

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

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, DC 20549**

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**FORM 10-Q**

(Mark One)

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

For the quarterly period ended September 30, 2016

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

COMMISSION FILE NUMBER 1-14793

**First BanCorp.**

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

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Puerto Rico  
(State or other jurisdiction of

66-0561882  
(I.R.S. employer

incorporation or organization)

identification number)

1519 Ponce de León Avenue, Stop 23

00908

Santurce, Puerto Rico

(Zip Code)

(Address of principal executive offices)

(787) 729-8200

(Registrant's telephone number, including area code)

Not applicable

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

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

Yes No

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

Yes No

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

Large accelerated filer

Accelerated filer

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

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

Yes      No

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

Common stock: 217,419,933 shares outstanding as of October 31, 2016.

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**FIRST BANCORP.**

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## Forward Looking Statements

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

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

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

preferred securities;

- a decrease in demand for the Corporation's products and services and lower revenues and earnings because of the continued recession in Puerto Rico;
- uncertainty as to the availability of certain funding sources, such as retail brokered certificates of deposit ("brokered CDs");
- the Corporation's reliance on brokered CDs to fund operations and provide liquidity;
- the risk of not being able to fulfill the Corporation's cash obligations or resume paying dividends to the Corporation's stockholders in the future due to the Corporation's need to receive approval from the New York FED and the Federal Reserve Board to declare or pay any dividends and to take dividends or any other form of payment representing a reduction in capital from FirstBank or FirstBank's failure to generate sufficient cash flow to make a dividend payment to the Corporation;
- the weakness of the real estate markets and of the consumer and commercial sectors and their impact on the credit quality of the Corporation's loans and other assets, which have contributed and may continue to contribute to, among other things, high levels of non-performing assets, charge-offs and provisions for loan and lease losses and may subject the Corporation to further risk from loan defaults and foreclosures;
- the ability of FirstBank to realize the benefits of its deferred tax assets subject to the remaining valuation allowance;
- adverse changes in general economic conditions in Puerto Rico, the U.S., and the U.S. Virgin Islands ("USVI") and British Virgin Islands ("BVI"), including the interest rate environment, market liquidity, housing absorption rates, real estate prices, and disruptions in the U.S. capital markets, which reduced interest margins and affected funding sources, and has affected

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

- an adverse change in the Corporation's ability to attract new clients and retain existing ones;
- the risk that additional portions of the unrealized losses in the Corporation's investment portfolio are determined to be other-than-temporary, including additional impairments on the Puerto Rico government's obligations;
- uncertainty about regulatory and legislative changes for financial services companies in Puerto Rico, the U.S., the USVI and the BVI, which could affect the Corporation's financial condition or performance and could cause the Corporation's actual results for future periods to differ materially from prior results and anticipated or projected results;
- changes in the fiscal and monetary policies and regulations of the U.S. federal government and the Puerto Rico and other governments, including those determined by the Federal Reserve Board, the New York FED, the Federal Deposit Insurance Corporation ("FDIC"), government-sponsored housing agencies, and regulators in Puerto Rico, the USVI and the BVI;
- the risk of possible failure or circumvention of controls and procedures and the risk that the Corporation's risk management policies may not be adequate;
- the risk that the FDIC may increase the deposit insurance premium and/or require special assessments to replenish its insurance fund, causing an additional increase in the Corporation's non-interest expenses;
- the impact on the Corporation's results of operations and financial condition of acquisitions and dispositions;
- a need to recognize impairments on the Corporation's financial instruments, goodwill or other intangible assets relating to acquisitions;
- the risk that downgrades in the credit ratings of the Corporation's long-term senior debt will adversely affect the Corporation's ability to access necessary external funds;

- the impact on the Corporation's businesses, business practices and results of operations of a potential higher interest rate environment; and
- general competitive factors and industry consolidation.

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

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



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

|   | <b>September<br/>30, 2016</b> | <b>December<br/>31, 2015</b> |
|---|-------------------------------|------------------------------|
| (In thousands, except for share information)  |                               |                              |
| <b>ASSETS</b>   |                               |                              |
| Cash and due from banks   | \$ 518,835                    | \$ 532,985                   |
| Money market investments:   |                               |                              |
| Time deposits with other financial institutions   | 2,800                         | 3,000                        |
| Other short-term investments  | 7,308                         | 216,473                      |
| Total money market investments  | 10,108                        | 219,473                      |
| Investment securities available for sale, at fair value:  |                               |                              |
| Securities pledged that can be repledged  | 661,554                       | 793,562                      |
| Other investment securities   | 1,182,299                     | 1,092,833                    |
| Total investment securities available for sale  | 1,843,853                     | 1,886,395                    |
| Investment securities held to maturity, at amortized cost:  |                               |                              |
| Securities pledged that can be repledged  | -                             | -                            |
| Other investment securities   | 156,190                       | 161,483                      |
| Total investment securities held to maturity, fair value of \$132,241 (2015- \$131,544)   | 156,190                       | 161,483                      |
| Other equity securities   | 28,717                        | 32,169                       |
| Loans, net of allowance for loan and lease losses of \$214,070<br>(2015 - \$240,710)  | 8,649,584                     | 8,871,672                    |
| Loans held for sale, at lower of cost or market   | 56,779                        | 35,869                       |
| Total loans, net  | 8,706,363                     | 8,907,541                    |
| Premises and equipment, net   | 154,208                       | 161,016                      |
| Other real estate owned   | 139,446                       | 146,801                      |
| Accrued interest receivable on loans and investments  | 41,439                        | 48,697                       |
| Other assets  | 476,094                       | 476,459                      |
| Total assets  | \$ 12,075,253                 | \$ 12,573,019                |
| <b>LIABILITIES</b>  |                               |                              |
| Non-interest-bearing deposits   | \$ 1,473,528                  | \$ 1,336,559                 |
| Interest-bearing deposits   | 7,507,785                     | 8,001,565                    |
| Total deposits  | 8,981,313                     | 9,338,124                    |
| Securities sold under agreements to repurchase  | 600,000                       | 700,000                      |
| Advances from the Federal Home Loan Bank (FHLB)   | 355,000                       | 455,000                      |
| Other borrowings  | 216,187                       | 226,492                      |
| Accounts payable and other liabilities  | 122,867                       | 159,269                      |
| Total liabilities   | 10,275,367                    | 10,878,885                   |
| <b>STOCKHOLDERS' EQUITY</b>   |                               |                              |
| Preferred stock, authorized, 50,000,000 shares:   |                               |                              |
| Non-cumulative Perpetual Monthly Income Preferred Stock: issued 22,004,000<br>shares, outstanding 1,444,146 shares, aggregate liquidation value of \$36,104 | 36,104                        | 36,104                       |
| Common stock, \$0.10 par value, authorized, 2,000,000,000 shares;   |                               |                              |

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|  |               |               |
|--|---------------|---------------|
| issued, 218,605,179 shares (2015 - 216,051,128 shares issued)                                    | 21,861        | 21,605        |
| Less: Treasury stock (at par value)  | (122)         | (96)          |
| Common stock outstanding, 217,387,647 shares outstanding (2015 - 215,088,698 shares outstanding) | 21,739        | 21,509        |
| Additional paid-in capital   | 930,390       | 926,348       |
| Retained earnings, includes legal surplus reserve of \$42,798                                    | 807,293       | 737,922       |
| Accumulated other comprehensive income (loss), net of tax of \$7,752                             | 4,360         | (27,749)      |
| Total stockholders' equity   | 1,799,886     | 1,694,134     |
| Total liabilities and stockholders' equity   | \$ 12,075,253 | \$ 12,573,019 |

The accompanying notes are an integral part of these statements.

**FIRST BANCORP.**  
**CONSOLIDATED STATEMENTS OF INCOME**  
**(Unaudited)**

|   | <b>Quarter Ended</b> |             | <b>Nine-Month Per</b> |             |
|---|----------------------|-------------|-----------------------|-------------|
|   | <b>September 30,</b> |             | <b>Ended</b>          |             |
|   | <b>2016</b>          | <b>2015</b> | <b>2016</b>           | <b>2015</b> |
| (In thousands, except per share information)  |                      |             |                       |             |
| <b>Interest and dividend income:</b>  |                      |             |                       |             |
| Loans   | \$ 131,017           | \$ 136,597  | \$ 398,267            | \$ 412,000  |
| Investment securities   | 11,894               | 12,805      | 40,065                | 40,000      |
| Money market investments  | 662                  | 410         | 3,006                 | 1,000       |
| Total interest income   | 143,573              | 149,812     | 441,338               | 453,000     |
| <b>Interest expense:</b>  |                      |             |                       |             |
| Deposits  | 16,742               | 16,851      | 51,223                | 51,000      |
| Securities sold under agreements to repurchase  | 5,363                | 5,216       | 16,868                | 16,000      |
| Advances from FHLB  | 1,474                | 955         | 4,416                 | 2,000       |
| Other borrowings  | 1,816                | 1,861       | 5,777                 | 5,000       |
| Total interest expense  | 25,395               | 24,883      | 78,284                | 76,000      |
| Net interest income   | 118,178              | 124,929     | 363,054               | 377,000     |
| <b>Provision for loan and lease losses</b>  |                      |             |                       |             |
| Net interest income after provision for loan and lease losses                             | 96,675               | 93,753      | 299,512               | 238,000     |
| <b>Non-interest income:</b>   |                      |             |                       |             |
| Service charges and fees on deposit accounts  | 5,788                | 5,082       | 17,206                | 14,000      |
| Mortgage banking activities   | 5,485                | 4,270       | 15,131                | 12,000      |
| Net gain on sale of investments   | 6,096                | -           | 6,104                 | -           |
| Other-than-temporary impairment (OTTI) losses on available-for-sale debt securities:      |                      |             |                       |             |
| Total other-than-temporary impairment losses  | -                    | -           | (1,845)               | (29,500)    |
| Portion of other-than-temporary impairment recognized in other comprehensive income (OCI) | -                    | (231)       | (4,842)               | 16,000      |
| Net impairment losses on available-for-sale debt securities                               | -                    | (231)       | (6,687)               | (13,400)    |
| Gain on early extinguishment of debt  | -                    | -           | 4,217                 | -           |
| Insurance commission income   | 1,363                | 1,265       | 6,174                 | 5,000       |
| Bargain purchase gain   | -                    | -           | -                     | 13,000      |
| Other non-interest income   | 7,414                | 8,372       | 22,248                | 24,000      |
| Total non-interest income   | 26,146               | 18,758      | 64,393                | 58,000      |
| <b>Non-interest expenses:</b>   |                      |             |                       |             |
| Employees' compensation and benefits  | 38,005               | 37,284      | 113,841               | 110,000     |
| Occupancy and equipment   | 13,888               | 15,248      | 41,114                | 44,000      |
| Business promotion  | 3,169                | 4,097       | 11,220                | 10,000      |
| Professional fees   | 10,672               | 10,709      | 32,775                | 44,000      |
| Taxes, other than income taxes  | 3,927                | 3,065       | 11,475                | 9,000       |
| Insurance and supervisory fees  | 5,604                | 6,590       | 20,013                | 20,000      |
| Net loss on other real estate owned (OREO) and OREO operations                            | 2,603                | 4,345       | 9,134                 | 11,000      |

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|   |           |           |           |       |
|---|-----------|-----------|-----------|-------|
| Credit and debit card processing expenses             | 3,546     | 4,283     | 10,102    | 12,   |
| Communications  | 1,711     | 2,189     | 5,244     | 5,    |
| Other non-interest expenses                           | 5,178     | 5,467     | 15,926    | 17,   |
| Total non-interest expenses                           | 88,303    | 93,277    | 270,844   | 287,  |
| <b>Income before income taxes</b>                     | 34,518    | 19,234    | 93,061    | 8,    |
| <b>Income tax expense</b>                             | (10,444)  | (4,476)   | (23,690)  | (2,6  |
| <b>Net income</b>                                     | \$ 24,074 | \$ 14,758 | \$ 69,371 | \$ 6, |
| <b>Net income attributable to common stockholders</b> | \$ 24,074 | \$ 14,758 | \$ 69,371 | \$ 6, |
| <b>Net income per common share:</b>                   |           |           |           |       |
| Basic   | \$ 0.11   | \$ 0.07   | \$ 0.33   | \$ 0  |
| Diluted   | \$ 0.11   | \$ 0.07   | \$ 0.32   | \$ 0  |
| <b>Dividends declared per common share</b>            | \$ -      | \$ -      | \$ -      | \$ -  |

The accompanying notes are an integral part of these statements.

**FIRST BANCORP.****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME****(Unaudited)**

|   | <b>Quarter Ended</b>          |             | <b>Nine-Month Period</b>      |             |
|---|-------------------------------|-------------|-------------------------------|-------------|
|   | <b>September 30,<br/>2016</b> | <b>2015</b> | <b>September 30,<br/>2016</b> | <b>2015</b> |
| (In thousands)  |                               |             |                               |             |
| Net income  | \$ 24,074                     | \$ 14,758   | \$ 69,371                     | \$ 6,330    |
| Available-for-sale debt securities on which an other-than-temporary impairment has been recognized:       |                               |             |                               |             |
| Unrealized (loss) gain on debt securities on which an other-than-temporary impairment has been recognized | (2,228)                       | (457)       | (773)                         | 915         |
| Reclassification adjustment for other-than-temporary impairment on debt securities included in net income | -                             | 231         | 6,687                         | 13,484      |
| All other unrealized gains and losses on available-for-sale securities:                                   |                               |             |                               |             |
| Reclassification adjustments for net gain included in net income  | (6,096)                       | -           | (6,104)                       | -           |
| All other unrealized holding (losses) gains on available-for-sale securities arising during the period    | (3,833)                       | 16,935      | 32,299                        | (718)       |
| Other comprehensive (loss) income for the period  | (12,157)                      | 16,709      | 32,109                        | 13,681      |
| Total comprehensive income  | \$ 11,917                     | \$ 31,467   | \$ 101,480                    | \$ 20,011   |

The accompanying notes are an integral part of these statements.

