2,167)	(24,100)	(5,700)	(29,800)
Finance leases	72	(982)	(910)	(927)	(344)	(1,271)
Consumer loans	(16,104)	1,842	(14,262)	(15,260)	(3,898)	(19,158)
Total loans	(20,803)	983	(19,820)	(12,389)	(10,760)	(23,149)
Total interest income	\$ (21,515)	\$ (3,249)	\$ (24,764)	\$ (14,025)	\$ (13,533)	\$ (27,558)
Interest expense on interest-bearing liabilities:						
Brokered CDs	\$ (6,975)	\$ 3,999	\$ (2,976)	\$ (6,673)	\$ 1,683	\$ (4,990)
Other interest-bearing deposits	150	878	1,028	1,001	(4,888)	(3,887)
Other borrowed funds	(5,213)	3,239	(1,974)	(4,026)	(280)	(4,306)
FHLB advances	1,424	369	1,793	430	180	610
Total interest expense	(10,614)	8,485	(2,129)	(9,268)	(3,305)	(12,573)
Change in net interest income	\$ (10,901)	\$ (11,734)	\$ (22,635)	\$ (4,757)	\$ (10,228)	\$ (14,985)

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

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

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

	<b>Year Ended December 31,</b>		
	<b>2016</b>	<b>2015</b>	<b>2014</b>
<b>(Dollars in thousands)</b>			
Interest income - GAAP	\$ 585,292	\$ 605,569	\$ 633,949
Unrealized gain on derivative instruments	-	(139)	(1,258)
Interest income excluding valuations	585,292	605,430	632,691
Prepayment penalty income on a commercial mortgage loan tied to an interest rate swap	-	-	(2,546)
Interest income excluding valuations and the \$2.5 million prepayment penalty collected	585,292	605,430	630,145
Tax-equivalent adjustment	13,268	17,894	18,191
Prepayment penalty collected on a commercial mortgage loan	-	-	2,546
Interest income on a tax-equivalent basis excluding valuations	598,560	623,324	650,882
Interest expense - GAAP	101,174	103,303	115,876
Net interest income - GAAP	\$ 484,118	\$ 502,266	\$ 518,073
Net interest income excluding valuations and the \$2.5 million prepayment penalty income	\$ 484,118	\$ 502,127	\$ 514,269
Net interest income on a tax-equivalent basis excluding valuations	\$ 497,386	\$ 520,021	\$ 535,006
<b>Average Balances</b>			
Loans and leases	\$ 8,896,709	\$ 9,162,927	\$ 9,382,011
Total securities, other short-term investments and interest-bearing cash balances	2,805,658	2,929,304	2,954,436
Average interest-earning assets	\$ 11,702,367	\$ 12,092,231	\$ 12,336,447
Average interest-bearing liabilities	\$ 9,044,329	\$ 9,699,542	\$ 10,341,256
<b>Average Yield/Rate</b>			
Average yield on interest-earning assets - GAAP	5.00%	5.01%	5.14%
Average rate on interest-bearing liabilities - GAAP	1.12%	1.07%	1.12%
Net interest spread - GAAP	3.88%	3.94%	4.02%
Net interest margin - GAAP	4.14%	4.15%	4.20%
Average yield on interest-earning assets excluding valuations and the \$2.5 million prepayment penalty income	5.00%	5.01%	5.11%
Average rate on interest-bearing liabilities excluding valuations	1.12%	1.07%	1.12%
Net interest spread excluding valuations and the \$2.5 million prepayment penalty income	3.88%	3.94%	3.99%
Net interest margin excluding valuations and the \$2.5 million prepayment penalty income	4.14%	4.15%	4.17%

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Average yield on interest-earning assets on a tax-equivalent basis and excluding valuations	5.11%	5.15%	5.28%
Average rate on interest-bearing liabilities excluding valuations	1.12%	1.07%	1.12%
Net interest spread on a tax-equivalent basis and excluding valuations	3.99%	4.08%	4.16%
Net interest margin on a tax-equivalent basis and excluding valuations	4.25%	4.30%	4.34%

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

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

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

### **2016 compared to 2015**

Net interest income for the year ended December 31, 2016 amounted to \$484.1 million, a decrease of \$18.1 million, when compared to \$502.3 million in 2015. The \$18.1 million decrease in net interest income was primarily due to:

- A \$15.2 million decrease in interest income on consumer loans and finance leases mainly attributable to the decrease of \$142.8 million in the average balance of this portfolio, primarily auto loans.
- A \$3.9 million decrease in interest income on investment securities, primarily reflecting the gradual reinvestment of MBS prepayments and proceeds from debt securities called prior to maturity in lower-yielding investments, given the low interest rate environment, and an adverse impact of \$1.0 million related to the discontinuance of interest income recognition on bonds of the GDB and the Puerto Rico Public Buildings Authority that were placed in non-performing status during the third quarter of 2016.
- A \$1.2 million decrease in interest income on commercial and construction loans reflecting a decline of \$153.4 million in the average balance of these portfolios that resulted in a decrease of approximately \$3.6 million in interest income and the adverse impact of the classification of certain large commercial relationships as non-performing during 2016, partially offset by an increase of approximately \$1.4 million in prepayment penalties and deferred fees amortization, recovery of interest income on certain non-performing loans that were fully paid off, and the upward repricing of variable commercial loans tied to higher short-term interest rates.
- A \$1.2 million decrease in interest income on residential mortgage loans primarily due to lower cash collections on residential non-performing loans.



Partially offset by:

- A \$2.1 million decrease in interest expense, including a decrease of \$3.0 million in interest expense on brokered CDs primarily related to a \$622.7 million decrease in the average volume of brokered CDs that offset higher costs on new issuances, and a \$2.2 million decrease in interest expense on repurchase agreements primarily reflecting the effect of the repayment of \$400 million of repurchase agreements matured in 2016 that carried an average cost of 3.35%. During 2016, the Corporation repaid \$1.3 billion of maturing brokered CDs with an all-in cost of 0.96% and new issuances amounted to \$633.5 million with an all-in cost of 1.21%. The aforementioned decreases were partially offset by increases of \$1.8 million and \$1.0 million in interest expense on FHLB advances and non-brokered deposits (i.e. savings, interest-bearing checking and retail CDs), respectively.
- A \$1.2 million increase in interest income on interest-bearing cash and cash equivalent balances due to increases in fed fund rates late in 2015 and 2016.

The net interest margin decreased slightly to 4.14% for the year ended December 31, 2016 compared to 4.15% for 2015 driven by lower yields on investment securities, higher funding costs and the decrease in size of the consumer loans portfolio.

On an adjusted tax-equivalent basis, net interest income for the year ended December 31, 2016 decreased \$22.6 million to \$497.4 million when compared to 2015. In addition to the facts discussed above, the decrease for the 2016 period also includes a reduction of \$4.6 million in the tax-equivalent adjustment attributable to a lower volume of tax-exempt assets.

#### **2015 compared to 2014**

Net interest income for the year ended December 31, 2015 amounted to \$502.3 million, a decrease of \$15.8 million, when compared to \$518.1 million in 2014. The net interest margin, excluding fair value adjustments and the \$2.5 million prepayment penalty collected on a commercial mortgage loan paid off in the fourth quarter of 2014, decreased by 2 basis points to 4.15% for 2015, compared to 2014. The \$15.8 million decrease in net interest income was primarily due to:

- A \$30.1 million decrease in interest income on commercial loans, including a decrease of approximately \$24.1 million attributable to a \$592.2 million decline in the average volume of such loans and the adverse impact of approximately \$3.8 million in interest payments received from the PREPA credit facility accounted for on a cost-recovery basis.
- A \$20.4 million decrease in interest income on consumer loans and finance leases, including a decrease of approximately \$16.2 million related to a \$148.0 million decrease in the average volume of such loans and a \$3.8 million decrease due to the fact that the remaining discount on the credit card portfolio acquired in 2012 was fully accreted into income in the first half of 2014.
- A \$7.6 million decrease in interest income on MBS investments, including a decrease of approximately \$4.6 million attributable to a \$180.0 million decline in the average volume of MBS investments and a \$3.0 million decrease related to lower yields reflecting, among other things, an acceleration of prepayments and the gradual reinvestment of MBS prepayments in lower-yielding investments given the low interest rate environment.

These variances were partially offset by:

- A \$28.6 million increase in the interest income on residential mortgage loans primarily related to several acquisitions of loan portfolios from Doral Bank and Doral Financial completed in the second and fourth quarters of 2014 and the first quarter of 2015.
- An \$8.9 million decrease in interest expense on deposits, including a \$5.0 million reduction in interest expense on brokered CDs primarily related to a \$670.5 million decrease in the average volume of brokered CDs. Interest expense on non-brokered interest-bearing deposits decreased by \$3.9 million mainly due to lower deposit pricing that resulted in an 8 basis points reduction in the average cost of such deposits to 0.75% in 2015 from 0.83% in 2014. The decrease in interest expense on non-brokered deposits was achieved despite the \$126.7 million increase in the average balance of such deposits.
- A \$4.6 million decrease in interest expense on repurchase agreements mainly related to the aforementioned restructuring of \$400 million of repurchase agreements and the netting effect of the \$2.7 million interest income earned in 2015 on \$200 million of reverse repurchase agreements entered into in 2015 that qualifies for offsetting accounting pursuant to ASC 210-20-45-11.

On an adjusted tax-equivalent basis, net interest income for the year ended December 31, 2015 decreased \$15.0 million to \$520.0 million when compared to 2014. In addition to the facts discussed above, the decrease for the 2015

period also includes a reduction of \$0.3 million in the tax-equivalent adjustment attributable to a lower volume of tax-exempt assets, primarily MBS investments held by the Corporation's IBE subsidiary, FirstBank Overseas Corporation.

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

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

During 2016, the Corporation recorded a provision for loan and lease losses of \$86.7 million, compared to \$172.0 million in 2015 and \$109.5 million in 2014. The provisions for the year ended December 31, 2016, 2015 and 2014 includes the \$1.8 million charge associated with the sale of the \$16.3 million pool of non-performing assets in the fourth quarter of 2016, the charge of \$46.9 million associated with the bulk sale of assets completed during the second quarter of 2015, and the charge of \$1.4 million related to the acquisition of residential mortgage loans from Doral Financial in the second quarter of 2014 in full satisfaction of secured borrowings owed by such entity to FirstBank.

## 2016 compared to 2015

The adjusted provision for loan and lease losses, excluding the impact of the charges mentioned above, decreased by \$40.2 million in 2016, as compared to the adjusted provision for 2015, driven by:

- A \$23.2 million decrease in the adjusted provision for commercial and construction loans, primarily reflecting, among other things, the impact in 2015 of the \$35 million increase in the general reserve for commercial loans extended to or guaranteed by the Puerto Rico government (excluding municipalities) reflecting the impact of both the migration of certain of these loans to adverse classification categories and a \$19.2 million charge related to qualitative factor adjustments that stressed the historical loss rates applied to these loans, partially offset by lower loan loss recoveries and the impact in 2015 of an \$8.1 million reserve release adjustment for construction loans that reflected adjustments to the general reserve given the stabilization in the asset quality of land loans. During the third quarter of 2015, the Corporation adversely classified its exposure to commercial mortgage loans guaranteed by the TDF and the general reserve for commercial loans was increased in the fourth quarter of 2015 due to qualitative factor adjustments applied to the Puerto Rico government-related exposure, including this particular portfolio. The migration of the loans guaranteed by the TDF to non-performing and impaired status in the first quarter of 2016 did not result in significant increases to the allowance for loan losses. As of December 31, 2016, the total reserve coverage ratio (general and specific reserves) related to commercial loans extended to or guaranteed by the Puerto Rico government (excluding municipalities) was 17% compared to 19% as of December 31, 2015.
- An \$11.7 million decrease in the provision for consumer loans driven by lower charge-offs and loss severity and the overall decrease in the size of the portfolio. Consumer loan net-charge offs decreased by \$7.9 million in 2016 compared to 2015.
- A \$5.3 million decrease in the adjusted provision for residential mortgage loans mainly related to lower delinquency levels, lower charges to the reserve for PCI loans, and the overall decrease in the size of this portfolio.