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

|  | <b>Nine-Month Period Ended</b> |                  |
|--|--------------------------------|------------------|
|  | <b>September</b>               | <b>September</b> |
|  | <b>30,</b>                     | <b>30,</b>       |
|  | <b>2016</b>                    | <b>2015</b>      |
| (In thousands)   |                                |                  |
| <b>Cash flows from operating activities:</b>                                       |                                |                  |
| Net income   | \$ 69,371                      | \$ 6,330         |
| Adjustments to reconcile net income to net cash provided by operating activities:  |                                |                  |
| Depreciation and amortization  | 13,359                         | 15,923           |
| Amortization of intangible assets  | 3,669                          | 3,817            |
| Provision for loan and lease losses  | 63,542                         | 138,412          |
| Deferred income tax expense (benefit)  | 19,153                         | (102)            |
| Stock-based compensation   | 5,132                          | 4,535            |
| Gain on sales of investments   | (6,104)                        | -                |
| Bargain purchase gain  | -                              | (13,443)         |
| Gain on early extinguishment of debt   | (4,217)                        | -                |
| Other-than-temporary impairments on debt securities                                | 6,687                          | 13,484           |
| Unrealized loss (gain) on derivative instruments                                   | 19                             | (47)             |
| Net gain on disposition of premises and equipment and other assets                 | (686)                          | (137)            |
| Net gain on sales of loans   | (7,794)                        | (5,312)          |
| Net amortization/accretion of premiums, discounts and deferred loan fees and costs | (6,629)                        | (4,244)          |
| Originations and purchases of loans held for sale                                  | (354,006)                      | (323,565)        |
| Sales and repayments of loans held for sale  | 355,636                        | 329,635          |
| Amortization of broker placement fees  | 2,300                          | 3,564            |
| Net amortization/accretion of premium and discounts on investment securities       | 4,503                          | 6,431            |
| Decrease in accrued interest receivable  | 7,258                          | 3,894            |
| (Decrease) increase in accrued interest payable                                    | (27,865)                       | 3,297            |
| (Increase) decrease in other assets  | (10,275)                       | 8,478            |
| (Decrease) increase in other liabilities   | (13,944)                       | 8,175            |
| Net cash provided by operating activities  | 119,109                        | 199,125          |
| <b>Cash flows from investing activities:</b>                                       |                                |                  |
| Principal collected on loans   | 2,174,933                      | 2,223,880        |
| Loans originated and purchased   | (2,085,444)                    | (2,180,333)      |
| Proceeds from sales of loans held for investment                                   | 20,186                         | 107,702          |
| Proceeds from sales of repossessed assets  | 43,093                         | 48,195           |
| Proceeds from sales of available-for-sale securities                               | 219,780                        | -                |
| Purchases of available-for-sale securities   | (420,513)                      | (161,366)        |
| Purchases of securities held to maturity   | -                              | (4,530)          |
| Proceeds from principal repayments and maturities of available-for-sale securities | 270,345                        | 212,972          |
| Proceeds from principal repayments and maturities of held-to-maturity securities   | 5,293                          | 5,068            |
| Additions to premises and equipment  | (8,239)                        | (9,594)          |
| Net redemptions (purchases) of other equity securities                             | 3,452                          | (567)            |

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|   |            |            |
|---|------------|------------|
| Proceeds from sale of premises and equipment and other assets | 2,265      | 2,511      |
| Net cash received from acquisition                            | -          | 217,659    |
| Net cash outflows from purchase/sale of insurance contracts   | (960)      | -          |
| Net cash provided by investing activities                     | 224,191    | 461,597    |
| <b>Cash flows from financing activities:</b>                  |            |            |
| Net decrease in deposits                                      | (358,930)  | (294,126)  |
| Change in securities sold under agreements to repurchase      | (100,000)  | (200,000)  |
| Repayment of FHLB advances                                    | (100,000)  | -          |
| Repurchase of outstanding common stock                        | (860)      | (967)      |
| Repayment of junior subordinated debentures                   | (7,025)    | -          |
| Net cash used in financing activities                         | (566,815)  | (495,093)  |
| Net (decrease) increase in cash and cash equivalents          | (223,515)  | 165,629    |
| Cash and cash equivalents at beginning of period              | 752,458    | 796,108    |
| Cash and cash equivalents at end of period                    | \$ 528,943 | \$ 961,737 |
| Cash and cash equivalents include:                            |            |            |
| Cash and due from banks                                       | \$ 518,835 | \$ 742,251 |
| Money market instruments                                      | 10,108     | 219,486    |
|   | \$ 528,943 | \$ 961,737 |

The accompanying notes are an integral part of these statements.

**FIRST BANCORP.****CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY****(Unaudited)**

|   | <b>Nine-Month Period Ended</b> |                               |
|---|--------------------------------|-------------------------------|
|   | <b>September 30,<br/>2016</b>  | <b>September 30,<br/>2015</b> |
| (In thousands)  |                                |                               |
| <b>Preferred Stock</b>  | \$ 36,104                      | \$ 36,104                     |
| <b>Common Stock outstanding:</b>                                  |                                |                               |
| Balance at beginning of period                                    | 21,509                         | 21,298                        |
| Common stock issued as compensation                               | 63                             | 33                            |
| Common stock withheld for taxes                                   | (26)                           | (18)                          |
| Common stock issued in exchange for trust preferred securities    | -                              | 85                            |
| Restricted stock grants   | 193                            | 102                           |
| Restricted stock forfeited  | -                              | (2)                           |
| Balance at end of period  | 21,739                         | 21,498                        |
| <b>Additional Paid-In-Capital:</b>                                |                                |                               |
| Balance at beginning of period                                    | 926,348                        | 916,067                       |
| Stock-based compensation  | 5,132                          | 4,535                         |
| Common stock withheld for taxes                                   | (834)                          | (949)                         |
| Common stock issued in exchange for trust preferred securities    | -                              | 5,543                         |
| Restricted stock grants   | (193)                          | (102)                         |
| Common stock issued as compensation                               | (63)                           | (33)                          |
| Restricted stock forfeited  | -                              | 2                             |
| Balance at end of period  | 930,390                        | 925,063                       |
| <b>Retained Earnings:</b>   |                                |                               |
| Balance at beginning of period                                    | 737,922                        | 716,625                       |
| Net income  | 69,371                         | 6,330                         |
| Balance at end of period  | 807,293                        | 722,955                       |
| <b>Accumulated Other Comprehensive Income (Loss), net of tax:</b> |                                |                               |
| Balance at beginning of period                                    | (27,749)                       | (18,351)                      |
| Other comprehensive income, net of tax                            | 32,109                         | 13,681                        |
| Balance at end of period  | 4,360                          | (4,670)                       |
| Total stockholders' equity  | \$ 1,799,886                   | \$ 1,700,950                  |

The accompanying notes are an integral part of these statements.



**FIRST BANCORP.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

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

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

During the second quarter of 2016, the Corporation reviewed its historical accounting treatment as loans 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 transactions as investment securities rather than loans does not have a material effect on previously reported results of operations, financial condition, or cash flows and, accordingly, these financing arrangements have been accounted for and reported as held-to-maturity investment securities and not as loans since the second quarter of 2016.

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

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

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

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

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

In June 2016, the FASB updated the Codification and issued ASU 2016-13, Financial Instruments – Credit Losses (Topic 326), which introduces new guidance for the accounting for credit losses on instruments within its scope. The new guidance introduces an

approach based on expected losses to estimate credit losses on certain types of financial instruments. It also modifies the impairment model for available-for-sale debt securities and provides for a simplified accounting model for purchased financial assets with credit deterioration since their origination.

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

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

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

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

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

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

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

In August 2016, the FASB updated the Codification to provide specific guidance on the classification and presentation of certain cash payments and cash receipts in the statement of cash flows. This guidance is intended to reduce diversity in practice in how certain transactions are classified in the statement of cash flows. The amendments in this Update provide guidance on the following eight specific cash flow issues: (1) Debt Prepayment or Debt Extinguishment Costs: Cash payments for debt prepayment or debt extinguishment costs should be classified as cash outflows for financing activities; (2) Settlement of Zero-Coupon Debt Instruments or Other Debt Instruments with Coupon Interest Rates That Are Insignificant in Relation to the Effective Interest Rate of the Borrowing: At the settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing, the issuer should classify the portion of the cash payment attributable to the accreted interest related to the debt discount as cash outflows for operating activities, and the portion of the cash payment attributable to the principal as cash outflows for financing activities; (3) Contingent Consideration Payments Made after a Business Combination: Cash payments not made soon after the acquisition date of a business combination by an acquirer to settle a contingent consideration

liability should be separated and classified as cash outflows for financing activities and operating activities. Cash payments up to the amount of the contingent consideration liability recognized at the acquisition date (including measurement-period adjustments) should be classified as financing activities; any excess should be classified as operating activities. Cash payments made soon after the acquisition date of a business combination by an acquirer to settle a contingent consideration liability should be classified as cash outflows for investing activities; (4) Proceeds from the Settlement of Insurance Claims: Cash proceeds received from the settlement of insurance claims should be classified on the basis of the related insurance coverage (that is, the nature of the loss). For insurance proceeds that are received in a lump-sum settlement, an entity should determine the classification on the basis of the nature of each loss included in the settlement; (5) Proceeds from the Settlement of Corporate-Owned Life Insurance Policies, including Bank-Owned Life Insurance Policies: Cash proceeds received from the settlement of corporate-owned life insurance policies should be classified as cash inflows from investing activities. The cash payments for premiums on corporate-owned policies may be classified as cash outflows for investing activities, operating activities, or a combination of investing and operating activities; (6) Distributions Received from Equity Method Investees: When a reporting entity applies the equity method, it should make an accounting policy election to classify distributions received from equity method investees using either of the following approaches: a. Cumulative earnings approach: Distributions received are considered returns on investment and classified as cash inflows from operating activities, unless the investor's cumulative distributions received less distributions received in prior periods that were determined to be returns of investment exceed cumulative equity in earnings recognized by the investor. When such an excess occurs, the current-period distribution up to this excess should be considered a return of investment and classified as cash inflows from investing activities. b. Nature of the distribution approach: Distributions received should be classified on the basis of the nature of the activity or activities of the investee that generated the distribution as either a return on investment (classified as cash inflows from operating activities) or a return of investment (classified as cash inflows from investing activities) when such information is available to the investor. If an entity elects to apply the nature of the distribution approach and the information to apply that approach to distributions received from an individual equity method investee is not available to the investor, the entity should report a change in accounting principle on a retrospective basis by applying the cumulative earnings approach in (a) for that investee. In such situations, an entity should disclose that a change in accounting principle has occurred with respect to the affected investee(s) due to the lack of available information and should provide the disclosures required in paragraphs 250-10-50-1(b) and 250-10-50-2, as applicable. This amendment does not address equity method investments measured using the fair value option; (7) Beneficial Interests in Securitization Transactions: A transferor's beneficial interest obtained in a securitization of financial assets should be disclosed as a non cash activity, and cash receipts from payments on a transferor's beneficial interests in securitized trade receivables should be classified as cash inflows from investing activities; (8) Separately Identifiable Cash Flows and Application of the Predominance Principle: The classification of cash receipts and payments that have aspects of more than one class of cash flows should be determined first by applying specific guidance in generally accepted accounting principles (GAAP). In the absence of specific guidance, an entity should determine each separately identifiable source or use within the cash receipts and cash payments on the basis of the nature of the underlying cash flows. An entity should then classify each separately identifiable source or use within the cash receipts and payments on the basis of their nature in financing, investing, or operating activities. In situations in which cash receipts and payments have aspects of more than one class of cash flows and cannot be separated by source or use, the appropriate classification should depend on the activity that is likely to be the predominant source or use of cash flows for the item. For public business entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted. The amendments in this Update should be applied using a retrospective transition method to each period presented. If it is impracticable to apply the amendments retrospectively for some of the issues, the amendments for those issues would be applied prospectively as of the earliest date practicable. The Corporation is currently evaluating the impact of the adoption of this guidance, if any, on its consolidated financial statements.

In October 2016, the FASB updated the Codification to improve the accounting for the income tax consequences of intra-entity transfers of assets other than inventory. With this Update, entities are required to recognize the income tax consequences of an intra-entity transfer of an asset other than inventory, when the transfer occurs. Under current GAAP, the recognition of current and deferred income taxes for an intra-entity assets transfer is prohibited until the assets are sold to an outside party. This Update does not include new disclosure requirements; however, existing disclosure requirements might be applicable when accounting for the current and deferred income taxes for an intra-entity transfer of an asset other than inventory. For example, GAAP requires an entity to disclose a comparison of income tax expense (benefit) with statutory expectations (a rate reconciliation for public entities or a description of the nature of each significant reconciling item for nonpublic entities) and also requires an entity to disclose the types of temporary differences and carryforwards that give rise to a significant portion of deferred income taxes. For public business entities, the amendments in this Update are effective for annual reporting periods beginning after December 15, 2017, including interim reporting periods within those annual reporting periods. Early adoption is permitted for all entities as of the beginning of an annual reporting period for which financial statements (interim or annual) have not been issued or made available for issuance. The Corporation is currently evaluating the impact of the adoption of this guidance, if any, on its consolidated financial statements.

In October 2016, the FASB updated the Codification to modify the criteria used by a reporting entity when determining if it is the primary beneficiary of a variable interest entity (“VIE”) when the entities are under common control and the reporting entity has indirect interests in the VIE through related parties. If the reporting entity meets the first criteria in that it has the power to direct the activities of the VIE that are most significant to its economic performance, it is required to consider all interests held indirectly through related entities in determining if it meets the second criterion, the obligation to absorb losses of the VIE, or the right to receive

benefits from it that are potentially significant to the VIE. The amendments in this Update are effective for public business entities for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. The Corporation is currently evaluating the impact of the adoption of this guidance, if any, on its consolidated financial statements.

## NOTE 2 – EARNINGS PER COMMON SHARE

The calculations of earnings per common share for the quarters and nine-month periods ended September 30, 2016 and 2015 are as follows:

|   | Quarter Ended<br>September 30, |           | Nine-Month Period Ended<br>September 30, |          |
|---|--------------------------------|-----------|--|----------|
|   | 2016                           | 2015      | 2016                                     | 2015     |
| (In thousands, except per share information)        |                                |           |  |          |
| Net income  | \$ 24,074                      | \$ 14,758 | \$ 69,371                                | \$ 6,330 |
| Net income attributable to common stockholders      | \$ 24,074                      | \$ 14,758 | \$ 69,371                                | \$ 6,330 |
| <b>Weighted-Average Shares:</b>                     |                                |           |  |          |
| Average common shares outstanding                   | 212,927                        | 211,820   | 212,682                                  | 211,255  |
| Average potential dilutive common shares            | 3,651                          | 1,963     | 2,577                                    | 1,341    |
| Average common shares outstanding-assuming dilution | 216,578                        | 213,783   | 215,259                                  | 212,596  |
| <b>Earnings per common share:</b>                   |                                |           |  |          |
| Basic   | \$ 0.11                        | \$ 0.07   | \$ 0.33                                  | \$ 0.03  |
| Diluted   | \$ 0.11                        | \$ 0.07   | \$ 0.32                                  | \$ 0.03  |

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

Potential common shares consist of common stock issuable under the assumed exercise of stock options, unvested shares of restricted stock, and outstanding warrants using the treasury stock method. This method assumes that the potential common shares are issued and the proceeds from the exercise, in addition to the amount of compensation cost attributable to future services, are used to purchase common stock at the exercise date. The difference between the number of potential shares issued and the shares purchased is added as incremental shares to the actual number of shares outstanding to compute diluted earnings per share. Stock options, unvested shares of restricted stock, and

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

outstanding warrants that result in lower potential shares issued than shares purchased under the treasury stock method are not included in the computation of dilutive earnings per share since their inclusion would have an antidilutive effect on earnings per share. Stock options not included in the computation of outstanding shares because they were antidilutive amounted to 34,989 and 69,848 as of September 30, 2016 and 2015, respectively.



**NOTE 3 – STOCK-BASED COMPENSATION**

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

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

|   | <b>Number of<br/>Options</b> | <b>Weighted-Average<br/>Exercise Price</b> | <b>Weighted-Average<br/>Remaining<br/>Contractual Term<br/>(Years)</b> | <b>Aggregate<br/>Intrinsic Value<br/>(In thousands)</b> |
|---|------------------------------|--|--|---|
| Beginning of period outstanding and exercisable | 69,848                       | \$ 160.30                                  |  |   |
| Options expired                                 | (34,326)                     | 183.37                                     |  |   |
| Options cancelled                               | (533)                        | 138.00                                     |  |   |
| End of period outstanding and exercisable       | 34,989                       | \$ 138.00                                  | 0.3  | \$ -  |

On May 24, 2016, the Corporation's stockholders approved the amendment and restatement of the First BanCorp Omnibus Incentive Plan, as amended (the "Omnibus Plan"), to, among other things, increase the number of shares of Common Stock reserved for issuance under the Omnibus Plan, to extend the term of the Omnibus Plan to May 24, 2026 and to re-approve the material terms of the performance goals under the Omnibus Plan for purposes of Section 162(m) of the U.S. Internal Revenue Code of 1986, as amended. The Omnibus Plan provides for equity-based compensation incentives (the "awards") through the grant of stock options, stock appreciation rights, restricted stock, restricted stock units, performance shares, cash-based awards and other stock-based awards. The Omnibus Plan authorizes the issuance of up to 14,169,807 shares of common stock, subject to adjustments for stock splits, reorganizations, and other similar events. As of September 30, 2016, 6,924,391 shares of common stock were available for issuance under the Omnibus Plan. The Corporation's Board of Directors, upon receiving the relevant recommendation of the Compensation Committee, has the power and authority to determine those eligible to receive awards and to establish the terms and conditions of any awards, subject to various limits and vesting restrictions that apply to individual and aggregate awards.

Under the Omnibus Plan, during the first nine months of 2016, 130,873 shares of restricted stock were awarded to the Corporation's independent directors subject to a one-year vesting period. Also during the first nine months of 2016, the Corporation issued 1,794,702 shares of restricted stock to employees subject to vesting periods that range from 2 to 3 years. Included in those 1,794,702 shares of restricted stock are 1,546,137 shares granted to certain senior officers consistent with the requirements of the Troubled Asset Relief Program ("TARP") Interim Final Rule, which permit TARP recipients to grant "long-term restricted stock" without violating the prohibition on paying or accruing a bonus

payment provided that: (i) the value of the grant may not exceed one-third of the amount of the employee's annual compensation, (ii) no portion of the grant may vest before two years after the grant date, and (iii) the grant must be subject to a further restriction on transfer or payment as described below. Specifically, the stock that has otherwise vested may not become transferable at any time earlier than as permitted under the schedule set forth by TARP, which is based on the repayment in 25% increments of the aggregate financial assistance received from the U.S. Treasury. Hence, notwithstanding the vesting period mentioned above, the senior officers covered by TARP are restricted from transferring the shares. The U.S. Treasury confirmed that, effective March 2014, it has recovered more than 25% of its investment in First BanCorp. Therefore, the restrictions on transfer relating to 25% of certain shares granted under TARP requirements have been released.

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

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

|   | <b>Nine-Month Period Ended<br/>September 30, 2016</b> |   |
|---|---|---|
|   | <b>Number of shares<br/>of restricted<br/>stock</b>   | <b>Weighted-Average<br/>Grant Date<br/>Fair Value</b> |
| Non-vested shares at beginning of year  | 2,968,461   | \$ 3.34   |
| Granted                                 | 1,925,575   | 1.87  |
| Forfeited                               | (1,000)   | 6.03  |
| Vested                                  | (683,713)   | 3.80  |
| Non-vested shares at September 30, 2016 | 4,209,323   | \$ 2.59   |

For the quarter and nine-month period ended September 30, 2016, the Corporation recognized \$1.0 million and \$2.9 million, respectively, of stock-based compensation expense related to restricted stock awards, compared to \$0.9 million and \$2.9 million for the same periods in 2015. As of September 30, 2016, there was \$4.6 million of total unrecognized compensation cost related to nonvested shares of restricted stock. The weighted average period over which the Corporation expects to recognize such cost is 1.4 years.

During the first nine months of 2015, 219,531 shares of restricted stock were awarded to the Corporation's independent directors subject to vesting periods that range from 1 to 5 years. In addition, during the first nine months of 2015, the Corporation issued 793,964 shares of restricted stock to employees subject to vesting periods that range from 3 months to 3 years. Included in those 793,964 shares of restricted stock are 615,464 shares granted to certain senior officers consistent with the requirements of TARP. The employees covered by TARP are restricted from transferring the shares, subject to certain conditions as explained above.

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

Stock-based compensation accounting guidance requires the Corporation to reverse compensation expense for any awards that were forfeited due to employee or director turnover. Approximately \$5 thousand and \$36 thousand of

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

compensation expense was reversed during the first nine months of 2016 and 2015, respectively, related to forfeited awards.

Also, under the Omnibus Plan, effective April 1, 2013, the Corporation's Board of Directors determined to increase the salary amounts paid to certain executive officers primarily by paying the increased salary amounts in the form of shares of the Corporation's common stock, instead of cash. During the first nine months of 2016, the Corporation issued 629,476 shares of common stock (first nine months of 2015 – 330,254 shares) with a weighted average market value of \$3.60 (first nine months of 2015 – \$5.14) as salary stock compensation. This resulted in a compensation expense of \$2.2 million recorded in the first nine months of 2016 (first nine months of 2015 – \$1.7 million).

For the first nine months of 2016, the Corporation withheld 189,604 shares (first nine months of 2015 – 108,731 shares) from the common stock paid to certain senior officers as additional compensation and 65,498 shares of restricted stock that vested during the first nine months of 2016 (first nine months of 2015 – 72,918) to cover employees' payroll and income tax withholding liabilities; these shares are held as treasury shares. The Corporation paid any fractional share of salary stock that the officer was entitled to in cash. In the consolidated financial statements, the Corporation treats shares withheld for tax purposes as common stock repurchases.

**NOTE 4 – INVESTMENT SECURITIES*****Investment Securities Available for Sale***

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

|  | Amortized<br>cost | Noncredit<br>Loss<br>Component<br>of OTTI<br>Recorded<br>in OCI | September 30, 2016<br>Gross Unrealized |        | Fair value | Weighted<br>average<br>yield % |
|--|-------------------|---|--|--------|------------|--------------------------------|
|  |                   |   | gains                                  | losses |            |                                |
| (Dollars in thousands)                                     |                   |   |  |        |            |                                |
| U.S. Treasury securities:                                  |                   |   |  |        |            |                                |
| Due within one year  | \$ 7,513          | \$ -  | \$ 1                                   | \$ -   | \$ 7,514   | 0.57                           |
| Obligations of U.S.<br>government-sponsored<br>agencies:   |                   |   |  |        |            |                                |
| Due within one year  | 9,629             | -   | 4                                      | -      | 9,633      | 0.70                           |
| After 1 to 5 years   | 496,782           | -   | 3,215                                  | 53     | 499,944    | 1.32                           |
| After 10 years   | 44,724            | -   | 7                                      | 133    | 44,598     | 0.87                           |
| Puerto Rico government<br>obligations:                     |                   |   |  |        |            |                                |
| After 1 to 5 years   | 21,423            | 12,023  | -                                      | -      | 9,400      | 4.38                           |
| After 5 to 10 years  | 845               | -   | 6                                      | -      | 851        | 5.20                           |
| After 10 years   | 21,205            | 3,196   | 116                                    | 1,556  | 16,569     | 5.39                           |
| United States and Puerto<br>Rico<br>government obligations | 602,121           | 15,219  | 3,349                                  | 1,742  | 588,509    | 1.53                           |
| Mortgage-backed securities:                                |                   |   |  |        |            |                                |
| FHLMC certificates:  |                   |   |  |        |            |                                |
| After 5 to 10 years  | 6,314             | -   | 145                                    | -      | 6,459      | 2.31                           |
| After 10 years   | 251,516           | -   | 3,504                                  | 62     | 254,958    | 2.10                           |
|  | 257,830           | -   | 3,649                                  | 62     | 261,417    | 2.10                           |

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

|   |              |           |           |          |              |      |
|---|--------------|-----------|-----------|----------|--------------|------|
| GNMA certificates:  |              |           |           |          |              |      |
| Due within one year   | 1            | -         | -         | -        | 1            | 1.69 |
| After 1 to 5 years  | 93           | -         | 3         | -        | 96           | 3.85 |
| After 5 to 10 years   | 98,314       | -         | 2,557     | -        | 100,871      | 3.05 |
| After 10 years  | 131,216      | -         | 12,532    | -        | 143,748      | 4.37 |
|   | 229,624      | -         | 15,092    | -        | 244,716      | 3.81 |
| FNMA certificates:  |              |           |           |          |              |      |
| After 1 to 5 years  | 22,594       | -         | 452       | -        | 23,046       | 1.99 |
| After 5 to 10 years   | 26,448       | -         | 577       | 19       | 27,006       | 2.06 |
| After 10 years  | 602,540      | -         | 14,534    | 20       | 617,054      | 2.31 |
|   | 651,582      | -         | 15,563    | 39       | 667,106      | 2.29 |
| Collateralized mortgage obligations issued or guaranteed by the FHLMC and GNMA: |              |           |           |          |              |      |
| After 5 to 10 years   | 19,853       | -         | 7         | 33       | 19,827       | 1.18 |
| After 10 years  | 39,530       | -         | 25        | 7        | 39,548       | 1.21 |
|   | 59,383       | -         | 32        | 40       | 59,375       | 1.20 |
| Other mortgage pass-through trust certificates:                                 |              |           |           |          |              |      |
| After 5 to 10 years   | 81           | -         | -         | -        | 81           | 7.20 |
| After 10 years  | 30,606       | 8,476     | -         | -        | 22,130       | 2.37 |
|   | 30,687       | 8,476     | -         | -        | 22,211       | 2.37 |
| Total mortgage-backed securities  | 1,229,106    | 8,476     | 34,336    | 141      | 1,254,825    | 2.48 |
| Other   |              |           |           |          |              |      |
| After 1 to 5 years  | 100          | -         | -         | -        | 100          | 1.50 |
| Equity Securities <sup>(1)</sup>  | 413          | -         | 6         | -        | 419          | 2.15 |
| Total investment securities available for sale                                  |              |           |           |          |              |      |
|   | \$ 1,831,740 | \$ 23,695 | \$ 37,691 | \$ 1,883 | \$ 1,843,853 | 2.17 |