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

## 2015 compared to 2014

The adjusted provision for loan and lease losses increased by \$17.0 million in 2015, as compared to 2014, driven by:

- A \$36.9 million increase in the adjusted provision for commercial and construction loans, including a \$35 million increase in the general reserve related to commercial loans extended to or guaranteed by the Puerto Rico government (excluding municipalities) that reflects the migration of loans guaranteed by the TDF to adverse classification categories as well as a \$19.2 million charge related to an adjustment for qualitative factors that stressed the historical loss rates applied to the Government loans (excluding municipalities). As of December 31, 2015, the total reserve coverage ratio (general and specific reserves) related to commercial loans extended to or guaranteed by the Puerto Rico government (excluding municipalities) was 19%. The increase in the adjusted provision also reflects reductions in loan loss recoveries of \$11.5 million in the Florida region. This was partially offset by an \$8.1 million reserve release for construction loans recorded in the fourth quarter of 2015 that reflected adjustments to the general reserve given the stabilization in the asset quality of land loans.
- A \$12.9 million increase in the provision for residential mortgage loans driven by several factors including inherent loss severities of loans in late stages of delinquency, decreases in appraised values, the overall increase in the size of this portfolio and the establishment of a \$4.0 million reserve for PCI loans acquired from Doral Financial in May 2014. The reserve for PCI loans was driven by the revision of the expected cash flows of the portfolio for the remaining term of the loan pool based on market conditions.

Partially offset by:

- A decrease in the provision for consumer loans of \$32.8 million mainly due to improvements in charge-off trends and lower loss severity rates on auto loans. Consumer loans net charge-offs decreased by \$16.7 million for 2015 compared to 2014, including loan loss recoveries of \$2.7 million on the sale in the second quarter of 2015 of certain auto and personal loans that had been fully charged-off in prior periods. The decrease in the provision also reflects the decline in the size of this portfolio.

**Non-Interest Income**

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

	<b>2016</b>	<b>2015</b>	<b>2014</b>
(In thousands)			
Service charges on deposit accounts	\$ 22,965	\$ 20,330	\$ 16,709
Mortgage banking activities	20,435	17,217	14,685
Insurance income	8,473	7,058	6,868
Broker-dealer income	789	-	459
Other operating income	30,111	32,794	30,032
Non-interest income before net gain (loss) on investments, gain on early extinguishment of debt, bargain purchase gain, gain on sale of merchant contracts, and equity in loss of unconsolidated entity	82,773	77,399	68,753
Net gain on sale of investments	6,104	-	262
Gain from recovery of investments previously written off	1,547	-	-
OTTI on debt securities	(6,687)	(16,517)	(388)
Net gain (loss) on investments	964	(16,517)	(126)
Gain on early extinguishment of debt	4,217	-	-
Bargain purchase gain	-	13,443	-
Gain on sale of merchant contracts	-	7,000	-
Equity in loss of unconsolidated entity	-	-	(7,279)
Total	\$ 87,954	\$ 81,325	\$ 61,348

Non-interest income primarily consists of income from service charges on deposit accounts; commissions derived from various banking, securities and insurance activities; gains and losses on mortgage banking activities; interchange and other fees related to debit and credit cards; equity in earnings (loss) of the unconsolidated entity through the second quarter of 2014; and net gains and losses on investments and impairments.

Service charges on deposit accounts include monthly fees, overdraft fees, cash management and other fees on deposit accounts as well as corporate cash management fees.

Income from mortgage banking activities includes gains on sales and securitization of loans, revenues earned for administering residential mortgage loans originated by the Corporation and subsequently sold with servicing retained, and unrealized gains and losses on forward contracts used to hedge the Corporation's securitization pipeline. In addition, lower-of-cost-or-market valuation adjustments to the Corporation's residential mortgage loans held for sale portfolio and servicing rights portfolio, if any, are recorded as part of mortgage banking activities.

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

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

The other operating income category is composed of miscellaneous fees such as debit, credit card and point of sale (POS) interchange fees, as well as contractual shared revenues from merchant contracts sold in the fourth quarter of 2015.

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

The gain on early extinguishment of debt is related to the repurchase and cancellation in the first quarter of 2016 of \$10 million in trust preferred securities of the FBP Statutory Trust II that were auctioned in a public sale at which the Corporation was invited to participate. The Corporation repurchased and cancelled the repurchased trust preferred securities, resulting in a commensurate reduction in the related Floating Rate Junior Subordinated Debentures. The Corporation's winning bid equated to 70% of the \$10 million par value. The 30% discount, plus accrued interest, resulted in a gain of \$4.2 million, which is reflected in the statement of income as a "Gain on early extinguishment of debt." As of December 31, 2016, the Corporation still has Floating Rate Junior Subordinated Debentures ("subordinated debt") outstanding in the aggregate amount of \$216.2 million.

The bargain purchase gain is related to assets acquired and deposits assumed from Doral Bank in the first quarter of 2015. On February 27, 2015, FirstBank acquired 10 Puerto Rico branches of Doral Bank, assumed \$522.7 million in deposits related to such branches, acquired approximately \$324.8 million in principal balance of loans, primarily residential mortgage loans, acquired \$5.5 million of property, plant and equipment and received \$217.7 million of cash, through an alliance with Popular Inc. (“Popular”), who was the successful lead bidder with the FDIC on the failed Doral Bank, as well as other co-bidders. Under the FDIC’s bidding format, Popular was the lead bidder and party to the purchase and assumption agreement with the FDIC covering all assets and deposits to be acquired by Popular and its alliance co-bidders. Popular entered into back to back purchase assumption agreements with the alliance co-bidders, including FirstBank, for the transferred assets and deposits. There is no loss-share arrangement with the FDIC related to the acquired assets, meaning that FirstBank assumed all losses with respect to such assets, with no financial assistance from the FDIC. The gain of \$13.4 million represents the excess of the estimated fair value of the assets acquired (including cash payments of \$217.7 million received from the FDIC) over the estimated fair value of the liabilities assumed. Refer to Note 2 – Business Combination, of the Corporation’s audited financial statements for the year ended December 31, 2016 included in Item 8 of this Form 10-K, for further information, including the fair values of assets acquired and liabilities assumed in this transaction.

The gain on the sale of merchant contracts is associated with a long-term strategic marketing alliance entered during the fourth quarter of 2015 as part of the sale of FirstBank’s merchant contracts portfolio. Effective October 31, 2015, FirstBank entered into a long-term strategic marketing alliance with Evertec, Inc. (“Evertec”) to which FirstBank sold its merchant contracts portfolio and related POS terminals. Evertec acquired FirstBank’s merchant contracts and will continue to provide processing services, customer service and support operations to FirstBank’s merchant locations. Merchant services will be marketed through FirstBank’s branches and offices in Puerto Rico and the Virgin Islands. Under the 10-year marketing and referral agreement, FirstBank and Evertec share, in accordance with agreed terms, revenues generated by the existing and incremental merchant contracts over the term of the agreement. The Corporation sold the merchant contracts for \$10.0 million, recorded a gain on the sale of \$7.0 million in the fourth quarter of 2015 and deferred \$3.0 million that is being recognized into income over the marketing and referral agreement term.

Equity in earnings (losses) of unconsolidated entity relates to FirstBank’s investment in CPG/GS, the entity that purchased \$269 million of loans from FirstBank during the first quarter of 2011. The Bank holds a 35% subordinated ownership interest in CPG/GS. The majority owner of CPG/GS is entitled to recover its initial investment and a priority return of 12% prior to any return paid to the Bank. The adjustments of \$7.3 million recorded in the first half of 2014 reduced to zero the book value of the Bank’s investment in CPG/GS. No negative investments need to be reported as the Bank has no legal obligation or commitment to provide further financial support to this entity; thus, no further losses are being recorded on this investment. Any potential increase in the carrying value of the investment in CPG/GS under the Hypothetical Liquidation Book Value method would depend upon how better off the Bank is at the end of the period than it was at the beginning of the period after the waterfall calculation performed to determine the amount of gain allocated to the investors.

## **2016 compared to 2015**

Non-interest income for 2016 amounted to \$88.0 million, compared to \$81.3 million for 2015. The \$6.6 million increase in non-interest income was primarily due to:



- A \$9.8 million decrease in OTTI charges on debt securities. During the first quarter of 2016, the Corporation recorded OTTI charges of \$6.3 million on three Puerto Rico government debt securities held by the Corporation as part of its available-for-sale securities portfolio, specifically bonds of the GDB and the Puerto Rico Public Buildings Authority. This was the third OTTI charge on these securities recorded since June 30, 2015, as OTTI charges of \$12.9 million and \$3.0 million were booked in the second and fourth quarters of 2015, respectively.
- The \$6.1 million gain on sales of U.S. agency MBS completed in the third quarter of 2016.
- The \$4.2 million gain recorded in the first quarter of 2016 on the repurchase and cancellation of \$10 million in trust preferred securities.
- A \$3.2 million increase in revenues from the mortgage banking business, driven by a \$1.7 million increase in the gain on sales of residential mortgage loans in the secondary market associated with both a higher volume of sales and higher gain margins tied to market interest rate levels and a \$0.9 million increase in gains on TBAs MBS forward contracts. Loans sold in the secondary market to U.S. government-sponsored entities amounted to \$482.6 million in 2016 with a related gain of \$15.2 million, compared to \$427.9 million with a related gain of \$13.5 million in 2015. In addition, loan servicing fees increased by \$0.4 million associated with the increase in the servicing portfolio.
- A \$2.6 million increase in service charges on deposits, primarily associated with the full period impact of deposits assumed from Doral Bank late in February 2015, as well as the implementation of new service and transactional fees on certain products in November 2015.

- A \$2.2 million increase in brokerage and insurance commissions, primarily related to the sale of large fixed annuities contracts in the fourth quarter of 2016.
- A \$1.5 million gain recorded in the fourth quarter of 2016 from the recovery of a residual CMO that was previously written off.

Partially offset by:

- The impact in 2015 of the \$13.4 million bargain purchase gain on assets acquired and deposits assumed from Doral Bank.
- The impact in 2015 of a \$7.0 million gain on the sale of merchant contracts associated with a long-term strategic alliance entered in the fourth quarter of 2015 as part of the sale of the FirstBank Puerto Rico merchant contracts portfolio.
- A \$2.7 million decrease in “other operating income” in the table above, reflecting a \$5.4 million decrease in fees from merchant transactions due to the sale of merchant contracts completed in the fourth quarter of 2015 (a reduction of approximately \$3.3 million in processing costs, depreciation and other expenses related to the sale of merchant contracts was reflected in non-interest expenses). The decrease in fees from merchant contracts was partially offset by the impact in 2015 of the \$0.6 million loss on the sale of a commercial mortgage loan held for sale included in the bulk sale of assets, a \$0.6 million gain on the sale of fixed assets recorded in 2016, a \$0.4 million fee recorded as income in 2016 associated with a terminated credit agreement in which the Bank was committed to purchase a loan participation and a \$0.7 million increase in ATM fees that reflects both changes in the fee structure and the expansion of the Bank’s automatic teller network with a total of 80 new locations.