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

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|   | Amortized cost | Noncredit<br>Loss<br>Component<br>of OTTI<br>Recorded<br>in OCI | Gross Unrealized |        | Fair value | Weighted<br>average<br>yield % |
|---|----------------|---|------------------|--------|------------|--------------------------------|
|   |                |   | gains            | losses |            |                                |
| (Dollars in thousands)  |                |   |                  |        |            |                                |
| U.S. Treasury securities:                                     |                |   |                  |        |            |                                |
| After 1 to 5 years  | \$ 7,530       | \$ -  | \$ -             | \$ 33  | \$ 7,497   | 0.57                           |
| Obligations of U.S.<br>government-sponsored<br>agencies:      |                |   |                  |        |            |                                |
| Due within one<br>year  | 14,624         | -   | 4                | 10     | 14,618     | 0.68                           |
| After 1 to 5 years  | 384,323        | -   | 174              | 4,305  | 380,192    | 1.32                           |
| After 5 to 10 years   | 58,150         | -   | 343              | 242    | 58,251     | 2.34                           |
| Puerto Rico Government<br>obligations:                        |                |   |                  |        |            |                                |
| After 1 to 5 years  | 25,663         | 14,662  | -                | -      | 11,001     | 4.38                           |
| After 5 to 10 years   | 855            | -   | -                | -      | 855        | 5.20                           |
| After 10 years  | 23,162         | 5,255   | 134              | 1,680  | 16,361     | 5.40                           |
| United States and Puerto<br>Rico<br>Government<br>obligations | 514,307        | 19,917  | 655              | 6,270  | 488,775    | 1.75                           |
| Mortgage-backed<br>securities:                                |                |   |                  |        |            |                                |
| FHLMC certificates:   |                |   |                  |        |            |                                |
| After 5 to 10 years   | 336            | -   | 31               | -      | 367        | 4.95                           |
| After 10 years  | 287,711        | -   | 1,073            | 1,706  | 287,078    | 2.14                           |
|   | 288,047        | -   | 1,104            | 1,706  | 287,445    | 2.15                           |
| GNMA<br>certificates:   |                |   |                  |        |            |                                |
| Due within one year   | 2              | -   | -                | -      | 2          | 1.70                           |
| After 1 to 5 years  | 109            | -   | 5                | -      | 114        | 4.26                           |
| After 5 to 10 years   | 120,298        | -   | 3,182            | -      | 123,480    | 3.07                           |
| After 10 years  | 165,175        | -   | 12,822           | 20     | 177,977    | 4.38                           |
|   | 285,584        | -   | 16,009           | 20     | 301,573    | 3.83                           |
| FNMA certificates:  |                |   |                  |        |            |                                |
| After 1 to 5 years  | 2,552          | -   | 74               | -      | 2,626      | 3.32                           |
| After 5 to 10 years   | 21,557         | -   | 433              | 233    | 21,757     | 2.73                           |

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

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|   |              |           |           |           |              |      |
|---|--------------|-----------|-----------|-----------|--------------|------|
| After 10 years  | 759,247      | -         | 5,628     | 6,063     | 758,812      | 2.34 |
|   | 783,356      | -         | 6,135     | 6,296     | 783,195      | 2.35 |
| Other mortgage<br>pass-through<br>trust certificates: |              |           |           |           |              |      |
| After 5 to 10 years                                   | 92           | -         | 1         | -         | 93           | 7.26 |
| After 10 years  | 34,905       | 9,691     | -         | -         | 25,214       | 2.26 |
|   | 34,997       | 9,691     | 1         | -         | 25,307       | 2.26 |
| Total mortgage-backed<br>securities                   | 1,391,984    | 9,691     | 23,249    | 8,022     | 1,397,520    | 2.61 |
| Other   |              |           |           |           |              |      |
| After 1 to 5 years                                    | 100          | -         | -         | -         | 100          | 1.50 |
| Total investment securities<br>available for sale     | \$ 1,906,391 | \$ 29,608 | \$ 23,904 | \$ 14,292 | \$ 1,886,395 | 2.38 |

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



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

|  | As of September 30, 2016 |        |                   |           |            |           |
|--|--------------------------|--------|-------------------|-----------|------------|-----------|
|  | Less than 12 months      |        | 12 months or more |           | Total      |           |
|  | Unrealized               |        | Unrealized        |           | Unrealized |           |
|  | Fair Value               | Losses | Fair Value        | Losses    | Fair Value | Losses    |
|  | (In thousands)           |        |                   |           |            |           |
| <b>Debt securities:</b>  |                          |        |                   |           |            |           |
| Puerto Rico Government obligations   | \$ -                     | \$ -   | \$ 21,688         | \$ 16,775 | \$ 21,688  | \$ 16,775 |
| U.S. Treasury and U.S. government agencies obligations                     | 60,970                   | 186    | -                 | -         | 60,970     | 186       |
| <b>Mortgage-backed securities:</b>   |                          |        |                   |           |            |           |
| FNMA   | 18,245                   | 39     | -                 | -         | 18,245     | 39        |
| FHLMC  | 54,269                   | 62     | -                 | -         | 54,269     | 62        |
| Collateralized mortgage obligations issued or guaranteed by FHLMC and GNMA | 31,896                   | 40     | -                 | -         | 31,896     | 40        |
| Other mortgage pass-through trust certificates                             | -                        | -      | 22,130            | 8,476     | 22,130     | 8,476     |
| <b>Equity securities</b>   | 2                        | -      | -                 | -         | 2          | -         |
|  | \$ 165,382               | \$ 327 | \$ 43,818         | \$ 25,251 | \$ 209,200 | \$ 25,578 |

|  | As of December 31, 2015 |          |                   |           |              |           |
|--|-------------------------|----------|-------------------|-----------|--------------|-----------|
|  | Less than 12 months     |          | 12 months or more |           | Total        |           |
|  | Unrealized              |          | Unrealized        |           | Unrealized   |           |
|  | Fair Value              | Losses   | Fair Value        | Losses    | Fair Value   | Losses    |
|  | (In thousands)          |          |                   |           |              |           |
| <b>Debt securities:</b>                                |                         |          |                   |           |              |           |
| Puerto Rico Government obligations                     | \$ -                    | \$ -     | \$ 23,008         | \$ 21,597 | \$ 23,008    | \$ 21,597 |
| U.S. Treasury and U.S. government agencies obligations | 198,243                 | 929      | 210,504           | 3,661     | 408,747      | 4,590     |
| <b>Mortgage-backed securities:</b>                     |                         |          |                   |           |              |           |
| FNMA   | 437,305                 | 4,516    | 88,013            | 1,780     | 525,318      | 6,296     |
| FHLMC  | 141,890                 | 1,338    | 19,306            | 368       | 161,196      | 1,706     |
| GNMA   | 1,047                   | 20       | -                 | -         | 1,047        | 20        |
| Other mortgage pass-through trust certificates         | -                       | -        | 25,214            | 9,691     | 25,214       | 9,691     |
|  | \$ 778,485              | \$ 6,803 | \$ 366,045        | \$ 37,097 | \$ 1,144,530 | \$ 43,900 |

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



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

Debt securities issued by U.S. government agencies, U.S. government-sponsored entities and the U.S. Treasury accounted for approximately 97% of the total available-for-sale portfolio as of September 30, 2016 and no credit losses are expected, given the explicit and implicit guarantees provided by the U.S. federal government. The Corporation's OTTI assessment was concentrated mainly on available-for-sale Puerto Rico Government debt securities, with an amortized cost of \$43.5million, and on private label mortgage-backed securities ("MBS") with an amortized cost of \$30.6 million, and for which credit losses are evaluated on a quarterly basis. The Corporation considered the following factors in determining whether a credit loss exists and the period over which the debt security is expected to recover:

- The length of time and the extent to which the fair value has been less than the amortized cost basis;
- Any adverse change to the credit conditions and liquidity of the issuer, taking into consideration the latest information available about the financial condition of the issuer, credit ratings, the failure of the issuer to make scheduled principal or interest payments, recent legislation and government actions affecting the issuer's industry and actions taken by the issuer to deal with the present economic climate;
- Changes in the near term prospects of the underlying collateral of a security, if any, such as changes in default rates, loss severity given default, and significant changes in prepayment assumptions; and
- The level of cash flows generated from the underlying collateral, if any, supporting the principal and interest payments of the debt securities.

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

|  | Quarter Ended         |                       | Nine-Month Period Ended |                       |
|--|-----------------------|-----------------------|-------------------------|-----------------------|
|  | September 30,<br>2016 | September 30,<br>2015 | September 30,<br>2016   | September 30,<br>2015 |
| (In thousands)   |                       |                       |                         |                       |
| Total other-than-temporary impairment losses                 | \$ -                  | \$ -                  | \$ (1,845)              | \$ (29,521)           |
| Portion of other-than-temporary impairment recognized in OCI | -                     | (231)                 | (4,842)                 | 16,037                |
| Net impairment losses recognized in earnings (1)             | \$ -                  | \$ (231)              | \$ (6,687)              | \$ (13,484)           |

- (1) For the nine-month periods ended September 30, 2016 and 2015, approximately \$6.3 million and \$12.9 million, respectively, of the credit impairment recognized in earnings consisted of credit losses on Puerto Rico Government debt securities and \$0.4 million and \$0.6 million, respectively, was associated with credit losses on private label MBS.



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

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

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

| <b>Cumulative OTTI credit losses recognized in earnings on securities still held</b> |                    |                    |                      |
|--|--------------------|--------------------|----------------------|
|  | <b>Credit</b>      | <b>Credit</b>      |                      |
|  | <b>impairments</b> | <b>impairments</b> |                      |
| <b>June 30,</b>  |                    |                    | <b>September 30,</b> |
|  |                    |                    |                      |

|   | <b>2015</b>    | <b>recognized in earnings</b>                | <b>recognized in earnings on securities that have</b> | <b>2015</b>    |
|---|----------------|--|---|----------------|
|   | <b>Balance</b> | <b>on securities not previously impaired</b> | <b>been previously impaired</b>                       | <b>Balance</b> |
| (In thousands)  |                |  |   |                |
| Available-for-sale securities                                   |                |  |   |                |
| Puerto Rico Government obligations                              | \$ 12,856      | \$ -   | \$ -  | \$ 12,856      |
| Private label MBS   | 6,174          | -  | 231   | 6,405          |
| Total OTTI credit losses for available-for-sale debt securities | \$ 19,030      | \$ -   | \$ 231  | \$ 19,261      |

**Cumulative OTTI credit losses recognized in earnings on securities still held**

|   | <b>December 31,</b> | <b>Credit impairments recognized in earnings</b> | <b>Credit impairments recognized in earnings on securities that have</b> | <b>September 30,</b> |
|---|---------------------|--|--|----------------------|
|   | <b>2014</b>         | <b>on securities not previously impaired</b>     | <b>been previously impaired</b>  | <b>2015</b>          |
|   | <b>Balance</b>      | <b>on securities not previously impaired</b>     | <b>been previously impaired</b>  | <b>Balance</b>       |
| (In thousands)  |                     |  |  |                      |
| Available-for-sale securities                                   |                     |  |  |                      |
| Puerto Rico Government obligations                              | \$ -                | \$ 12,856  | \$ -   | \$ 12,856            |
| Private label MBS   | 5,777               | -  | 628  | 6,405                |
| Total OTTI credit losses for available-for-sale debt securities | \$ 5,777            | \$ 12,856  | \$ 628   | \$ 19,261            |

In the first quarter of 2016, the Corporation recorded a \$6.3million OTTI charge on three Puerto Rico Government debt securities held by the Corporation as part of its available-for-sale securities portfolio, specifically bonds of the GDB maturing on February 1, 2019 and the Puerto Rico Public Buildings Authority maturing on July 1, 2028. This was the third OTTI charge on these securities recorded since June 30, 2015, as OTTI charges of \$12.9 million and \$3.0 million were booked in the second and fourth quarters of 2015, respectively, and reduced the amortized cost basis of these three Puerto Rico Government debt securities to \$35.6million as of September 30, 2016, including accrued interest of \$0.9 million.

During the first nine months of 2016, in consideration of the latest available information about the Puerto Rico Government's financial condition, including the enactment of a debt moratorium law and the declaration of a state of emergency at the GDB, the issuance of the GDB and the Commonwealth's audited financial statements for the fiscal year ended June 30, 2014, as well as the issuance of exchange proposals with the Commonwealth's creditors related to its outstanding bond obligations, the Corporation applied a discounted cash flow analysis to its Puerto Rico Government debt securities in order to calculate the cash flows expected to be collected and to determine if any portion of the decline in market value of these securities was considered a credit-related other-than-temporary impairment. The analysis derives an estimate of value based on the present value of risk-adjusted cash flows of the underlying securities and included the following components:

- The contractual future cash flows of the bonds are projected based on the key terms as set forth in the official statements for each security. Such key terms include, among others, the interest rate, amortization schedule, if any, and maturity date.
- The risk-adjusted cash flows are calculated based on a probability of default analysis and recovery rate assumptions, including the weighting of different scenarios of ultimate recovery, considering the credit rating of each security. Constant monthly default rates are assumed throughout the life of the bonds, which considers the respective security's credit rating as of the date of the analysis.
- The adjusted future cash flows are then discounted at the original effective yield of each investment based on the purchase price and expected risk-adjusted future cash flows as of the purchase date of each investment.

The discounted risk-adjusted cash flow analysis for the three Puerto Rico Government bonds mentioned above assumed a default probability of 100%, thus reflecting that it is more likely than not that these three bonds will default during their remaining terms. Based on this analysis, the Corporation determined that it is unlikely to receive all of the remaining contractual interest and principal amounts when due on these bonds and recorded, in the first quarter of 2016, other-than-temporary credit-related impairment charges amounting to \$6.3 million, assuming recovery rates ranging from 35% to 80% (with a weighted average of 61%). On August 1, 2016, the GDB defaulted on a \$28 million payment of interest due to its creditors, including interest due on bonds held by the Corporation. Similarly, the Puerto Rico Public Building Authority made only a partial payment on its interest payment due on October 1, 2016. In the third quarter of 2016, as a result of the recent defaults, the Corporation discontinued income recognition related to,

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

and placed in non-performing status, the bonds of the GDB and the Puerto Rico Public Building Authority. As of September 30, 2016, the amortized cost of these bonds, including accrued interest of \$0.9 million, was \$35.6 million (\$22.3 million of GDB bonds and \$13.3 million of Puerto Rico Public Buildings Authority bonds), recorded at their aggregate fair value of \$19.5 million (\$9.4 million of GDB bonds and \$10.1 million of Puerto Rico Public Buildings Authority bonds).

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

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

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

|                                | September 30, 2016 |                 | December 31, 2015 |                 |
|--------------------------------|--------------------|-----------------|-------------------|-----------------|
|                                | Weighted Average   | Range           | Weighted Average  | Range           |
| Discount rate                  | 13.3%              | 12.03% - 13.58% | 14.5%             | 14.5%           |
| Prepayment rate                | 13.7%              | 6.5% - 22.5%    | 25%               | 15.92% - 31.25% |
| Projected Cumulative Loss Rate | 4%                 | 0.2% - 9.1%     | 4%                | 0.18% - 6.66%   |



**Investments Held to Maturity**

The amortized cost, gross unrealized gains and losses, approximate fair value, weighted-average yield and contractual maturities of investment securities held to maturity as of September 30, 2016 and December 31, 2015 were as follows:

|  |    | <b>September 30, 2016</b> |   |           |                   | <b>Weighted<br/>average<br/>yield %</b> |
|--|----|---------------------------|---|-----------|-------------------|---|
|  |    | <b>Amortized cost</b>     | <b>Gross Unrealized<br/>gains                      losses</b> |           | <b>Fair value</b> |   |
| Puerto Rico Municipal Bonds:                 |    |                           |   |           |                   |   |
| After 1 to 5 years                           | \$ | 1,136                     | \$ -  | \$ 27     | \$ 1,109          | 5.38                                    |
| After 5 to 10 years                          |    | 10,741                    | -   | 782       | 9,959             | 4.41                                    |
| After 10 years                               |    | 144,313                   | -   | 23,140    | 121,173           | 4.66                                    |
| Total investment securities held to maturity | \$ | 156,190                   | \$ -  | \$ 23,949 | \$ 132,241        | 4.65                                    |

|  |    | <b>December 31, 2015</b> |   |           |                   | <b>Weighted<br/>average<br/>yield %</b> |
|--|----|--------------------------|---|-----------|-------------------|---|
|  |    | <b>Amortized cost</b>    | <b>Gross Unrealized<br/>gains                      losses</b> |           | <b>Fair value</b> |   |
| Puerto Rico Municipal Bonds:                 |    |                          |   |           |                   |   |
| After 1 to 5 years                           | \$ | 1,371                    | \$ -  | \$ 37     | \$ 1,334          | 5.38                                    |
| After 5 to 10 years                          |    | 11,523                   | -   | 1,041     | 10,482            | 4.25                                    |
| After 10 years                               |    | 148,589                  | -   | 28,861    | 119,728           | 4.64                                    |
| Total investment securities held to maturity | \$ | 161,483                  | \$ -  | \$ 29,939 | \$ 131,544        | 4.62                                    |

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

|                             | As of September 30, 2016 |                   |                   |                   |            |                   |
|-----------------------------|--------------------------|-------------------|-------------------|-------------------|------------|-------------------|
|                             | Less than 12 months      |                   | 12 months or more |                   | Total      |                   |
|                             | Fair Value               | Unrealized Losses | Fair Value        | Unrealized Losses | Fair Value | Unrealized Losses |
|                             | (In thousands)           |                   |                   |                   |            |                   |
| <b>Debt securities:</b>     |                          |                   |                   |                   |            |                   |
| Puerto Rico Municipal Bonds | \$ -                     | \$ -              | \$ 132,241        | \$ 23,949         | \$ 132,241 | \$ 23,949         |

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

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

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

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

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

**NOTE 5 – OTHER EQUITY SECURITIES**

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

As of September 30, 2016 and December 31, 2015, the Corporation had investments in FHLB stock with a book value of \$26.6 million and \$31.3 million, respectively. The net realizable value is a reasonable proxy for the fair value of these instruments. Dividend income from FHLB stock for the quarters ended September 30, 2016 and 2015 was \$0.4 million and \$0.3 million, respectively, and for the nine-month periods ended September 30, 2016 and 2015 was \$1.1 million and \$0.8 million, respectively.

The shares of FHLB stock owned by the Corporation were issued by the FHLB of New York. The FHLB of New York is part of the Federal Home Loan Bank System, a national wholesale banking network of 11 regional, stockholder-owned congressionally chartered banks. The Federal Home Loan Banks are all privately capitalized and operated by their member stockholders. The system is supervised by the Federal Housing Finance Agency, which ensures that the Federal Home Loan Banks operate in a financially safe and sound manner, remain adequately capitalized and able to raise funds in the capital markets, and carry out their housing finance mission.

The Corporation has other equity securities that do not have a readily available fair value. The carrying value of such securities as of September 30, 2016 and December 31, 2015 was \$2.1 million and \$0.9 million, respectively.

**NOTE 6 – LOANS HELD FOR INVESTMENT**

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

|   | <b>As of</b>         |    | <b>As of</b>        |
|---|----------------------|----|---------------------|
|   | <b>September 30,</b> |    | <b>December 31,</b> |
|   | <b>2016</b>          |    | <b>2015</b>         |
| (In thousands)  |                      |    |                     |
| Residential mortgage loans, mainly secured by first mortgages | \$ 3,299,942         | \$ | 3,344,719           |

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|                                     |    |           |    |           |
|-------------------------------------|----|-----------|----|-----------|
| Commercial loans:                   |    |           |    |           |
| Construction loans                  |    | 124,298   |    | 156,195   |
| Commercial mortgage loans           |    | 1,545,014 |    | 1,537,806 |
| Commercial and Industrial loans (1) |    | 2,167,011 |    | 2,246,513 |
| Total commercial loans              |    | 3,836,323 |    | 3,940,514 |
| Finance leases                      |    | 229,577   |    | 229,165   |
| Consumer loans                      |    | 1,497,812 |    | 1,597,984 |
| Loans held for investment           |    | 8,863,654 |    | 9,112,382 |
| Allowance for loan and lease losses |    | (214,070) |    | (240,710) |
| Loans held for investment, net      | \$ | 8,649,584 | \$ | 8,871,672 |

(1)As of September 30, 2016 and December 31, 2015, includes \$949.9 million and \$1.0 billion, respectively, of commercial loans that are secured by real estate but are not dependent upon the real estate for repayment.

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

| (In thousands)                                     | <b>September 30,<br/>2016</b> | <b>December 31,<br/>2015</b> |
|--|-------------------------------|------------------------------|
| Non-performing loans:                              |                               |                              |
| Residential mortgage                               | \$ 162,201                    | \$ 169,001                   |
| Commercial mortgage                                | 191,449                       | 51,333                       |
| Commercial and Industrial                          | 137,016                       | 137,051                      |
| Construction:                                      |                               |                              |
| Land   | 11,761                        | 12,174                       |
| Construction-commercial                            | 36,953                        | 39,466                       |
| Construction-residential                           | 2,053                         | 2,996                        |
| Consumer:  |                               |                              |
| Auto loans   | 14,615                        | 17,435                       |
| Finance leases                                     | 1,969                         | 2,459                        |
| Other consumer loans                               | 8,695                         | 10,858                       |
| Total non-performing loans held for investment (1) | \$ 566,712                    | \$ 442,773                   |
| (2)(3)   |                               |                              |

- (1) As of September 30, 2016 and December 31, 2015, excludes \$8.1 million of non-performing loans held for sale.
- (2) Amount excludes purchased-credit impaired ("PCI") loans with a carrying value of approximately \$168.1 million and \$173.9 million as of September 30, 2016 and December 31, 2015, respectively, primarily mortgage loans acquired from Doral Bank in the first quarter of 2015 and from Doral Financial in the second quarter of 2014, as further discussed below. These loans are not considered non-performing due to the application of the accretion method, under which these loans will accrete interest income over the remaining life of the loans using an estimated cash flow analysis.
- (3) Non-performing loans exclude \$415.9 million and \$414.9 million of Troubled Debt Restructuring ("TDR") loans that are in compliance with modified terms and in accrual status as of September 30, 2016 and December 31, 2015, respectively.

### ***Loans in Process of Foreclosure***

As of September 30, 2016, the recorded investment of residential mortgage loans collateralized by residential real estate property that are in the process of foreclosure amounted to \$135.0 million. The Corporation commences the foreclosure process on residential real estate loans when a borrower becomes 120 days delinquent in accordance with the guidelines of the Consumer Financial Protection Bureau (CFPB). Foreclosure procedures and timelines vary depending on whether the property is located in a judicial or non-judicial state. Judicial states (Puerto Rico) require the foreclosure to be processed through the state's court while foreclosures in non-judicial states are processed without court intervention. Foreclosure timelines vary according to state law and Investor Guidelines. Occasionally, foreclosures may be delayed due to mandatory mediations, bankruptcy proceedings, court delays and title issues, among other reasons.



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

| As of<br>September<br>30, 2016<br>(In thousands)   | 30-59<br>Days Past<br>Due | 60-89<br>Days Past<br>Due | 90 days<br>or<br>more<br>Past<br>Due<br>(1) | Total<br>Past Due | Purchased<br>Credit-Impaired<br>Loans | Current      | Total loans<br>held for<br>investment | 90 days<br>past due<br>and still<br>accruing<br>(2) |
|--|---------------------------|---------------------------|---|-------------------|---------------------------------------|--------------|---------------------------------------|---|
| Residential<br>mortgage:<br>FHA/VA<br>and other<br>government-guaranteed<br>loans (2) (3)<br>(4) | -                         | \$ 5,310                  | \$ 81,677                                   | \$ 86,987         | \$ -                                  | \$ 44,949    | \$ 131,936                            | \$ 81,677   |
| Other<br>residential<br>mortgage<br>loans (4)  | -                         | 87,425                    | 179,648                                     | 267,073           | 165,014                               | 2,735,919    | 3,168,006                             | 17,447  |
| Commercial:<br>Commercial<br>and Industrial<br>loans   | 44,967                    | 500                       | 138,484                                     | 183,951           | -                                     | 1,983,060    | 2,167,011                             | 1,468   |
| Commercial<br>mortgage<br>loans (4)  | -                         | 3,436                     | 196,240                                     | 199,676           | 3,127                                 | 1,342,211    | 1,545,014                             | 4,791   |
| Construction:<br>Land (4)  | -                         | 765                       | 12,137                                      | 12,902            | -                                     | 20,495       | 33,397                                | 376   |
| Construction-commercial-<br>(4)  | -                         | -                         | 36,953                                      | 36,953            | -                                     | 38,460       | 75,413                                | -   |
| Construction-residential<br>(4)  | -                         | -                         | 2,721                                       | 2,721             | -                                     | 12,767       | 15,488                                | 668   |
| Consumer:<br>Auto loans  | 63,470                    | 13,743                    | 14,615                                      | 91,828            | -                                     | 766,969      | 858,797                               | -   |
| Finance<br>leases  | 8,199                     | 2,312                     | 1,969                                       | 12,480            | -                                     | 217,097      | 229,577                               | -   |
| Other<br>consumer<br>loans   | 8,192                     | 4,824                     | 12,806                                      | 25,822            | -                                     | 613,193      | 639,015                               | 4,111   |
| Total loans<br>held for<br>investment  | \$ 124,828                | \$ 118,315                | \$ 677,250                                  | \$ 920,393        | \$ 168,141                            | \$ 7,775,120 | \$ 8,863,654                          | \$ 110,538  |

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

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charged-off at 180 days.