#### **2015 compared to 2014**

Non-interest income for 2015 amounted to \$81.3 million, compared to non-interest income of \$61.3 million for 2014. The \$20.0 million increase in non-interest income was primarily due to:

- The \$13.4 million bargain purchase gain on assets acquired and liabilities assumed from Doral Bank in the first quarter of 2015.

- The \$7.0 million gain on the sale of merchant contracts completed in the fourth quarter of 2015.
- The impact in 2014 of the \$7.3 million equity in the loss of an unconsolidated entity on the Bank's investment in CPG/GS.
- A \$3.6 million increase in service charges on deposits primarily associated with the deposits assumed from Doral Bank late in February 2015 as well as the aforementioned implementation of new service and transactional fees on certain products beginning in the fourth quarter of 2015.
- A \$2.5 million increase in revenues from the mortgage banking business driven by a \$1.2 million decrease in losses on TBAs MBS forward contracts, a \$1.1 million decrease in charges related to compensatory fees imposed by government-sponsored agencies, and a \$0.2 million increase in servicing fees tied to a larger portfolio. Realized gains on sales of residential mortgage loans amounting to \$13.5 million in 2015 remained flat as compared to 2014. Loans sold in the secondary market to U.S. government-sponsored entities amounted to \$427.9 million in 2015, compared to \$337.2 million in 2014. Higher margins were observed in 2014 due, in part, to the sale of re-performing mortgage loans.
- A \$1.3 million increase in merchant-related income despite the sale of merchant-contracts completed early in the fourth quarter of 2015.

Partially offset by:

- A \$16.1 million increase in OTTI charges on debt securities. During 2015, the Corporation recorded \$15.9 million in OTTI charges on bonds of the GDB and the Puerto Rico Building Authority held by the Corporation as part of its available-for-sale securities portfolio.

**Non-Interest Expenses**

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

	2016	2015	2014
(In thousands)			
Employees' compensation and benefits	\$ 151,493	\$ 150,059	\$ 135,422
Occupancy and equipment	55,159	59,295	58,290
Insurance and supervisory fees	24,920	29,021	39,131
Taxes, other than income taxes	15,139	12,669	18,089
Professional fees:			
Collections, appraisals and other credit-related fees	9,890	12,833	12,064
Outsourcing technology services	20,264	18,547	18,439
Other professional fees	13,983	24,252	17,437
Credit and debit card processing expenses	13,635	16,177	15,449
Business promotion	11,419	15,234	16,531
Communications	6,759	7,726	7,766
Net loss on OREO and OREO operations	11,533	15,788	20,596
Other	20,886	22,229	19,039
Total	\$ 355,080	\$ 383,830	\$ 378,253

**2016 compared to 2015**

Non-interest expenses decreased by \$28.8 million to \$355.1 million for the year ended December 31, 2016, compared to \$383.8 million for 2015. The decrease was primarily due to the following:

- An \$11.5 million decrease in total professional service fees mainly driven by the impact in 2015 of several items, including costs of \$3.7 million related to the acquisition and conversion of loan and deposit accounts acquired from Doral Bank to the FirstBank systems, \$3.6 million of interim servicing costs related to loans and deposits acquired from Doral Bank, costs of \$1.3 million related to special projects and strategic, stress testing and capital planning matters, and \$0.9 million of professional service fees directly related to the bulk sale of assets. In addition, there was a \$2.9 million decrease in collections, appraisals and other credit-related professional service fees associated with lower costs on troubled loans resolution efforts.
- A \$4.3 million decrease in losses on OREO operations primarily reflecting a \$3.0 million decrease in write downs to the value of OREO properties, a \$0.7 million decrease in OREO-operating expenses, including lower property taxes, and a \$1.0 million increase in rental income associated with both a higher inventory of income-producing properties and increased occupancy.

- A \$4.1 million decrease in occupancy and equipment costs reflecting reductions in depreciation, electricity and repairs expenses, including a reduction of approximately \$1.2 million related to the depreciation of POS terminals sold as part of the sale of merchant contracts in the fourth quarter of 2015.
- A \$3.9 million decrease in the FDIC insurance premium expense, included as part of “Insurance and supervisory fees” in the table above reflecting, among other things, a reduction in the initial base assessment rate, and reductions in brokered deposits and average assets.
- A \$3.8 million decrease in business promotion expenses, primarily due to lower costs associated with credit card and deposit reward programs, including the effect of the \$2.7 million adjustment recorded during the fourth quarter of 2016 to reduce the credit card rewards liability due to the expiration of reward points earned by customers up to September 2013 (the conversion date of the credit card portfolio acquired from FIA in May 2012). Most of these points had been accrued at acquisition date and ultimately experienced a redemption pattern materially different from those points accrued after conversion. Reduced advertising and marketing expenses also contributed to this variance.
- A \$2.5 million decrease in processing expenses mainly due to the sale of merchant contracts in the fourth quarter of 2015.
- A \$1.3 million decrease in “other operating expenses” in the table above, including reductions of \$1.6 million in supplies and printing costs, \$0.2 million in the amortization of intangible assets, and a \$0.5 million decrease in losses and expenses related

to non-real estate repossessed assets. These variances were partially offset by a \$0.9 million increase in charges to the provision for unfunded loan commitments tied to the utilization of a floor plan revolving credit facility.

Partially offset by:

- A \$2.5 million increase in taxes, other than income taxes, primarily due to the increase in the sales tax rate from 7% to 11.5% effective in Puerto Rico since July 1, 2015 and the sales tax of 4% on designated professional services effective in Puerto Rico since October 1, 2015.
- A \$1.4 million increase in employees' compensation, mainly due to merit salary increases, the full year impact of personnel costs associated with branches acquired from Doral Bank in February 2015, and higher stock-based compensation, partially offset by the impact in 2015 of costs of \$2.2 million related to a voluntary early retirement program.

#### **2015 compared to 2014**

Non-interest expenses for 2015 were \$383.8 million compared to \$378.3 million for 2014. The increase was primarily due to:

- A \$14.6 million increase in employees' compensation and benefit expenses, including the \$2.2 million costs related to the voluntary early retirement program, mainly due to salary merit increases, the impact of personnel costs related to the branches acquired from Doral Bank in 2015, which accounted for approximately \$2.7 million of the increase, a \$1.4 million increase in stock-based compensation expense, and a \$2.1 million increase in incentive and performance-based compensation.
- A \$7.7 million increase in total professional service fees driven by the aforementioned impact of \$3.7 million in professional service fees related to the acquisition and conversion of loan and deposit accounts acquired from Doral Bank to the FirstBank systems, the \$3.6 million incurred in interim servicing costs also related to loans and deposits acquired from Doral Bank, \$1.3 million in consulting and legal expenses for special projects as well as strategic, stress testing and capital planning matters that are not expected to be incurred on an ongoing basis, a \$0.8 million increase in collections, appraisals and other credit-related professional service fees related to troubled loan resolution efforts, and \$0.9 million of professional service fees directly associated with the bulk sale of assets completed in 2015. These increases were partially offset by a \$2.2 million decrease in legal fees, including the impact in 2014 of \$1.2 million of professional fees incurred in the two separate acquisitions of mortgage loans from Doral Financial and Doral Bank in 2014.

- A \$1.0 million increase in occupancy and equipment costs primarily related to rental, depreciation and maintenance expenses associated with the acquired Doral Bank branches.
- A \$3.2 million increase in “other expenses” in the table above, that primarily includes increases in supplies and printing and the amortization of the core deposit intangible associated with the acquired Doral Bank branches in 2015 and a \$0.9 million increase in the provision for unfunded loan commitments.

Partially offset by:

- A \$10.5 million decrease in the FDIC insurance premium expense reflecting, among other things, the continued decrease in brokered CDs, a strengthened capital position and an improved earnings to assets average ratio for most of the year. This expense is included as part of “Insurance and supervisory fees” in the table above.
- A \$5.4 million decrease in taxes, other than income taxes, reflecting the elimination of Puerto Rico’s national gross receipts tax effective January 1, 2015 that represented a decrease of approximately \$5.7 million, partially offset by incremental costs of approximately \$0.5 million associated with the sales and use tax including the new 4% sales and use tax applicable to business-to-business services and designated professional services.
- A \$4.8 million decrease in OREO-related expenses reflecting an increase of \$3.7 million in rental income from income-producing OREO properties and a \$2.0 million decrease in losses on the sale of OREO properties, partially offset by higher OREO operating expenses such as repairs and management fees.
- A \$1.3 million decrease in business promotion expenses mainly due to lower marketing expenses.

## Income Taxes

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

Under the 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 NOL carry-forward period. The 2011 PR Code provides a dividend received deduction of 100% on dividends received from "controlled" subsidiaries subject to taxation in Puerto Rico and 85% on dividends received from other taxable domestic corporations.

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

For additional information relating to income taxes, see Note 26 – Income Taxes, of the Corporation's audited financial statements for the year ended December 31, 2016 included in Item 8 of this Form 10-K, including the reconciliation of the statutory to the effective income tax rate for 2016, 2015 and 2014.

### 2016 compared to 2015

For 2016, the Corporation recorded an income tax expense of \$37.0 million compared to an income tax expense of \$6.4 million for 2015. The increase in income tax expense for 2016, when compared to 2015, was mainly driven by higher taxable income, as the year 2015 was impacted by an incremental pre-tax loss of \$48.7 million on the bulk sale of assets. The effective tax rate for the year ended December 31, 2016 was 28% compared to 23% for the year ended December 31, 2015.



The Corporation's net deferred tax assets amounted to \$281.7 million as of December 31, 2016, net of a valuation allowance of \$207.2 million. The net deferred tax assets of the Corporation's banking subsidiary, FirstBank, amounted to \$277.4 million as of December 31, 2016, net of a valuation allowance of \$171.0 million, compared to net deferred tax assets of \$306.4 million as of December 31, 2015. In 2010, the Corporation established a valuation allowance for substantially all of the deferred tax assets of its banking subsidiary, FirstBank, primarily due to significant operational losses driven by charges to the provision for loan losses, a three-year cumulative loss position as of the end of 2010, and uncertainty regarding the amount of future taxable income that the Bank could forecast. As of December 31, 2014, based upon the assessment of all positive and negative evidence, management concluded that it was more likely than not that FirstBank will generate sufficient taxable income within the applicable NOL carry-forward periods to realize \$308.2 million of its deferred tax assets and, therefore, reversed \$302.9 million of the valuation allowance. During 2016, management reassessed the need for a valuation allowance and concluded, based upon the assessment of all positive and negative evidence, that it is more likely than not that FirstBank will generate sufficient taxable income within the applicable NOL carry-forward periods to realize \$277.4 million of its deferred tax asset. The positive evidence considered by management to conclude on the adequacy of the valuation allowance as of December 31, 2016 includes factors such as: FirstBank's three-year cumulative gain position of \$206.7 million; forecasts of future profitability under several potential scenarios that support the partial utilization of NOLs prior to their expiration between 2021 through 2024; two consecutive years of taxable income (taxable year 2015 being the first year with taxable income since 2008); and sustained pre-tax pre-provision for loan losses income. These factors demonstrate demand for FirstBank's products and services and improvements in credit quality measures that have resulted in reduced credit exposures, when compared to the period that led to the full valuation allowance, and have resulted in improvements in both sustainability of profitability and management's ability to forecast future losses. The negative evidence considered by management include: Puerto Rico's current economic conditions, which resulted in the enactment of PROMESA, the uncertainty related to government loan concentration and the still elevated levels of non-performing assets.