- (2) It is the Corporation's policy to report delinquent residential mortgage loans insured by the FHA or guaranteed by the VA as past-due loans 90 days and still accruing as opposed to non-performing loans since the principal repayment is insured. These balances include \$29.6 million of residential mortgage loans insured by the FHA or guaranteed by the VA, which are over 15 months delinquent and are no longer accruing interest as of September 30, 2016.
- (3) As of September 30, 2016, includes \$45.6 million of defaulted loans collateralizing Government National Mortgage Association ("GNMA") securities for which the Corporation has an unconditional option (but not an obligation) to repurchase the defaulted loans.
- (4) According to the Corporation's delinquency policy and consistent with the instructions for the preparation of the Consolidated Financial Statements for Bank Holding Companies (FR Y-9C) required by the Federal Reserve Board, residential mortgage, commercial mortgage, and construction loans are considered past due when the borrower is in arrears two or more monthly payments. FHA/VA government-guaranteed loans, other residential mortgage loans, commercial mortgage loans, land loans and construction-residential loans past due 30-59 days as of September 30, 2016 amounted to \$8.7 million, \$144.3 million, \$7.6 million, \$0.7 million and \$0.3 million, respectively.

**As of  
December 31,  
2015**

| (In thousands)   | <b>30-59<br/>Days<br/>Past Due</b> | <b>60-89<br/>Days Past<br/>Due</b> | <b>90 days<br/>or more<br/>Past Due<br/>(1)</b> | <b>Total<br/>Past<br/>Due</b> | <b>Purchased<br/>Credit-<br/>Impaired<br/>Loans</b> | <b>Current</b> | <b>Total loans<br/>held for<br/>investment</b> | <b>90 days<br/>past due<br/>and still<br/>accruing<br/>(2)</b> |
|--|------------------------------------|------------------------------------|---|-------------------------------|---|----------------|--|--|
| Residential mortgage:                                    |                                    |                                    |   |                               |   |                |  |  |
| FHA/VA and other government-guaranteed loans (2) (3) (4) | \$ -                               | \$ 6,048                           | \$ 90,168                                       | \$ 96,216                     | \$ -  | \$ 46,925      | \$ 143,141                                     | \$ 90,168  |
| Other residential mortgage loans (4)                     | -                                  | 90,406                             | 185,018   | 275,424                       | 170,766   | 2,755,388      | 3,201,578                                      | 16,017   |
| Commercial:  |                                    |                                    |   |                               |   |                |  |  |
| Commercial and Industrial loans                          | 5,577                              | 6,412                              | 150,893   | 162,882                       | -   | 2,083,631      | 2,246,513                                      | 13,842   |
| Commercial mortgage loans (4)                            | -                                  | 24,729                             | 63,805  | 88,534                        | 3,147   | 1,446,125      | 1,537,806                                      | 12,472   |
| Construction:  |                                    |                                    |   |                               |   |                |  |  |
| Land (4)   | -                                  | 161                                | 12,350  | 12,511                        | -   | 39,363         | 51,874   | 176  |
| Construction-commercial                                  | -                                  | 11,722                             | 39,466  | 51,188                        | -   | 32,142         | 83,330   | -  |
|  | -                                  | -                                  | 6,042   | 6,042                         | -   | 14,949         | 20,991   | 3,046  |

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



## Construction-residential

(4)

## Consumer:

|                                 |           |            |            |            |            |              |              |            |
|---------------------------------|-----------|------------|------------|------------|------------|--------------|--------------|------------|
| Auto loans                      | 70,836    | 16,787     | 17,435     | 105,058    | -          | 829,922      | 934,980      | -          |
| Finance leases                  | 7,664     | 3,100      | 2,459      | 13,223     | -          | 215,942      | 229,165      | -          |
| Other consumer loans            | 9,462     | 5,524      | 15,124     | 30,110     | -          | 632,894      | 663,004      | 4,266      |
| Total loans held for investment | \$ 93,539 | \$ 164,889 | \$ 582,760 | \$ 841,188 | \$ 173,913 | \$ 8,097,281 | \$ 9,112,382 | \$ 139,987 |

- (1) Includes non-performing loans and accruing loans that are contractually delinquent 90 days or more (i.e. FHA/VA guaranteed loans and credit cards). Credit card loans continue to accrue finance charges and fees until charged-off at 180 days.
- (2) It is the Corporation's policy to report delinquent residential mortgage loans insured by the FHA or guaranteed by the VA as past-due loans 90 days and still accruing as opposed to non-performing loans since the principal repayment is insured. These balances include \$37.3 million of residential mortgage loans insured by the FHA or guaranteed by the VA, which are over 15 months delinquent and are no longer accruing interest as of December 31, 2015.
- (3) As of December 31, 2015, includes \$38.5 million of defaulted loans collateralizing GNMA securities for which the Corporation has an unconditional option (but not an obligation) to repurchase the defaulted loans.
- (4) According to the Corporation's delinquency policy and consistent with the instructions for the preparation of the Consolidated Financial Statements for Bank Holding Companies (FR Y-9C) required by the Federal Reserve Board, residential mortgage, commercial mortgage, and construction loans are considered past due when the borrower is in arrears two or more monthly payments. FHA/VA government-guaranteed loans, other residential mortgage loans, commercial mortgage loans, land loans and construction-residential loans past due 30-59 days as of December 31, 2015 amounted to \$11.0 million, \$162.9 million, \$38.6 million, \$5.7 million and \$0.8 million, respectively.

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

**Commercial Credit Exposure-Credit Risk Profile Based on Creditworthiness Category:**

| <b>September 30, 2016</b><br>(In thousands) | <b>Substandard</b> | <b>Doubtful</b> | <b>Loss</b> | <b>Total Adversely Classified (1)</b> | <b>Total Portfolio</b> |
|---|--------------------|-----------------|-------------|---------------------------------------|------------------------|
| Commercial mortgage                         | \$ 218,523         | \$ 36,211       | \$ -        | \$ 254,734                            | \$ 1,545,014           |
| Construction:                               |                    |                 |             |                                       |                        |
| Land  | 20,175             | -               | -           | 20,175                                | 33,397                 |
| Construction-commercial                     | 36,953             | -               | -           | 36,953                                | 75,413                 |
| Construction-residential                    | 2,053              | -               | -           | 2,053                                 | 15,488                 |
| Commercial and Industrial                   | 159,498            | 72,806          | 445         | 232,749                               | 2,167,011              |

**Commercial Credit Exposure-Credit Risk Profile Based on Creditworthiness Category:**

| <b>December 31, 2015</b><br>(In thousands) | <b>Substandard</b> | <b>Doubtful</b> | <b>Loss</b> | <b>Total Adversely Classified (1)</b> | <b>Total Portfolio</b> |
|--|--------------------|-----------------|-------------|---------------------------------------|------------------------|
| Commercial mortgage                        | \$ 252,941         | \$ 140          | \$ -        | \$ 253,081                            | \$ 1,537,806           |
| Construction:                              |                    |                 |             |                                       |                        |
| Land                                       | 14,035             | 1               | -           | 14,036                                | 51,874                 |
| Construction-commercial                    | 39,466             | -               | -           | 39,466                                | 83,330                 |
| Construction-residential                   | 2,996              | -               | -           | 2,996                                 | 20,991                 |
| Commercial and Industrial                  | 140,827            | 71,341          | 354         | 212,522                               | 2,246,513              |

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

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

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

**Doubtful-** Doubtful classifications have all the weaknesses inherent in those classified Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts,

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conditions and values, highly questionable and improbable. A Doubtful classification may be appropriate in cases where significant risk exposures are perceived, but loss cannot be determined because of specific reasonable pending factors which may strengthen the credit in the near term.

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

|   | Consumer Credit Exposure-Credit Risk Profile based on Payment activity |                               |            |                   |                   |
|---|--|-------------------------------|------------|-------------------|-------------------|
|   | Residential Real Estate  |                               | Consumer   |                   |                   |
|   | FHA/VA/<br>Guaranteed<br>(1)   | Other<br>residential<br>loans | Auto       | Finance<br>Leases | Other<br>Consumer |
| <b>September 30, 2016</b><br>(In thousands) |  |                               |            |                   |                   |
| Performing                                  | \$ 131,936   | \$ 2,840,791                  | \$ 844,182 | \$ 227,608        | \$ 630,320        |
| Purchased                                   | -  | 165,014                       | -          | -                 | -                 |
| Credit-Impaired (2)                         | -  | 162,201                       | 14,615     | 1,969             | 8,695             |
| Non-performing                              | -  | 162,201                       | 14,615     | 1,969             | 8,695             |
| Total                                       | \$ 131,936   | \$ 3,168,006                  | \$ 858,797 | \$ 229,577        | \$ 639,015        |

- (1) It is the Corporation's policy to report delinquent residential mortgage loans insured by the FHA or guaranteed by the VA as past due loans 90 days and still accruing as opposed to non-performing loans since the principal repayment is insured. These balances include \$29.6 million of residential mortgage loans insured by the FHA or guaranteed by the VA, which are over 15 months delinquent and are no longer accruing interest as of September 30, 2016.
- (2) PCI loans are excluded from non-performing statistics due to the application of the accretion method, under which these loans will accrete interest income over the remaining life of the loans using estimated cash flow analysis.

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

- (1) It is the Corporation's policy to report delinquent residential mortgage loans insured by the FHA or guaranteed by the VA as past due loans 90 days and still accruing as opposed to non-performing loans since the principal repayment is insured. These balances include \$37.3 million of residential mortgage loans insured by the FHA or guaranteed by the VA, which are over 15 months delinquent and are no longer accruing interest as of December 31, 2015.
- (2) PCI loans are excluded from non-performing statistics due to the application of the accretion method, under which these loans will accrete interest income over the remaining life of the loans using estimated cash flow analysis.

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

### Impaired Loans

(In thousands)

|  |                     |                          |                            |                    | Quarter                                  | Nine-Month               |                             |                          |                 |
|--|---------------------|--------------------------|----------------------------|--------------------|--|--------------------------|-----------------------------|--------------------------|-----------------|
|  |                     |                          |                            |                    | Ended                                    | Period Ended             |                             |                          |                 |
|  |                     |                          |                            |                    | September 30, 2016                       |                          |                             |                          |                 |
|  | Recorded Investment | Unpaid Principal Balance | Related Specific Allowance | Average Investment | Year-To-Date Recognized on Accrual Basis | Recognized on Cash Basis | Recognized on Accrual Basis | Recognized on Cash Basis | Interest Income |
| <b>As of September 30, 2016</b>            |                     |                          |                            |                    |  |                          |                             |                          |                 |
| <b>With no related allowance recorded:</b> |                     |                          |                            |                    |  |                          |                             |                          |                 |
| FHA/VA-Guaranteed loans                    | \$ -                | \$ -                     | \$ -                       | \$ -               | \$ -                                     | \$ -                     | \$ -                        | \$ -                     | \$ -            |
| Other residential mortgage loans           | 64,198              | 78,361                   | -                          | 67,024             | 139                                      | 103                      | 376                         | 496                      |                 |
| Commercial:                                |                     |                          |                            |                    |  |                          |                             |                          |                 |
| Commercial mortgage loans                  | 51,974              | 63,759                   | -                          | 56,826             | 206                                      | 119                      | 599                         | 609                      |                 |
| Commercial and Industrial Loans            | 17,069              | 26,672                   | -                          | 20,407             | 13                                       | -                        | 13                          | -                        |                 |
| Construction:                              |                     |                          |                            |                    |  |                          |                             |                          |                 |
| Land                                       | 60                  | 89                       | -                          | 60                 | -  | -                        | -                           | -                        |                 |
| Construction-commercial                    | -                   | -                        | -                          | -                  | -  | -                        | -                           | -                        |                 |
| Construction-residential                   | 956                 | 1,531                    | -                          | 956                | -  | -                        | -                           | -                        |                 |
| Consumer:                                  |                     |                          |                            |                    |  |                          |                             |                          |                 |
| Auto loans                                 | 888                 | 888                      | -                          | 901                | 6  | -                        | 10                          | -                        |                 |
| Finance leases                             | 168                 | 168                      | -                          | 168                | 1  | -                        | 1                           | -                        |                 |
| Other consumer loans                       | 3,770               | 5,045                    | -                          | 3,892              | 11                                       | 25                       | 59                          | 80                       |                 |
|  | \$ 139,083          | \$ 176,513               | \$ -                       | \$ 150,234         | \$ 376                                   | \$ 247                   | \$ 1,058                    | \$ 1,185                 |                 |
| <b>With an allowance recorded:</b>         |                     |                          |                            |                    |  |                          |                             |                          |                 |
| FHA/VA-Guaranteed loans                    | \$ -                | \$ -                     | \$ -                       | \$ -               | \$ -                                     | \$ -                     | \$ -                        | \$ -                     | \$ -            |
| Other residential mortgage loans           | 379,841             | 428,395                  | 9,667                      | 385,052            | 4,396                                    | 375                      | 13,160                      | 1,192                    |                 |
| Commercial:                                |                     |                          |                            |                    |  |                          |                             |                          |                 |
| Commercial mortgage loans                  | 146,526             | 166,066                  | 25,907                     | 152,753            | 136                                      | 57                       | 339                         | 179                      |                 |
| Commercial and Industrial Loans            | 161,105             | 189,683                  | 28,668                     | 171,575            | 618                                      | 49                       | 1,708                       | 203                      |                 |
| Construction:                              |                     |                          |                            |                    |  |                          |                             |                          |                 |
| Land                                       | 9,346               | 13,534                   | 903                        | 9,395              | 21                                       | 18                       | 52                          | 35                       |                 |
| Construction-commercial                    | 36,953              | 38,781                   | 1,977                      | 38,516             | -  | -                        | -                           | -                        |                 |
| Construction-residential                   | 392                 | 551                      | 124                        | 392                | -  | -                        | -                           | -                        |                 |
| Consumer:                                  |                     |                          |                            |                    |  |                          |                             |                          |                 |
| Auto loans                                 | 24,135              | 24,135                   | 3,674                      | 25,913             | 476                                      | -                        | 1,379                       | -                        |                 |
| Finance leases                             | 2,408               | 2,408                    | 62                         | 2,493              | 48                                       | -                        | 150                         | -                        |                 |
| Other consumer loans                       | 13,065              | 13,448                   | 1,700                      | 13,868             | 356                                      | 15                       | 1,005                       | 32                       |                 |
|  | \$ 773,771          | \$ 877,001               | \$ 72,682                  | \$ 799,957         | \$ 6,051                                 | \$ 514                   | \$ 17,793                   | \$ 1,641                 |                 |