In determining whether management's projections of future taxable income used to determine the valuation allowance reversal are reliable, management considered objective evidence supporting the forecast's assumptions as well as recent experience to conclude as to the Bank's ability to reasonably project future results of operations. The analysis included the evaluation of multiple financial

scenarios, including scenarios where credit losses remain elevated. Further, while Puerto Rico's economy is expected to remain challenging due to inherent uncertainties, the Corporation believes that it can reasonably forecast future taxable income at sufficient levels over the future period of time that FirstBank has available to realize part of the December 31, 2016 net deferred tax asset as further described below.

The Corporation expects to realize approximately \$171.5 million of deferred tax assets associated with FirstBank's NOLs prior to their expiration periods, compared to \$182.1 million expected to be realized as of December 31, 2015. In addition, as of December 31, 2016, approximately \$117.0 million of the deferred tax assets of the Corporation are attributable to temporary differences or tax credit carry-forwards that have no expiration date, compared to \$127.8 million in 2015. Approximately \$20.5 million of other non-NOLs related deferred tax assets of the Corporation are fully reserved with a valuation allowance, compared to \$19.4 million as of December 31, 2015, given limitations and uncertainties as to their future utilization. The increase in fully reserved deferred tax assets is related to the increase in cumulative other than temporary impairments on investment securities. The ability to recognize the remaining deferred tax assets that continue to be subject to a valuation allowance will be evaluated on a quarterly basis to determine if there are any significant events that would affect the ability to utilize these deferred tax assets.

Management's estimate of future taxable income is based on internal projections that consider historical performance, multiple internal scenarios and assumptions, as well as external data that management believes is reasonable. If events are identified that affect the Corporation's ability to utilize its deferred tax assets, the analysis will be updated to determine if any adjustments to the valuation allowance are required. If actual results differ significantly from the current estimates of future taxable income, even if caused by adverse macro-economic conditions, the remaining valuation allowance may need to be increased. Such an increase could have a material adverse effect on the Corporation's financial condition and results of operations. Conversely, better than expected results and continued positive results and trends could result in further releases to the deferred tax valuation allowance; any such decreases could have a material positive effect on the Corporation's financial condition and results of operations.

#### **2015 compared to 2014**

For 2015, the Corporation recorded an income tax expense of \$6.4 million compared to an income tax benefit of \$300.6 million for 2014. The income tax benefit for the year 2014 primarily reflects the \$302.9 million partial reversal of the valuation allowance of the Bank's deferred tax assets described above. Other variances were primarily related to higher taxable income in 2015 and the disallowance of \$7.7 million of NOL carryforwards.

As of December 31, 2016 and 2015, the Corporation did not have UTBs recorded on its books. During 2014, the Corporation reached a final settlement with the IRS in connection with the 2007-2009 examination periods. As a result, during 2014, the Corporation released a portion of its reserve for uncertain tax positions, resulting in a tax benefit of \$1.8 million, and paid \$2.5 million to settle the tax liability resulting from the audit.

## OPERATING SEGMENTS

Based upon the Corporation's organizational structure and the information provided to the Chief Executive Officer of the Corporation and, to a lesser extent, the Board of Directors, the operating segments are driven primarily by the Corporation's lines of business for its operations in Puerto Rico, the Corporation's principal market, and by geographic areas for its operations outside of Puerto Rico. As of December 31, 2016, the Corporation had six reportable segments: Commercial and Corporate Banking; Consumer (Retail) Banking; Mortgage Banking; Treasury and Investments; United States operations; and Virgin Islands operations. Management determined the reportable segments based on the internal reporting used to evaluate performance and to assess where to allocate resources. Other factors such as the Corporation's organizational chart, nature of the products, distribution channels and the economic characteristics of the products were also considered in the determination of the reportable segments. For additional information regarding First BanCorp.'s reportable segments, please refer to Note 33 – Segment Information, of the Corporation's audited financial statements for the year ended December 31, 2016 included in Item 8 of this Form 10-K.

The accounting policies of the segments are the same as those described in Note 1 – Nature of Business and Summary of Significant Accounting Policies, of the Corporation's audited financial statements for the year ended December 31, 2016 included in Item 8 of this Form 10-K. The Corporation evaluates the performance of the segments based on net interest income, the provision for loan and lease losses, non-interest income, and direct non-interest expenses. The segments are also evaluated based on the average volume of their interest-earning assets less the allowance for loan and lease losses. In 2016, 2015, and 2014, other operating expenses not allocated to a particular segment amounted to \$101.1 million, \$103.9 million, and \$94.3 million, respectively. Expenses pertaining to corporate administrative functions that support the operating segment but are not specifically attributable to or managed by any segment are not included in the reported financial results of the operating segments. The unallocated corporate expenses include certain general and administrative expenses and related depreciation and amortization expenses.

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

### *Commercial and Corporate Banking*

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. FirstBank has developed expertise in a wide variety of industries. The Commercial and Corporate Banking segment offers commercial loans, including commercial real estate and construction loans, and floor plan financings, as well as other products, such as cash management and business management services. This segment also includes the Corporation's broker-dealer activities, which are primarily concentrated in municipal securities underwriting and selling for local Puerto Rico municipal bond issuers and other investment banking activities, such as advisory services, capital raising efforts on behalf of clients and assistance with financial transaction structuring. A substantial portion of the commercial and corporate banking portfolio is secured by the underlying value of the real estate collateral and the personal guarantees of the borrowers. Since commercial loans involve greater credit risk than a typical residential mortgage loan because they are larger in size and more risk is concentrated in a single borrower, the Corporation has and maintains a credit risk management infrastructure designed to mitigate potential losses associated with commercial lending, including underwriting and loan review functions, sales of loan participations and continuous monitoring of concentrations within portfolios.

The highlights of the Commercial and Corporate Banking segment's financial results for the years ended December 31, 2016, 2015 and 2014 include the following:

- Segment income before taxes for the year ended December 31, 2016 was \$35.3 million compared to a loss of \$15.8 million for 2015 and income of \$69.1 million for 2014.
- Net interest income for the year ended December 31, 2016 was \$96.7 million compared to \$115.8 million and \$150.9 million for the years ended December 31, 2015 and 2014, respectively. The decrease in net interest income for 2016, compared to 2015, was mainly related to a decrease of \$239.5 million in the average balance of commercial and construction loans in Puerto Rico and the adverse impact of large commercial relationships classified as non-performing during 2016. Inflows to non-performing loans during the first quarter of 2016 included the Corporation's exposure to commercial mortgage loans guaranteed by the TDF with a book value of \$111.8 million as of December 31, 2016 for which interest payments collected are now applied against principal. The decrease in net interest income for 2015, compared to 2014, was mainly related to a decrease of \$615.2 million in the average balance

of commercial and construction loans in Puerto Rico and the adverse impact of approximately \$3.8 million in interest payments received in 2015 from the PREPA credit facility accounted for on a cost-recovery basis.

- The provision for loan losses for 2016 was \$28.6 million compared to \$101.6 million and \$40.1 million for 2015 and 2014, respectively. The fluctuations in the provision were driven by the impact in 2015 of both the \$46.9 million charge related to the bulk sale of assets completed in the second quarter of 2015 and a \$35 million increase in the general reserve for commercial loans extended to or guaranteed by the Puerto Rico government (excluding municipalities) due to the migration of certain loans to adverse classification categories in the third quarter of 2015 and adjustments related to increased qualitative reserve factors applied to these loans. Refer to “Provision for Loan and Lease Losses” above and “Risk Management – Allowance for Loan and Lease Losses and Non-performing Assets” below for additional information with respect to the credit quality of the Corporation’s commercial and construction loan portfolio.
- Total non-interest income for the year ended December 31, 2016 amounted to \$7.8 million compared to \$12.5 million and \$5.2 million for the years ended December 31, 2015 and 2014, respectively. The decrease in 2016, compared to 2015, was driven by a \$5.7 million decrease in fees from merchant transactions attributable to this segment related to the sale of merchant contracts completed in the fourth quarter of 2015, including the \$4.2 million portion of the gain on the sale of merchant contracts attributable to this segment. This was partially offset by fee income of \$0.8 million from the broker-dealer subsidiary primarily associated with the sale of large fixed annuities contracts, and the impact in 2015 of the \$0.6 million loss on the sale of a commercial mortgage loan held for sale included as part of the bulk sale of assets. The increase in 2015, compared to 2014, includes the \$4.2 million portion of the gain on the sale of merchant contracts recorded in 2015 attributable to this segment and increases in cash management and overdraft fees on deposit accounts of corporate clients, partially offset by a \$0.5 million decrease in fee income from the broker-dealer subsidiary as a result of underwriting fees on a bond issuance of the Puerto Rico government that took place in the first quarter of 2014, and the aforementioned \$0.6 million loss on the sale of a commercial mortgage loan held for sale included as part of the bulk sale of assets in 2015.

- Direct non-interest expenses for 2016 were \$40.7 million, compared to \$42.5 million in 2015, and \$47.0 million in 2014. The decrease in 2016, compared to 2015, reflects a \$1.8 million decrease related to the portion of the FDIC deposit insurance premium allocated to this segment and a \$0.6 million decrease in employee's compensation and benefits, partially offset by a \$0.9 million increase in the provision for unfunded loan commitments primarily related to a floor plan revolving credit agreement. The decrease in 2015, compared to 2014, reflects a \$6.8 million decrease related to the portion of the FDIC deposit insurance premium allocated to this segment, partially offset by \$1.2 million of professional service fees and OREO losses related to the bulk sale of assets completed in 2015.

### *Consumer (Retail) Banking*

The Consumer (Retail) Banking segment consists of the Corporation's consumer lending and deposit-taking activities conducted mainly through FirstBank's branch network in Puerto Rico. Loans to consumers include auto, boat and personal loans, credit cards and lines of credit. Deposit products include interest bearing and non-interest bearing checking and savings accounts, Individual Retirement Accounts and retail CDs. Retail deposits gathered through each branch of FirstBank's retail network serve as one of the funding sources for the lending and investment activities.

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

Personal loans, credit cards, and, to a lesser extent, marine financing also contribute to interest income generated on consumer lending. Management plans to continue to be active in the consumer loan market, applying the Corporation's strict underwriting standards. Other activities included in this segment are finance leases and insurance activities in Puerto Rico.

The highlights of the Consumer (Retail) Banking segment's financial results for the years ended December 31, 2016, 2015 and 2014 include the following:

- Segment income before taxes for the year ended December 31, 2016 was \$66.2 million compared to \$50.2 million and \$42.2 million for the years ended December 31, 2015 and 2014, respectively.
- Net interest income for the year ended December 31, 2016 was \$168.7 million compared to \$188.4 million and \$208.4 million for the years ended December 31, 2015 and 2014, respectively. The decrease in 2016, compared to

2015, was mainly due to a \$149.7 million decrease in the average balance of consumer loans in Puerto Rico and a decrease in income from funds lent to other business segments due to lower medium-term market interest rates in 2016. The decrease in 2015, compared to 2014, was mainly due to a \$152.1 million decrease in the average volume of consumer loans in Puerto Rico and a \$3.8 million decrease due to the fact that the remaining discount related to a credit card portfolio acquired in 2012 was fully accreted into income in the first half of 2014.

- The provision for loan and lease losses for 2016 decreased by \$12.4 million to \$34.2 million compared to 2015 and decreased by \$33.3 million to \$46.7 million when comparing 2015 with 2014. The decrease in the provision experienced over the last two years reflects improvements in charge-off trends, lower loss severities on auto loans and the overall decrease in the size of this portfolio.

- Non-interest income for the year ended December 31, 2016 was \$44.5 million compared to \$41.9 million and \$40.0 million for the years ended December 31, 2015 and 2014, respectively. The increase in 2016, compared to 2015, reflects increases of \$2.2 million in service charge on deposits, an increase of \$0.7 million in ATM fee income and commissions and an increase of \$1.5 million in insurance commission income, partially offset by a \$2.1 million decrease in merchant-related income due to the sale of merchant contracts in the fourth quarter of 2015. The increase in 2015, compared to 2014, reflects primarily a \$3.1 million increase in service charges on deposits mainly related to the deposits assumed from Doral Bank in 2015 as well as the implementation of new service and transactional fees on certain products beginning in the fourth quarter of 2015.

- Direct non-interest expenses for the year ended December 31, 2016 were \$112.8 million compared to \$133.4 million and \$126.3 million for the years ended December 31, 2015 and 2014, respectively. The decrease for 2016, compared to 2015, was mainly due to a \$2.0 million reduction in processing expenses, primarily related to the sale of merchant contracts in the fourth quarter of 2015, a \$4.4 million decrease in employees' compensation and benefits, a \$3.3 million decrease in business promotion expenses mainly due to lower costs associated with credit card and deposit reward programs, a \$1.9 million decrease in occupancy and equipment costs, a \$4.3 million decrease in professional service fees significantly impacted by costs in 2015 related to the conversion of deposit accounts acquired from Doral Bank to the FirstBank systems, and a \$0.8 million decrease in the FDIC insurance assessment portion allocated to this segment. The increase for 2015, compared to 2014, was mainly due to a \$5.4 million increase in employees' compensation, and a

\$1.4 million increase in occupancy and equipment costs, partially offset by the decrease of \$2.5 million in the FDIC insurance assessment portion allocated to this segment.

### *Mortgage Banking*

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

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

The highlights of the Mortgage Banking segment's financial results for the years ended December 31, 2016, 2015 and 2014 include the following:

- Segment income before taxes for the year ended December 31, 2016 was \$46.0 million compared to \$41.3 million for 2015 and \$35.1 million for 2014.
- Net interest income for the year ended December 31, 2016 was \$89.5 million compared to \$92.7 million and \$78.6 million for the years ended December 31, 2015 and 2014, respectively. The decrease in net interest income in 2016, compared to 2015, was mainly due to lower cash collections on residential non-performing loans and a decrease of \$38.6 million in the average balance of residential mortgage loans in Puerto Rico. The increase in net interest income in 2015, compared to 2014, was mainly related to the acquisition of several loan portfolios from Doral Financial and Doral Bank completed in the second and fourth quarters of 2014 and the first quarter of 2015. The Mortgage Banking portfolio is principally composed of fixed-rate residential mortgage loans tied to long-term interest rates.



- The provision for loan and lease losses for 2016 was \$24.9 million compared to \$30.0 million and \$17.6 million for the years ended December 31, 2015 and 2014, respectively. The decrease in the provision for 2016, compared to 2015, was mainly related to lower delinquency levels, lower charges to the reserve for PCI loans, and the overall decrease in the size of this portfolio. The increase in the provision for 2015, compared to 2014, was driven by several factors including inherent loss severities of loans in late stages of delinquency, decreases in appraised values, the overall decrease in the size of this portfolio and the establishment of a \$4.0 million reserve for PCI loans acquired from Doral Financial in May 2014.
- Non-interest income for the year ended December 31, 2016 was \$19.5 million compared to \$16.0 million and \$13.5 million for the years ended December 31, 2015 and 2014, respectively. The increase in 2016, compared to 2015, was mainly due to higher realized gains on sales of residential mortgage loans in the secondary market attributable to both a higher volume of sales and higher gain margins associated with changes in market interest rates, and realized gains on TBAs MBS forward contracts settled during the year. The increase in 2015, compared to 2014, was mainly due to lower losses on TBAs MBS forward contracts, lower charges related to compensatory fees imposed by government-sponsored entities and an increase in servicing fees tied to a larger portfolio.
- Direct non-interest expenses in 2016 were \$38.2 million compared to \$37.3 million and \$39.4 million in 2015 and 2014, respectively. The increase in 2016, compared to 2015, primarily reflects a \$1.6 million increase in employees' compensation and benefits, a \$0.5 million increase in professional service fees, and a \$0.4 million increase in supplies and printing costs, partially offset by a \$1.1 million decrease associated with the FDIC deposit insurance premium allocated to this segment and a \$0.5 million decrease in losses on OREO operations. The decrease in 2015, compared to 2014, reflects a \$1.4 million decrease associated with the FDIC deposit insurance premium allocated to this segment, a \$0.6 million decrease in losses on OREO operations, and a \$1.0 million decrease related to the national gross receipts tax, partially offset by a \$1.4 million increase in employees' compensation expenses.

*Treasury and Investments*

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

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

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

The highlights of the Treasury and Investments segment's financial results for the years ended December 31, 2016, 2015, and 2014 include the following:

- Segment income before taxes for the year ended December 31, 2016 amounted to \$54.6 million compared to \$6.5 million for 2015 and \$1.1 million for 2014.
- Net interest income for the year ended December 31, 2016 was \$53.2 million compared to net interest income of \$26.2 million and \$6.2 million for the years ended December 31, 2015 and 2014, respectively. The increase in net interest income in 2016, compared to 2015, reflects higher income from funds lent to other business segments associated with increases in short-term market interest rates, the benefit of reduced balances in brokered CDs, and the decrease in interest expense associated with the repayment of \$400 million of repurchase agreements that matured in 2016 and carried an average cost of 3.35%. The increase in net interest income in 2015, compared to 2014, primarily reflects the impact of the declining balances of brokered CDs, the restructuring of repurchase agreements, and the benefit of increases in short-term market rates experienced in the second half of 2015.
- Non-interest income for the year ended December 31, 2016 amounted to \$5.4 million, compared to a non-interest loss of \$15.9 million for the year ended December 31, 2015 and income of \$0.3 million for the year ended December 31, 2014. The non-interest income reported in 2016 consisted mainly of the \$6.1 million gain on sales of U.S. agency MBS, the \$4.2 million gain on the repurchase and cancellation of \$10 million in trust preferred securities, and the \$1.5 million recovery of a residual CMO previously written off, partially offset by OTTI charges on debt securities of \$6.7 million recorded in 2016, primarily on Puerto Rico government debt securities. The loss for 2015 was driven by OTTI charges on Puerto Rico government debt securities of \$15.9 million.

- Direct non-interest expenses for 2016 were \$4.0 million compared to \$3.8 million and \$5.4 million for 2015 and 2014, respectively. The increase in 2016, compared to 2015, reflects, among other things, increases in employees' compensation and benefits and in professional service fees. The decrease in 2015, compared to 2014, was mainly due to a \$0.9 million decrease in legal and consulting fees.

### *United States Operations*

The United States Operations segment consists of all banking activities conducted by FirstBank on the United States mainland. FirstBank provides a wide range of banking services to individual and corporate customers primarily in southern Florida through 11 branches. The United States Operations segment offers an array of both consumer and commercial banking products and services. Consumer banking products include checking, savings and money market accounts, retail CDs, internet banking services, residential mortgages, home equity loans and lines of credit, and automobile loans. Retail deposits, as well as FHLB advances and brokered CDs assigned to this operation serve as funding sources for its lending activities. Deposits gathered through FirstBank's branches in the United States also serve as one of the funding sources for the Corporation's overall lending and investment activities.

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

The highlights of the United States operations segment's financial results for the years ended December 31, 2016, 2015, and 2014 include the following:

- Segment income before taxes for the year ended December 31, 2016 was \$16.1 million compared to \$25.0 million and \$40.8 million for the years ended December 31, 2015 and 2014, respectively.
- Net interest income for the year ended December 31, 2016 was \$41.8 million compared to \$42.9 million and \$37.3 million for the years ended December 31, 2015 and 2014, respectively. The decrease in 2016, compared to 2015, was

mainly due to a decrease in income from funds lent to operating segments in Puerto Rico, partially offset by a \$197.5 million increase in the average balance of total loans in the United States, primarily commercial and residential mortgage loans. The increase in 2015, compared to 2014, was primarily related to an increase of \$97.9 million in the average volume of loans, primarily commercial and residential mortgage loans. The increases also reflect reductions in the average rate paid on deposits, and higher interest charges made to operating segments in Puerto Rico.

- During 2016, a negative provision of \$1.4 million was recorded for this segment, compared to negative provisions of \$8.0 million and \$27.7 million for 2015 and 2014, respectively. The lower negative provision in 2016, compared to 2015, primarily reflects lower reserve releases on commercial and construction loans as the declines in historical loss rates were partially offset by the overall increase in the size of this portfolio. In addition, loan loss recoveries decreased by \$1.6 million. The lower negative provision in 2015, compared to 2014, reflects an \$11.5 million decrease in loan loss recoveries of commercial and construction loans and lower reserve releases on these portfolios.
- Total non-interest income for the year ended December 31, 2016 amounted to \$3.6 million compared to \$2.8 million and \$2.5 million for the years ended December 31, 2015 and 2014, respectively. The increase in 2016, compared to 2015, was mainly due to a \$0.4 million fee recorded as income associated with a terminated credit agreement in which the Bank was committed to purchase a loan participation and the impact in 2015 of a \$0.2 million loss on the sale of fixed assets. The increase in 2015, compared to 2014, was mainly due to a \$0.2 million increase in the gain on sales of residential mortgage loans tied to a higher volume of sales.
- Direct non-interest expenses in 2016 were \$30.7 million compared to \$28.7 million and \$26.6 million for 2015 and 2014, respectively. The increase in 2016, compared to 2015, was mainly due to an increase of \$1.2 million in employees' compensation and benefits, including additional resources in the commercial and corporate banking area, and a \$0.7 million increase in rental expense of offices and premises. The increase in 2015, compared to 2014, was mainly due to an increase in employees' compensation of \$2.0 million, a \$0.6 million increase in OREO-related expenses and a \$0.3 million increase in occupancy and equipment costs, partially offset by a \$0.7 million decrease in the allocation of the FDIC insurance premium expense.

### *Virgin Islands Operations*

The Virgin Islands Operations segment consists of all banking activities conducted by FirstBank in the U.S. and British Virgin Islands, including retail and commercial banking services, with a total of 11 branches currently serving the islands in the USVI of St. Thomas, St. Croix and St. John, and the island of Tortola in the BVI. The Virgin Islands Operations segment is driven by its consumer, commercial lending and deposit-taking activities.