### Total:

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

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|                                  |            |              |           |            |          |        |           |          |      |
|----------------------------------|------------|--------------|-----------|------------|----------|--------|-----------|----------|------|
| FHA/VA-Guaranteed loans          | \$ -       | \$ -         | \$ -      | \$ -       | \$ -     | \$ -   | \$ -      | \$ -     | \$ - |
| Other residential mortgage loans | 444,039    | 506,756      | 9,667     | 452,076    | 4,535    | 478    | 13,536    | 1,688    |      |
| Commercial:                      |            |              |           |            |          |        |           |          |      |
| Commercial mortgage loans        | 198,500    | 229,825      | 25,907    | 209,579    | 342      | 176    | 938       | 788      |      |
| Commercial and Industrial Loans  | 178,174    | 216,355      | 28,668    | 191,982    | 631      | 49     | 1,721     | 203      |      |
| Construction:                    |            |              |           |            |          |        |           |          |      |
| Land                             | 9,406      | 13,623       | 903       | 9,455      | 21       | 18     | 52        | 35       |      |
| Construction-commercial          | 36,953     | 38,781       | 1,977     | 38,516     | -        | -      | -         | -        |      |
| Construction-residential         | 1,348      | 2,082        | 124       | 1,348      | -        | -      | -         | -        |      |
| Consumer:                        |            |              |           |            |          |        |           |          |      |
| Auto loans                       | 25,023     | 25,023       | 3,674     | 26,814     | 482      | -      | 1,389     | -        |      |
| Finance leases                   | 2,576      | 2,576        | 62        | 2,661      | 49       | -      | 151       | -        |      |
| Other consumer loans             | 16,835     | 18,493       | 1,700     | 17,760     | 367      | 40     | 1,064     | 112      |      |
|                                  | \$ 912,854 | \$ 1,053,514 | \$ 72,682 | \$ 950,191 | \$ 6,427 | \$ 761 | \$ 18,851 | \$ 2,826 |      |

(In thousands)

|  | <b>Recorded<br/>Investment</b> | <b>Unpaid<br/>Principal<br/>Balance</b> | <b>Related<br/>Specific<br/>Allowance</b> | <b>Average<br/>Recorded<br/>Investment</b> |
|--|--------------------------------|---|---|--|
| <b>As of December 31, 2015</b>             |                                |   |   |  |
| <b>With no related allowance recorded:</b> |                                |   |   |  |
| FHA/VA-Guaranteed loans                    | \$ -                           | \$ -                                    | \$ -                                      | \$ -                                       |
| Other residential mortgage loans           | 65,495                         | 74,146                                  | -   | 67,282                                     |
| Commercial:                                |                                |   |   |  |
| Commercial mortgage loans                  | 54,048                         | 66,448                                  | -   | 54,967                                     |
| Commercial and Industrial Loans            | 27,492                         | 29,957                                  | -   | 28,326                                     |
| Construction:                              |                                |   |   |  |
| Land                                       | -                              | -                                       | -   | -  |
| Construction-commercial                    | 39,466                         | 40,000                                  | -   | 39,736                                     |
| Construction-residential                   | 3,046                          | 3,046                                   | -   | 3,098                                      |
| Consumer:                                  |                                |   |   |  |
| Auto loans                                 | -                              | -                                       | -   | -  |
| Finance leases                             | -                              | -                                       | -   | -  |
| Other consumer loans                       | 2,618                          | 4,300                                   | -   | 2,766                                      |
|  | \$ 192,165                     | \$ 217,897                              | \$ -                                      | \$ 196,175                                 |
| <b>With an allowance recorded:</b>         |                                |   |   |  |
| FHA/VA-Guaranteed loans                    | \$ -                           | \$ -                                    | \$ -                                      | \$ -                                       |
| Other residential mortgage loans           | 395,173                        | 440,947                                 | 21,787                                    | 398,790                                    |
| Commercial:                                |                                |   |   |  |
| Commercial mortgage loans                  | 27,479                         | 40,634                                  | 3,073                                     | 30,518                                     |
| Commercial and Industrial Loans            | 143,214                        | 164,050                                 | 18,096                                    | 148,547                                    |
| Construction:                              |                                |   |   |  |
| Land                                       | 9,578                          | 13,758                                  | 1,060                                     | 9,727                                      |
| Construction-commercial                    | -                              | -                                       | -   | -  |
| Construction-residential                   | 1,426                          | 2,180                                   | 142                                       | 1,476                                      |
| Consumer:                                  |                                |   |   |  |
| Auto loans                                 | 21,581                         | 21,581                                  | 6,653                                     | 23,531                                     |
| Finance leases                             | 2,077                          | 2,077                                   | 86  | 2,484                                      |
| Other consumer loans                       | 13,816                         | 14,043                                  | 1,684                                     | 14,782                                     |
|  | \$ 614,344                     | \$ 699,270                              | \$ 52,581                                 | \$ 629,855                                 |
| <b>Total:</b>                              |                                |   |   |  |
| FHA/VA-Guaranteed loans                    | \$ -                           | \$ -                                    | \$ -                                      | \$ -                                       |
| Other residential mortgage loans           | 460,668                        | 515,093                                 | 21,787                                    | 466,072                                    |
| Commercial:                                |                                |   |   |  |
| Commercial mortgage loans                  | 81,527                         | 107,082                                 | 3,073                                     | 85,485                                     |
| Commercial and Industrial Loans            | 170,706                        | 194,007                                 | 18,096                                    | 176,873                                    |
| Construction:                              |                                |   |   |  |
| Land                                       | 9,578                          | 13,758                                  | 1,060                                     | 9,727                                      |
| Construction-commercial                    | 39,466                         | 40,000                                  | -   | 39,736                                     |
| Construction-residential                   | 4,472                          | 5,226                                   | 142                                       | 4,574                                      |
| Consumer:                                  |                                |   |   |  |
| Auto loans                                 | 21,581                         | 21,581                                  | 6,653                                     | 23,531                                     |
| Finance leases                             | 2,077                          | 2,077                                   | 86  | 2,484                                      |

Adoption of new accounting requirements and recently issued but not yet effective accounting requirements 15

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|                      |            |            |           |            |
|----------------------|------------|------------|-----------|------------|
| Other consumer loans | 16,434     | 18,343     | 1,684     | 17,548     |
|                      | \$ 806,509 | \$ 917,167 | \$ 52,581 | \$ 826,030 |

Interest income of approximately \$7.8 million (\$6.9 million accrual basis and \$0.9 million cash basis) and \$24.8 million (\$19.8 million accrual basis and \$5.0 million cash basis) was recognized on impaired loans for the third quarter and nine-month period ended September 30, 2015, respectively.



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

| (In thousands)                                       | Quarter Ended<br>September 30, |            | Nine-Month Period Ended<br>September 30, |            |
|--|--------------------------------|------------|--|------------|
|  | 2016                           | 2015       | 2016                                     | 2015       |
| <b>Impaired Loans:</b>                               |                                |            |  |            |
| Balance at beginning of period                       | \$ 953,774                     | \$ 824,816 | \$ 806,509                               | \$ 945,407 |
| Loans determined impaired during the period          | 26,613                         | 37,528     | 261,544                                  | 135,350    |
| Charge-offs (1)                                      | (30,426)                       | (7,498)    | (50,027)                                 | (90,026)   |
| Loans sold, net of charge-offs                       | -                              | -          | -  | (67,836)   |
| Increases to impaired loans-additional disbursements | 1,091                          | 408        | 2,852                                    | 2,524      |
| Reclassification from loans held for sale (2)        | -                              | 40,005     | -  | 40,005     |
| Foreclosures   | (11,856)                       | (12,858)   | (28,466)                                 | (33,044)   |
| Loans no longer considered impaired                  | (2,674)                        | (25,877)   | (27,560)                                 | (39,062)   |
| Paid in full or partial payments                     | (23,668)                       | (13,811)   | (51,998)                                 | (50,605)   |
| Balance at end of period                             | \$ 912,854                     | \$ 842,713 | \$ 912,854                               | \$ 842,713 |

- (1) For the nine-month period ended September 30, 2015, includes \$63.9 million of charge-offs related to a bulk sale of assets completed in the second quarter of 2015, mostly comprised of non-performing and adversely classified commercial loans, as further discussed below.
- (2) 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 loan in the Virgin Islands. Accordingly, the loan was transferred back from held for sale to held for investment.

| (In thousands)                 | Quarter Ended<br>September 30, |           | Nine-Month Period Ended<br>September 30, |           |
|--------------------------------|--------------------------------|-----------|--|-----------|
|                                | 2016                           | 2015      | 2016                                     | 2015      |
| <b>Specific Reserve:</b>       |                                |           |  |           |
| Balance at beginning of period | \$ 86,372                      | \$ 49,918 | \$ 52,581                                | \$ 55,205 |
| Provision for loan losses      | 16,619                         | 9,439     | 70,011                                   | 81,796    |
| Net charge-offs                | (30,309)                       | (7,498)   | (49,910)                                 | (85,142)  |
| Balance at end of period       | \$ 72,682                      | \$ 51,859 | \$ 72,682                                | \$ 51,859 |



**PCI Loans**

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

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

The carrying amount of PCI loans follows:

|   | <b>September 30,<br/>2016</b> | <b>December 31,<br/>2015</b> |
|---|-------------------------------|------------------------------|
| (In thousands)                                    |                               |                              |
| Residential mortgage loans                        | \$ 165,014                    | \$ 170,766                   |
| Commercial mortgage loans                         | 3,127                         | 3,147                        |
| Total PCI loans                                   | \$ 168,141                    | \$ 173,913                   |
| Allowance for loan losses                         | (6,857)                       | (3,962)                      |
| Total PCI loans, net of allowance for loan losses | \$ 161,284                    | \$ 169,951                   |

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

| <b>As of September 30, 2016</b> | <b>30-59 Days</b> | <b>60-89 Days</b> | <b>90 days or more</b> | <b>Total Past Due</b> | <b>Total PCI loans</b> |
|---------------------------------|-------------------|-------------------|------------------------|-----------------------|------------------------|
|                                 |                   |                   |                        |                       |                        |

**Current**

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

(In thousands)

Residential

mortgage loans (1) \$ - \$12,048 \$26,621 \$38,669 \$126,345 \$165,014

(1)

Commercial

mortgage loans (1) - - 1,283 1,283 1,844 3,127

(1)

\$ - \$12,048 \$27,904 \$39,952 \$128,189 \$168,141

(1) According to the Corporation's delinquency policy and consistent with the instructions for the preparation of the Consolidated Financial Statements for Bank Holding Companies (FR Y-9C) required by the Federal Reserve Board, residential mortgage and commercial mortgage loans are considered past due when the borrower is in arrears two or more monthly payments. PCI residential mortgage loans and commercial mortgage loans past due 30-59 days as of September 30, 2016 amounted to \$22.3 million and \$0.4 million, respectively.

As of December 31, 2015

| (In thousands)                 | 30-59 Days | 60-89 Days | 90 days or more | Total Past Due | Total Current | Total PCI loans |
|--------------------------------|------------|------------|-----------------|----------------|---------------|-----------------|
| Residential mortgage loans (1) | \$ -       | \$16,094   | \$22,218        | \$38,312       | \$132,454     | \$170,766       |

(1)

Commercial

mortgage loans (1) - - 992 992 2,155 3,147

(1)

\$ - \$16,094 \$23,210 \$39,304 \$134,609 \$173,913

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

*Initial Fair Value and Accretable Yield of PCI Loans*

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

*Changes in accretable yield of acquired loans*

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

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

|   | Quarter Ended         |                       | Nine-Month Period Ended |                       |
|---|-----------------------|-----------------------|-------------------------|-----------------------|
|   | September 30,<br>2016 | September 30,<br>2015 | September 30,<br>2016   | September 30,<br>2015 |
| (In thousands)  |                       |                       |                         |                       |
| Balance at beginning of period                                  | \$ 122,179            | \$ 124,288            | \$ 118,385              | \$ 82,460             |
| Additions (accretable yield at acquisition of loans from Doral) | -                     | -                     | -                       | 38,319                |
| Accretion recognized in earnings                                | (2,875)               | (3,411)               | (8,691)                 | (8,695)               |
| Reclassification from non-accretable                            | -                     | 1,348                 | 9,610                   | 10,141                |
| Balance at end of period  | \$ 119,304            | \$ 122,225            | \$ 119,304              | \$ 122,225            |

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

|                                | Quarter Ended         |                       | Nine-Month Period Ended |                       |
|--------------------------------|-----------------------|-----------------------|-------------------------|-----------------------|
|                                | September 30,<br>2016 | September 30,<br>2015 | September 30,<br>2016   | September 30,<br>2015 |
| (In thousands)                 |                       |                       |                         |                       |
| Balance at beginning of period | \$ 169,690            | \$ 178,494            | \$ 173,913              | \$ 102,604            |
| Additions (1)                  | -                     | -                     | -                       | 79,889                |
| Accretion                      | 2,875                 | 3,411                 | 8,691                   | 8,695                 |
| Collections                    | (4,184)               | (5,663)               | (13,136)                | (14,946)              |
| Foreclosures                   | (240)                 | (157)                 | (1,327)                 | (157)                 |
| Ending balance                 | \$ 168,141            | \$ 176,085            | \$ 168,141              | \$ 176,085            |

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|  |            |            |            |            |
|--|------------|------------|------------|------------|
| Allowance for loan losses                        | (6,857)    | (3,163)    | (6,857)    | (3,163)    |
| Ending balance, net of allowance for loan losses | \$ 161,284 | \$ 172,922 | \$ 161,284 | \$ 172,922 |

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

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

|                                | Quarter Ended         |                       | Nine-Month Period Ended |                       |
|--------------------------------|-----------------------|-----------------------|-------------------------|-----------------------|
|                                | September 30,<br>2016 | September 30,<br>2015 | September 30,<br>2016   | September 30,<br>2015 |
|                                | (In thousands)        |                       |                         |                       |
| Balance at beginning of period | \$ 6,857              | \$ 3,163              | \$ 3,962                | \$ -                  |
| Provision for loan losses      | -                     | -                     | 2,895                   | 3,163                 |
| Balance at end of period       | \$ 6,857              | \$ 3,163              | \$ 6,857                | \$ 3,163              |

The outstanding principal balance of PCI loans, including amounts charged off by the Corporation, amounted to \$210.6 million as of September 30, 2016 (December 2015 - \$218.1 million).