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

The highlights of the Virgin Islands operations' financial results for the years ended December 31, 2016, 2015 and 2014 include the following:

- Segment income before taxes for the year ended December 31, 2016 was \$13.2 million compared to income of \$10.9 million and \$5.1 million for the years ended December 31, 2015 and 2014, respectively.
- Net interest income for the year ended December 31, 2016 was \$34.1 million compared to \$36.3 million and \$36.8 million for the years ended December 31, 2015 and 2014, respectively. The decrease in net interest income in 2016, compared to 2015, was mainly related to a \$35.9 million decrease in the average volume of loans, primarily commercial and industrial loans. The decrease in net interest income in 2015, compared to 2014, was mainly related to a \$12.4 million decrease in the average volume of loans, primarily residential mortgage loans.
- During 2016, a provision of \$0.4 million was recorded for this segment, compared to a provision of \$1.7 million in 2015 and a negative provision of \$0.4 million for 2014. The decrease in the provision for 2016, compared to 2015, was primarily reflected in the commercial and industrial loan portfolio. The increase in the provision for 2015, compared to 2014, was primarily related to a \$0.6 million increase in the provision for residential mortgage loans and the \$1.8 million provision on commercial and industrial loans recorded in 2015.
- Non-interest income for the year ended December 31, 2016 was \$7.1 million, compared to \$10.6 million and \$7.1 million for the years ended December 31, 2015 and 2014, respectively. The decrease in 2016, compared to 2015, was mainly related to a \$3.8 million decrease in merchant-related income, including the impact in 2015 of the \$2.8 million portion of the gain on the sale of merchant contracts attributable to this segment, and the impact in 2015 of a \$0.4 million gain on the sale of a parcel of land, partially offset by a \$0.2 million increase in service charges on deposits in 2016. The increase in 2015, compared to 2014, was mainly related to the aforementioned gain of \$2.8

million gain on the sale of merchant contracts attributable to this segment, and of \$0.4 million on the sale of a parcel of land.

- Direct non-interest expenses for the year ended December 31, 2016 were \$27.6 million compared to \$34.2 million and \$39.3 million for the years ended December 31, 2015 and 2014, respectively. The decrease in 2016, compared to 2015, was mainly due to a \$3.5 million decrease in employees' compensation and benefits, a \$1.8 million decrease in professional service fees, primarily legal and collection expenses related to the resolution of troubled loans, a \$0.8 million decrease in occupancy and equipment costs, a \$0.4 million decrease in processing expenses, primarily related to the sale of merchant contracts, a \$0.4 million decrease related to the portion of the FDIC insurance premium expense allocated to this segment, and a \$0.3 million decrease in business promotion expenses, partially offset by a \$0.5 million increase in losses on OREO operations. The decrease in 2015, compared to 2014, was mainly due to a \$2.6 million decrease in losses on OREO operations, a \$0.6 million decrease related to the allocation of the FDIC insurance premium expense to this segment, and a \$1.5 million decrease in occupancy and equipment costs.

**FINANCIAL CONDITION AND OPERATING DATA ANALYSIS****Financial Condition**

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

(In thousands)	2016	December 31, 2015	2014
<b>ASSETS</b>			
Interest-earning assets:			
Money market and other short-term investments	\$ 667,838	\$ 775,848	\$ 742,929
U.S. and Puerto Rico government obligations	746,890	636,734	514,626
Mortgage-backed securities	1,357,518	1,489,423	1,669,406
FHLB stock	31,449	26,522	27,155
Other investments	1,963	777	320
Total investments	2,805,658	2,929,304	2,954,436
Residential mortgage loans	3,302,519	3,272,464	2,751,366
Construction loans	143,095	169,666	198,450
Commercial loans	3,694,988	3,821,843	4,385,281
Finance leases	229,632	228,709	240,268
Consumer loans	1,526,475	1,670,245	1,806,646
Total loans	8,896,709	9,162,927	9,382,011
Total interest-earning assets	11,702,367	12,092,231	12,336,447
Total non-interest-earning assets <sup>(1)</sup>	687,775	689,322	310,998
Total assets	\$ 12,390,142	\$ 12,781,553	\$ 12,647,445
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>			
Interest-bearing liabilities:			
Interest-bearing checking accounts	\$ 1,073,821	\$ 1,096,087	\$ 1,075,513
Savings accounts	2,503,047	2,533,689	2,426,171
Certificates of deposit	2,367,874	2,294,939	2,296,314
Brokered CDs	1,805,443	2,428,185	3,098,724
Interest-bearing deposits	7,750,185	8,352,900	8,896,722
Other borrowed funds	833,283	997,615	1,131,959
FHLB advances	460,861	349,027	312,575
Total interest-bearing liabilities	9,044,329	9,699,542	10,341,256
Total non-interest-bearing liabilities	1,580,408	1,391,306	1,009,484
Total liabilities	10,624,737	11,090,848	11,350,740
Stockholders' equity:			
Preferred stock	36,104	36,104	46,576
Common stockholders' equity	1,729,301	1,654,601	1,250,129
Stockholders' equity	1,765,405	1,690,705	1,296,705
Total liabilities and stockholders' equity	\$ 12,390,142	\$ 12,781,553	\$ 12,647,445

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





The Corporation's total average assets were \$12.4 billion for the year ended December 31, 2016 compared to \$12.8 billion for 2015, a decrease of \$391.4 million. The variance primarily reflects a decrease of \$266.2 million in the average volume of loans, primarily commercial and consumer loans, and a \$108.0 million decrease in the average balance of interest-earning cash and cash equivalents.

The Corporation's total average liabilities were \$10.6 billion as of December 31, 2016, a decrease of \$466.1 million compared to December 31, 2015. The decrease was mainly related to a \$622.7 million decrease in the average balance of brokered CDs, partially offset by a \$195.2 million increase in the average balance of non-interest bearing deposits.

## Assets

The Corporation's total assets were approximately \$11.9 billion as of December 31, 2016, a decrease of \$650.6 million from December 31, 2015. The decrease was mainly due to a \$452.8 million decrease in cash and cash equivalents, associated with liquidity used to repay maturing brokered CDs and repurchase agreements. In addition, total loans (before the allowance) decreased by \$211.4 million, including a \$110.5 million reduction in consumer loans, primarily auto loans, a \$66.4 million reduction in commercial and construction loans, and a \$34.5 million reduction in residential mortgage loans primarily reflected in the Puerto Rico region.

## Loans Receivable, including Loans Held for Sale

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

	2016	2015	2014	2013	2012
(In thousands)					
Residential mortgage loans (1)(2)	\$ 3,296,031	\$ 3,344,719	\$ 3,011,187	\$ 2,549,008	\$ 2,747,217
Commercial loans:					
Commercial mortgage loans	1,568,808	1,537,806	1,665,787	1,823,608	1,883,798
Construction loans (3)	124,951	156,195	123,480	168,713	361,875
Commercial and Industrial loans	2,180,455	2,246,513	2,317,416	2,621,612	2,676,281

Loans to local financial institutions					
collateralized by real estate mortgages					
(2)	-	-	-	240,072	255,390
Total commercial loans	3,874,214	3,940,514	4,106,683	4,854,005	5,177,344
Finance leases	233,335	229,165	232,126	245,323	236,926
Consumer loans	1,483,293	1,597,984	1,750,419	1,821,196	1,775,751
Total loans held for investment	8,886,873	9,112,382	9,100,415	9,469,532	9,937,238
Less:					
Allowance for loan and lease losses	(205,603)	(240,710)	(222,395)	(285,858)	(435,414)
Total loans held for investment, net	8,681,270	8,871,672	8,878,020	9,183,674	9,501,824
Loans held for sale <sup>(3)</sup>	50,006	35,869	76,956	75,969	85,394
Total loans, net	\$ 8,731,276	\$ 8,907,541	\$ 8,954,976	\$ 9,259,643	\$ 9,587,218

- (1) On February 27, 2015 FirstBank acquired 10 Puerto Rico branches of Doral Bank and acquired, among other things, \$324.8 million in principal balance of loans at acquisition, primarily residential mortgage loans.
- (2) On May 30, 2014, FirstBank acquired from Doral Financial mortgage loans, mainly residential mortgage loans, having an unpaid principal balance at acquisition of \$241.7 million (estimated fair value at acquisition of \$226.0 million) in full satisfaction of secured borrowings with a book value of \$232.9 million owed by Doral Financial to FirstBank. In addition, on October 3, 2014, FirstBank purchased from Doral Bank performing residential mortgage loans with an outstanding unpaid principal balance at acquisition of \$192.6 million.
- (3) During the third quarter of 2015, upon the signing of a new agreement with the borrower, the Corporation changed its intent to sell a \$40.0 million construction-commercial loan in the Virgin Islands. Accordingly, the loan was transferred back from held for sale to held for investment and continues to be classified as a TDR and a non-performing loan.

## Lending Activities

As of December 31, 2016, the Corporation's total loans held for investment, before the allowance, amounted to \$8.9 billion, down \$225.5 million when compared to December 31, 2015. The decline primarily reflects a \$110.5 million decrease in the consumer and finance lease loan portfolio mainly driven by charge-offs and repayments that exceeded the volume of originations, a decrease of \$66.3 million in the commercial and construction loan portfolio and a \$48.7 million decrease in the residential mortgage loan portfolio, which was primarily reflected in the Puerto Rico region. The decrease in the commercial and construction loan portfolio includes reductions of \$195.3 million and \$49.7 million in Puerto Rico and the Virgin Islands, respectively, partially offset by an increase of \$178.7 million in the Florida (U.S.) region, as further discussed below.

As shown in the table above, as of December 31, 2016, the loans held for investment portfolio was comprised of commercial loans (44%), residential real estate loans (37%), and consumer and finance leases (19%). Of the total gross loan portfolio held for investment of \$8.9 billion as of December 31, 2016, approximately 78% had credit risk concentration in Puerto Rico, 15% in the United States (mainly in the state of Florida) and 7% in the Virgin Islands, as shown in the following tables, which also show the credit risk concentration as of December 31, 2015:

<b><u>As of December 31, 2016</u></b> <b>(In thousands)</b>	<b>Puerto Rico</b>	<b>Virgin Islands</b>	<b>United States</b>	<b>Total</b>
Residential mortgage loans	\$ 2,480,076	\$ 314,915	\$ 501,040	\$ 3,296,031
Commercial mortgage loans	1,177,550	79,365	311,893	1,568,808
Construction loans	42,753	44,687	37,511	124,951
Commercial and Industrial loans	1,571,097	139,795	469,563	2,180,455
Total commercial loans	2,791,400	263,847	818,967	3,874,214
Finance leases	233,335	-	-	233,335
Consumer loans	1,383,485	48,958	50,850	1,483,293
Total loans held for investment, gross	\$ 6,888,296	\$ 627,720	\$ 1,370,857	\$ 8,886,873
Loans held for sale	38,423	-	11,583	50,006
Total loans, gross	\$ 6,926,719	\$ 627,720	\$ 1,382,440	\$ 8,936,879

<b><u>As of December 31, 2015</u></b> <b>(In thousands)</b>	<b>Puerto Rico</b>	<b>Virgin Islands</b>	<b>United States</b>	<b>Total</b>
Residential mortgage loans	\$ 2,575,888	\$ 327,976	\$ 440,855	\$ 3,344,719
Commercial mortgage loans	1,208,347	69,773	259,686	1,537,806
Construction loans	63,654	69,874	22,667	156,195
Commercial and Industrial loans	1,714,660	173,916	357,937	2,246,513
Total commercial loans	2,986,661	313,563	640,290	3,940,514

Finance leases	229,165	-	-	229,165
Consumer loans	1,506,773	48,430	42,781	1,597,984
Total loans held for investment, gross	\$ 7,298,487	\$ 689,969	\$ 1,123,926	\$ 9,112,382
Loans held for sale	33,787	507	1,575	35,869
Total loans, gross	\$ 7,332,274	\$ 690,476	\$ 1,125,501	\$ 9,148,251

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

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

	<b>For the Year Ended December 31,</b>				
	<b>2016</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>
(In thousands)					
Beginning balance as of January 1	\$ 8,907,541	\$ 8,954,976	\$ 9,259,643	\$ 9,587,218	\$ 9,974,035
Residential real estate loans originated and purchased (1)	749,653	703,749	826,937	830,959	756,133
Construction loans originated and purchased	19,019	32,604	39,041	57,514	76,822
C&I and commercial mortgage loans originated and purchased	1,601,618	1,734,233	1,842,697	1,608,036	1,224,561
Finance leases originated	87,246	84,978	76,765	104,968	93,700
Consumer loans originated and purchased (2)	780,148	835,719	916,251	1,055,940	1,281,872
Total loans originated and purchased	3,237,684	3,391,283	3,701,691	3,657,417	3,433,088
Loans acquired from Doral Bank	-	311,410	-	-	-
Sales and securitizations of loans	(514,489)	(598,840)	(394,736)	(968,626)	(468,463)
Repayments and prepayments	(2,801,024)	(2,970,373)	(3,483,590)	(2,798,355)	(3,046,987)
Other decreases (3)	(98,436)	(180,915)	(128,032)	(218,011)	(304,455)
Net decrease	(176,265)	(47,435)	(304,667)	(327,575)	(386,817)
Ending balance as of December 31	\$ 8,731,276	\$ 8,907,541	\$ 8,954,976	\$ 9,259,643	\$ 9,587,218
Percentage decrease	(1.98)%	(0.53)%	(3.29)%	(3.42)%	(3.88)%

(1) For 2014, includes the purchase from Doral Bank of \$192.6 million in outstanding principal balance of performing residential mortgage loans.

(2) For 2012, includes the initial carrying value of \$368.9 million related to the credit card portfolio acquired from FIA and

\$226.9 million of subsequent utilization activity on outstanding credit cards.

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

### *Residential Real Estate Loans*

As of December 31, 2016, the Corporation's residential real estate loan portfolio held for investment decreased by \$48.7 million as compared to the balance as of December 31, 2015, mainly resulting from activities in Puerto Rico as principal repayments and charge-offs exceeded the volume of new loans originated and held for investment purposes. The residential mortgage loan portfolio held for investment in Puerto Rico and the Virgin Islands decreased during the year by \$95.8 million and \$13.1 million, respectively, partially offset by an increase of \$60.2 million in Florida.

The majority of the Corporation's outstanding balance of residential mortgage loans consists of fixed-rate, fully amortizing, and full documentation loans. In accordance with the Corporation's underwriting guidelines, residential real estate loans are mostly fully documented loans, and the Corporation does not originate negative amortization loans. Refer to "Contractual Obligations and Commitments" below for additional information about outstanding commitments to sell mortgage loans.

Residential mortgage loan originations and purchases for the year ended December 31, 2016 amounted to \$749.7 million compared to \$703.7 million for 2015 and \$826.9 million for 2014 (including the purchase of \$192.6 million of performing residential mortgage loans from Doral Bank in 2014). These statistics include purchases from mortgage bankers of \$85.0 million for the year ended December 31, 2016, compared to \$91.9 million in 2015 and \$146.5 million in 2014. The higher volume of loan originations in 2016, compared to 2015, includes an increase of \$52.9 million in Puerto Rico, primarily conforming loan originations and refinancings, partially offset by decreases of \$6.6 million and \$0.4 million in the Virgin Islands and Florida, respectively.

#### *Commercial and Construction Loans*

As of December 31, 2016, the Corporation's commercial and construction loan portfolio held for investment decreased by \$66.3 million to \$3.9 billion, as compared to the balance as of December 31, 2015. The decrease in commercial and construction loans includes a reduction of \$195.3 million in Puerto Rico driven by the repayment of several large commercial loans, the sale of a \$20.2 million commercial loan participation, the sale of the \$16.3 million pool of non-performing assets, and charge-offs, including the four large charge-offs totaling \$28.0 million noted above. The commercial and construction loan portfolio in the Virgin Islands decreased

by \$49.7 million primarily related to facilities granted to government entities in the U.S. Virgin Islands. In contrast, the commercial and construction loan portfolio in the Florida region increased by \$178.7 million during 2016. The Corporation has invested in facilities, opened in 2016 its 11th South Florida location and first branch within Miami's Brickell Financial District, has increased its resources dedicated to commercial and corporate banking functions and has invested in technology platforms as the Corporation expects to achieve continued growth in this region.

As of December 31, 2016, the Corporation had \$133.6 million outstanding (book value of \$124.5 million) in loans extended to the Puerto Rico government, its municipalities and public corporations, compared to \$153.2 million outstanding as of December 31, 2015. In addition, the outstanding balance of loans granted to the government of the Virgin Islands amounted to \$84.7 million as of December 31, 2016, compared to \$126.2 million as of December 31, 2015. Approximately \$91.0 million outstanding (\$81.9 million book value) of the granted credit facilities outstanding consisted of loans to public corporations, including the direct exposure to PREPA, with an outstanding balance of \$75 million (\$65.5 million book value) as of December 31, 2016, and approximately \$6.9 million consisted of loans to units of the Puerto Rico central government. The PREPA credit facility was placed in non-accrual status in the first quarter of 2015, and interest payments recorded on a cost-recovery basis. During the first quarter of 2017, the Corporation received an unsolicited offer and sold its outstanding participation in the PREPA line of credit with a book value of \$64 million at the time of sale (principal balance of \$75 million), thereby reducing its direct exposure to the Puerto Rico government. A specific reserve of approximately \$10.2 million had been allocated to this loan. Gross proceeds from the sale of \$53.2 million have resulted in an incremental loss of \$0.6 million as compared to the book value, net of reserve. This loss was recognized at the time of the sale in the first quarter of 2017.

In addition, the Corporation had \$35.7 million of loans extended to municipalities in Puerto Rico, which in most cases are supported by assigned property tax revenues. The vast majority of municipalities' revenues are independent of the Puerto Rico central government. These municipalities are required by law to levy special property taxes in such amounts as are required for the payment of all of their respective general obligation bonds and notes. Late in 2015, the GDB and the Municipal Revenue Collection Center (CRIM) signed and perfected a deed of trust. Through this deed, the GDB, as fiduciary, is bound to keep the CRIM funds separate from any other deposits and must distribute the funds pursuant to applicable law. The CRIM funds are deposited at another commercial depository financial institution in Puerto Rico.

Furthermore, as of December 31, 2016, the Corporation had \$127.7 million outstanding (book value of \$111.8 million) in credit facilities extended to the hotel industry in Puerto Rico under which the borrower and the operations of the underlying collateral are the primary sources of repayment and the TDF provides a secondary guarantee for payment performance, compared to \$129.4 million as of December 31, 2015. These facilities were placed in non-accrual status and classified as impaired in the first quarter of 2016, and interest payments are now applied against principal. Approximately \$2.0 million of interest payments received on loans guaranteed by the TDF since late March 2016 have been applied against principal. The Corporation has been receiving payments on the largest of these three facilities sufficient to cover the monthly contractual payments. This facility matured on February 1, 2017 and is currently under renegotiation. In addition, the borrower's cash flows related to the other two facilities are insufficient to cover debt service and the Corporation is not receiving collections from the TDF guarantee. As such, these two facilities are collateral dependent loans and charge-offs amounting to \$13.9 million were recorded during the second half of 2016, of which \$13.0 million was charged against reserves established in prior periods. These loans have been adversely classified since the third quarter of 2015. As of December 31, 2016, the loans guaranteed by the TDF are

being carried at 72% of unpaid principal balance, net of reserves and accumulated charge-offs. The Corporation measures impairment on these loans based on the fair value of the collateral and the existence of the government guarantee. Developments of the Puerto Rico government debt restructuring process, with the automatic stay on litigations under PROMESA set to expire on May 1, 2017, and actions taken or those that may have to be taken by the Commonwealth or the PROMESA oversight board to address Puerto Rico's fiscal and economic crisis could ultimately adversely affect the value of the Puerto Rico government guarantees, including the TDF guarantee. If as a result of developments, including discussions with regulators, loan rating downgrades, progress in the debt restructuring process, or for other reasons, the Corporation determines that additional impairment charges are necessary, such an action would adversely affect the Corporation's results of operations in the period in which such determination is taken. The Corporation's collections of principal and interest from the TDF in 2016 amounted to \$0.6 million compared to \$5.3 million in 2015.

As of December 31, 2016, the total reserve to book value coverage ratio related to commercial loans extended to or guaranteed by the Puerto Rico government (excluding municipalities) was 17% and the loans are being carried at 74% of unpaid principal balance, net of reserves and accumulated charge offs.

The TDF is a subsidiary of the GDB that facilitates private sector financings to Puerto Rico's hotel industry. Adverse developments related to the Puerto Rico government's fiscal situation introduced additional uncertainty regarding the TDF's ability to honor its guarantee, including the enactment of the Puerto Rico Emergency Moratorium and Financial Rehabilitation Act ("Act 21"). On June 30, 2016, pursuant to Act 21, the Puerto Rico governor ordered a moratorium on the payment of \$780 million of the Puerto Rico government's general obligations and the debt of certain other instrumentalities due on July 1, 2016. The Puerto Rico government has continued to default on general obligation bonds, including the payment due on January 1, 2017. This followed a default on the principal payment of \$367 million of the GDB's notes due on May 1, 2016. Puerto Rico's governor also issued an executive order



intended to protect the GDB's liquidity by allowing withdrawals only to fund necessary costs for essential services such as health, public safety and education services. Recently, the GDB defaulted on a \$28 million payment of interest due to its creditors on August 1, 2016, including interest due on the GDB's bonds held by the Corporation, as further discussed below.

As of December 31, 2016, the Corporation's total exposure to shared national credit ("SNC") loans amounted to \$717.6 million, compared to \$603.1 million as of December 31, 2015. As of December 31, 2016, approximately \$434.3 million of the SNC exposure is in Puerto Rico, including \$71.9 million of the loans guaranteed by the TDF. The increase is primarily related to participated loans originated in 2016 in both Puerto Rico and Florida regions.

Commercial and construction loan originations (excluding government loans) for 2016 amounted to \$1.6 billion compared to \$1.7 billion in 2015, a decrease of \$85.8 million. The decrease reflects a reduction of \$160.0 million in commercial and construction loan originations in Puerto Rico, partially offset by increases of \$68.1 million and \$6.2 million in Florida and the Virgin Islands, respectively.

Government loan originations for 2016 amounted to \$54.8 million compared to \$97.1 million for 2015. The decrease reflects the origination in 2015 of two large facilities in the U.S. Virgin Islands totaling \$43.2 million.

The Corporation has significantly reduced its exposure to construction loans and current originations are mainly draws from existing commitments.

The composition of the Corporation's construction loan portfolio held for investment as of December 31, 2016 by category and geographic location follows:

**As of December 31, 2016**

	<b>Puerto Rico</b>	<b>Virgin Islands</b>	<b>United States</b>	<b>Total</b>
(In thousands)				
Loans for residential housing projects:				
Mid-rise (1)	\$ 1,367	\$ 956	\$ -	\$ 2,323
Single-family, detached	3,259	-	7,401	10,660
Total for residential housing projects	4,626	956	7,401	12,983
Construction loans to individuals secured by residential properties	703	2,040	-	2,743
Loans for commercial projects	8,632	38,880	29,970	77,482
Land loans - residential	17,214	2,818	140	20,172
Land loans - commercial	11,614	-	-	11,614

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Total before net deferred fees and allowance for loan losses	\$ 42,789	\$ 44,694	\$ 37,511	\$ 124,994
Net deferred fees	(36)	(7)	-	(43)
Total construction loan portfolio, gross	42,753	44,687	37,511	124,951
Allowance for loan losses	(1,914)	(642)	(6)	(2,562)
Total construction loan portfolio, net	\$ 40,839	\$ 44,045	\$ 37,505	\$ 122,389

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

The following table presents further information on the Corporation's construction portfolio as of and for the year ended December 31, 2016:

(In thousands)	
Total undisbursed funds under existing commitments	\$ 41,271
Construction loans held for investment in non-accrual status	\$ 49,852
Construction loans held for sale in non-accrual status	\$ 8,079
Net charge offs - Construction loans	\$ 1,454
Allowance for loan losses - Construction loans	\$ 2,562
Non-performing construction loans to total construction loans, including held for sale	43.55%
Allowance for loan losses for construction loans to total construction loans held for investment	2.05%
Net charge-offs to total average construction loans	1.02%

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

(In thousands)	
Construction loan portfolio:	
Under \$300k	\$ 2,584
Over \$600k (1)	2,042
	\$ 4,626

(1) One residential housing project in Puerto Rico.

#### *Consumer Loans and Finance Leases*

As of December 31, 2016, the Corporation's consumer loan and finance lease portfolio decreased by \$110.5 million to \$1.7 billion, as compared to the portfolio balance of \$1.8 billion as of December 31, 2015. The decrease was mainly the result of charge-offs and repayments that exceeded the volume of new originations. The auto and finance lease portfolio decreased by \$82.9 million during 2016. The auto loan and finance lease portfolios in Puerto Rico amounted to \$793.4 million and \$233.3 million, respectively, as of December 31, 2016, compared to \$891.0 million and \$229.2 million, respectively, as of December 31, 2015. The remaining decrease in the consumer loan portfolio was primarily related to a \$14.4 million reduction in the credit card loan portfolio balance, to \$280.6 million as of December 31, 2016, and an \$8.7 million decrease in boat loans, to \$28.1 million as of December 31, 2016.

Originations of auto loans (including finance leases) in 2016 amounted to \$361.9 million, an increase of \$0.6 million, compared to \$361.3 million in 2015. The increase was primarily reflected in Florida and the Virgin Islands with increases of \$6.0 million and \$1.9 million, respectively, partially offset by a \$7.2 million reduction in Puerto Rico.

Personal loan originations, other than credit cards, in 2016 amounted to \$186.8 million compared to \$184.8 million in 2015. The utilization activity on the outstanding credit card portfolio in 2016 amounted to \$318.7 million compared to \$327.4 million in 2015.

## Investment Activities

As part of its liquidity, revenue diversification and interest rate risk strategies, First BanCorp. maintains an investment portfolio that is classified as available for sale or held to maturity. The Corporation's total available-for-sale investment securities portfolio as of December 31, 2016 amounted to \$1.9 billion, a decrease of \$4.5 million from December 31, 2015. The decrease was mainly driven by: (i) sales of approximately \$198.7 million of U.S. agency MBS that carried an average yield of 2.36% (\$204.8 million of cash proceeds including the gain on sales of \$6.1 million), (ii) U.S. agencies MBS prepayments and premium amortization of approximately \$238.9 million and \$8.2 million, respectively, (iii) Private label MBS prepayments of \$5.8 million, and (iv) U.S. agency debt securities matured or called prior to maturity of \$142 million. In addition, the fair value of available-for-sale securities decreased by approximately \$7.2 million during the year ended December 31, 2016.

These decreases were partially offset by purchases of approximately \$604.2 million of securities issued or guaranteed by U.S. agencies during 2016, including: (i) \$136.4 million of U.S. agencies callable debentures, (ii) \$45.8 million of SBA Guarantee Pool certificates, (iii) \$19.9 million of FHLMC guaranteed commercial mortgage-backed securities, (iv) \$39.9 million of collateralized mortgage obligations issued by GNMA, (v) \$357.2 million of U.S. agencies MBS, and (vi) a \$5.0 million bond issued by Farmer Mac.

Approximately 97% of the Corporation's available-for-sale securities portfolio is invested in U.S. Government and Agency debentures and U.S. government sponsored-agency MBS (mainly GNMA, FNMA and FHLMC fixed-rate securities).

During the first quarter of 2016, the Corporation recorded a \$6.3 million credit-related OTTI charge on three Puerto Rico government debt securities held by the Corporation as part of its available-for-sale securities portfolio, specifically bonds of the GDB and the Puerto Rico Public Buildings Authority. This was the third OTTI charge on these securities recorded since June 30, 2015, as OTTI charges of \$12.9 million and \$3.0 million were booked in the second and fourth quarters of 2015, respectively. The GDB and the Puerto Rico Public Buildings Authority bonds held by the Corporation are scheduled to mature on February 1, 2019 and on July 1, 2028, respectively. Pursuant to the Puerto Rico Emergency Moratorium and Financial Rehabilitation Act enacted on April 6, 2016, the Puerto Rico governor issued an executive order imposing a moratorium on the debt service payment required to be paid by the GDB on May 1, 2016. The GDB paid the scheduled interest payment of \$22 million but defaulted on the principal payment of \$367 million of its notes due to other creditors on May 1, 2016 and, on August 1, 2016, the GDB defaulted on a \$28 million payment of interest due to its creditors, including interest due on the GDB's bonds held by the Corporation. Similarly, the Puerto Rico Public Buildings Authority made only a partial payment on its interest payments due on October 1, 2016 and on January 1, 2017.

In the third quarter of 2016, as a result of the defaults, the Corporation discontinued income recognition related to, and placed in non-performing status, the bonds of the GDB and the Puerto Rico Public Buildings Authority held as part of the available-for-sale investment securities portfolio. As of December 31, 2016, the amortized cost of these bonds, including accrued interest of \$0.9 million, was \$35.6 million, recorded on the Corporation's books at their aggregate fair value of \$20.5 million.

In addition to bonds of the GDB and the Puerto Rico Public Buildings Authority, the Corporation owns bonds of the Puerto Rico Housing Finance Authority in the aggregate amount of \$7.9 million that are carried on the Corporation's books at their aggregate fair value of \$6.3 million and are current as to contractual payments as of December 31, 2016.

As of December 31, 2016, the Corporation's held-to-maturity investment securities portfolio amounted to \$156.2 million, down \$5.3 million from December 31, 2015. This decrease was driven by principal repayments received during the year. Held-to-maturity investment securities consist of financing arrangements with Puerto Rico municipalities issued in bond form, accounted for as securities, but underwritten as loans with features that are typically found in commercial loans. These obligations typically are not issued in bearer form, are not registered with the SEC and are not rated by external credit agencies. These bonds have seniority to the payment of operating costs and expenses of the municipality and are supported by assigned property tax revenues. Approximately 87% consist of obligations issued by five of the largest municipalities in Puerto Rico (San Juan, Carolina, Bayamon, Mayaguez and Guaynabo). These municipalities are required by law to levy special property taxes in such amounts as are required for the payment of all of their respective general obligation bonds and loans.

Refer to “Exposure to Puerto Rico Government” discussion below for information and details about the Corporation’s total direct exposure to the Puerto Rico government.

The following table presents the carrying value of investments as of December 31, 2016 and 2015:

(In thousands)	<b>2016</b>	<b>2015</b>
Money market investments	\$ 10,094	\$ 219,473
Investment securities available for sale, at fair value:		
U.S. government and agencies obligations	505,859	460,558
Puerto Rico government obligations	26,828	28,217
Mortgage-backed securities	1,348,725	1,397,520
Other	508	100
Total investment securities available for sale, at fair value	1,881,920	1,886,395
Investment securities held-to-maturity, at amortized cost:		
Puerto Rico Municipal Bonds	156,190	161,483
Other equity securities, including \$40.8 million and \$31.3 million of FHLB stock as of December 31, 2016 and 2015, respectively	42,992	32,169
Total money market and investment securities	\$ 2,091,196	\$ 2,299,520

Mortgage-backed securities as of December 31, 2016 and 2015 consisted of:

(In thousands)	<b>2016</b>	<b>2015</b>
Available-for-sale:		
FHLMC certificates	\$ 315,320	\$ 287,445
GNMA certificates	226,627	301,573
FNMA certificates	727,273	783,195
Collateralized mortgage obligations issued or guaranteed by FHLMC or GNMA	58,812	-
Other mortgage pass-through certificates	20,693	25,307
Total mortgage-backed securities	\$ 1,348,725	\$ 1,397,520

The carrying values of investment securities classified as available for sale and held to maturity as of December 31, 2016 by contractual maturity (excluding mortgage-backed securities and equity securities) are shown below:

(In thousands)	<b>Carrying Amount</b>	<b>Weighted average yield %</b>
U.S. government and agencies obligations		
Due within one year	\$ 7,509	0.57
Due after one year through five years	437,668	1.33
Due after five years through ten years	16,695	1.91
Due after ten years	43,987	1.12
	505,859	1.32
Puerto Rico government and municipality obligations		
Due after one year through five years	10,336	0.27
Due after five years through ten years	10,741	4.47
Due after ten years	161,941	4.37
	183,018	3.91
Other Investment Securities		
Due after one year through five years	100	1.50
Total	688,977	2.05
Mortgage-backed securities	1,348,725	2.49
Equity securities	408	2.44
Total investment securities available for sale and held to maturity	\$ 2,038,110	2.34

Net interest income of future periods could be affected by prepayments of mortgage-backed securities. Acceleration in the prepayments of mortgage-backed securities would lower yields on these securities, as the amortization of premiums paid upon acquisition of these securities would accelerate. Conversely, acceleration of the prepayments of mortgage-backed securities would increase yields on securities purchased at a discount, as the amortization of the discount would accelerate. These risks are directly linked to future period market interest rate fluctuations. Also, net interest income in future periods might be affected by the Corporation's investment in callable securities. As of December 31, 2016, the Corporation had approximately \$145.7 million in debt securities (U.S. Agencies and Puerto Rico government securities) with embedded calls and with an average yield of 1.42%. Refer to "Risk Management" 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 5 – Investment Securities, of the accompanying audited consolidated financial statements included in Item 8 of this Form 10-K for additional information regarding the Corporation's investment portfolio.



*Investment Securities and Loans Receivable Maturities*

The following table presents the maturities or repricings of the loan and investment portfolio as of December 31, 2016:

<b>One Year</b>	<b>2-5 Years</b>		<b>Over 5 Years</b>	
	<b>Fixed Interest</b>	<b>Variable Interest</b>	<b>Fixed</b>	<b>Variable</b>