### **Purchases and Sales of Loans**

During the first nine months of 2016, the Corporation purchased \$65.2 million of residential mortgage loans consistent with a seasoned strategic program to purchase ongoing residential mortgage loan production from mortgage bankers in Puerto Rico. Generally, the loans purchased from mortgage bankers were conforming residential mortgage loans. Purchases of conforming residential mortgage loans provide the Corporation the flexibility to retain or sell the loans, including through securitization transactions, depending upon the Corporation's interest rate risk management strategies. When the Corporation sells such loans, it generally keeps the servicing of the loans.

In the ordinary course of business, the Corporation sells residential mortgage loans (originated or purchased) to GNMA and government-sponsored entities ("GSEs") such as Fannie Mae ("FNMA") and Freddie Mac ("FHLMC"), which generally securitize the transferred loans into mortgage-backed securities for sale into the secondary market. The Corporation sold approximately \$108.5 million of performing residential mortgage loans to FNMA and FHLMC during the first nine months of 2016. Also, during the first nine months of 2016, the Corporation sold \$238.6 million of FHA/VA mortgage loans to GNMA, which packages them into mortgage-backed securities. The Corporation's continuing involvement in these sold loans consists primarily of servicing the loans. In addition, the Corporation agreed to repurchase loans when it breaches any of the representations and warranties included in the sale agreement. These representations and warranties are consistent with the GSEs' selling and servicing guidelines (i.e., ensuring that the mortgage was properly underwritten according to established guidelines).

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

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

During the first nine months of 2016 and 2015, the Corporation repurchased pursuant to its repurchase option with GNMA \$20.9 million and \$10.6 million, respectively, of loans previously sold to GNMA. The principal balance of these loans is fully guaranteed and the risk of loss related to the repurchased loans is generally limited to the difference between the delinquent interest payment advanced to GNMA computed at the loan's interest rate and the



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

Loan sales to FNMA and FHLMC are without recourse in relation to the future performance of the loans. The Corporation repurchased at par loans previously sold to FNMA and FHLMC in the amount of \$0.7 million and \$1.3 million during the first nine months of 2016 and 2015, respectively. The Corporation's risk of loss with respect to these loans is also minimal as these repurchased loans are generally performing loans with documentation deficiencies. No losses related to breaches of representations and warranties were incurred in the first nine months of 2016. Historically, losses experienced on these loans have been immaterial. As a consequence, as of September 30, 2016, the Corporation does not maintain a liability for estimated losses on loans expected to be repurchased as a result of breaches in loan and servicer representations and warranties.

In addition, the Corporation sold \$20.2 million and \$20.0 million in commercial mortgage loan participations during the first nine months of 2016 and 2015, respectively.

### **Bulk Sale of Assets**

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

## Loan Portfolio Concentration

The Corporation's primary lending area is Puerto Rico. The Corporation's banking subsidiary, First Bank, also lends in the USVI and BVI markets and in the United States (principally in the state of Florida). Of the total gross loans held for investment of \$8.9 billion as of September 30, 2016, approximately 78% have credit risk concentration in Puerto Rico, 15% in the United States, and 7% in the USVI and BVI.

As of September 30, 2016, the Corporation had \$134.0 million outstanding (book value of \$126.2 million) in credit facilities 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 credit facilities granted to the government of the Virgin Islands amounted to \$65.6 million as of September 30, 2016, compared to \$126.2 million as of December 31, 2015. Approximately \$91.4 million of the granted credit facilities outstanding (\$83.7 million book value) consisted of loans to public corporations, including a direct exposure to the Puerto Rico Electric Power Authority ("PREPA") with an outstanding balance of \$74.6 million (\$66.9 million book value) as of September 30, 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 are recorded on a cost-recovery basis. 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. Municipalities' revenues are independent of the Puerto Rico central government. These municipalities are required by law to levy special property taxes in such amounts as are required for the payment of all of their respective general obligation bonds and loans. Late in 2015, the GDB and the Municipal Revenue Collection Center (CRIM) signed a deed of trust. Through this deed, the GDB, as fiduciary, is bound to keep the CRIM funds separate from any other deposits and must distribute the funds pursuant to applicable law. The CRIM funds are deposited at another depository financial institution in Puerto Rico.

Furthermore, as of September 30, 2016, the Corporation had \$128.0 million outstanding (book value of \$112.8 million) in financings 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 ("TDF") provides a secondary guarantee for payment performance, compared to \$129.4 million outstanding 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 \$1.6 million of interest payments received on loans guaranteed by the TDF since late March 2016 have been applied against principal. As of the date of filing of this Form 10-Q, the largest of these three facilities is current on contractual payments as its operations are generating the cash flows to cover payments. The Corporation has been receiving partial payments from the other two facilities since their operations are insufficient to cover the entire contractual payments 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 \$13.7 million were recorded in the third quarter of 2016, of which \$12.8 million was charged against specific reserves established in prior periods. These loans have been adversely classified since the third quarter of 2015. The Corporation's collections of principal and interest from the TDF in the first half of 2016 amounted to \$0.6 million compared to \$5.3 million in the entire 2015 year.

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"), which gives Puerto Rico's governor emergency powers to deal with Puerto Rico's challenging fiscal situation, including the ability to declare a moratorium on all bonds and other payments. On June 30, 2016, pursuant to Act 21, the Puerto Rico governor ordered a moratorium on the payment of \$780 million of the Puerto Rico Government's general obligations and the debt of certain other instrumentalities due on July 1, 2016. This followed a default on the principal payment of \$367 million of GDB notes due on May 1, 2016. Puerto Rico's governor also issued an executive order intended to protect the GDB's liquidity by allowing withdrawals only to fund necessary costs for essential services such as health, public safety and education services. Recently, the GDB defaulted on a \$28 million payment of interest due to its creditors on August 1, 2016, including interest due on GDB bonds held by the Corporation.

As of September 30, 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 16% and the loans are being carried at 76% of unpaid principal balance, net of reserves and accumulated charge offs.

In addition, the Corporation had \$121.4 million in indirect exposure to residential mortgage loans that are guaranteed by the Puerto Rico Housing Finance Authority. Residential mortgage loans guaranteed by the Puerto Rico Housing Finance Authority are secured by the underlying properties and the guarantees serve to cover shortfalls in collateral in the event of a borrower default. The Puerto Rico government guarantees up to \$75 million of the principal 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.

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

### **Troubled Debt Restructurings**

The Corporation provides homeownership preservation assistance to its customers through a loss mitigation program in Puerto Rico that is similar to the U.S. government's Home Affordable Modification Program guidelines. Depending upon the nature of borrowers' financial condition, restructurings or loan modifications through this program as well as other restructurings of individual commercial, commercial mortgage, construction, and residential mortgage loans fit the definition of a TDR. A restructuring of a debt constitutes a TDR if the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider. Modifications involve changes in one or more of the loan terms that bring a defaulted loan current and provide sustainable affordability. Changes may include the refinancing of any past-due amounts, including interest and escrow, the extension of the maturity of the loan and modifications of the loan rate. As of September 30, 2016, the Corporation's total TDR loans held for investment of \$656.3 million consisted of \$378.7 million of residential mortgage loans, \$150.9 million of commercial and industrial loans, \$44.0 million of commercial mortgage loans, \$40.2 million of construction loans, and \$42.5 million of consumer loans. Outstanding unfunded commitments on TDR loans amounted to \$5.7 million as of September 30, 2016.

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

Prior to permanently modifying a loan, the Corporation may enter into trial modifications with certain borrowers. Trial modifications generally represent a six-month period during which the borrower makes monthly payments under the anticipated modified payment terms prior to a formal modification. Upon successful completion of a trial modification, the Corporation and the borrower enter into a permanent modification. TDR loans that are participating in or that have been offered a binding trial modification are classified as TDRs when the trial offer is made and

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

continue to be classified as TDRs regardless of whether the borrower enters into a permanent modification. As of September 30, 2016, we classified an additional \$5.6 million of residential mortgage loans as TDRs that were participating in or had been offered a trial modification.

For the commercial real estate, commercial and industrial, and construction loan portfolios, at the time of a restructuring, the Corporation determines, on a loan-by-loan basis, whether a concession was granted for economic or legal reasons related to the borrower's financial difficulty. Concessions granted for commercial loans could include: reductions in interest rates to rates that are considered below market; extension of repayment schedules and maturity dates beyond original contractual terms; waivers of borrower covenants; forgiveness of principal or interest; or other contractual changes that would be considered a concession. The Corporation mitigates loan defaults for its commercial loan portfolios through its collection function. The function's objective is to minimize both early stage delinquencies and losses upon default of commercial loans. In the case of the commercial and industrial, commercial mortgage, and construction loan portfolios, the Corporation's Special Asset Group ("SAG") focuses on strategies for the accelerated reduction of non-performing assets through note sales, short sales, loss mitigation programs, and sales of OREO.

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

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

| (In thousands)                        | <b>September 30, 2016</b>         |                                   |  |   |                  |              |
|---------------------------------------|-----------------------------------|-----------------------------------|--|---|------------------|--------------|
|                                       | <b>Interest rate below market</b> | <b>Maturity or term extension</b> | <b>Combination of reduction in interest rate and extension of maturity</b> | <b>Forgiveness of principal and/or interest</b> | <b>Other (1)</b> | <b>Total</b> |
| Troubled Debt Restructurings:         |                                   |                                   |  |   |                  |              |
| Non-FHA/VA Residential Mortgage loans | \$ 29,934                         | \$ 8,172                          | \$ 283,550   | \$ -  | \$ 57,065        | \$ 378,721   |
| Commercial Mortgage Loans             | 6,092                             | 1,219                             | 26,053   | -   | 10,608           | 43,972       |
| Commercial and Industrial Loans       | 2,153                             | 69,244                            | 25,263   | 2,637   | 51,593           | 150,890      |
| Construction Loans:                   |                                   |                                   |  |   |                  |              |
| Land                                  | -                                 | 285                               | 2,193  | -   | 402              | 2,880        |
| Construction-commercial               | -                                 | -                                 | -  | 36,953  | -                | 36,953       |
| Construction-residential              | -                                 | -                                 | -  | -   | 357              | 357          |
| Consumer Loans - Auto                 | -                                 | 1,921                             | 14,680   | -   | 8,422            | 25,023       |
| Finance Leases                        | -                                 | 424                               | 2,152  | -   | -                | 2,576        |
| Consumer Loans - Other                | 229                               | 2,185                             | 10,120   | 300   | 2,112            | 14,946       |
| Total Troubled Debt Restructurings    | \$ 38,408                         | \$ 83,450                         | \$ 364,011   | \$ 39,890                                       | \$ 130,559       | \$ 656,318   |

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

| (In thousands) | <b>December 31, 2015</b>          |                                   |  |   |                  |              |
|----------------|-----------------------------------|-----------------------------------|--|---|------------------|--------------|
|                | <b>Interest rate below market</b> | <b>Maturity or term extension</b> | <b>Combination of reduction in interest rate and extension of maturity</b> | <b>Forgiveness of principal and/or interest</b> | <b>Other (1)</b> | <b>Total</b> |

|  |           |           |            |           |            |            |  |
|--|-----------|-----------|------------|-----------|------------|------------|--|
| Troubled Debt<br>Restructurings:<br>Non-FHA/VA |           |           |            |           |            |            |  |
| Residential Mortgage loans                     | \$ 29,066 | \$ 6,027  | \$ 297,310 | \$ -      | \$ 50,269  | \$ 382,672 |  |
| Commercial Mortgage Loans                      | 4,379     | 1,244     | 26,109     | -         | 12,766     | 44,498     |  |
| Commercial and Industrial Loans                | 2,163     | 75,104    | 27,214     | 3,027     | 42,746     | 150,254    |  |
| Construction Loans:                            |           |           |            |           |            |            |  |
| Land   | -         | 229       | 2,165      | -         | 372        | 2,766      |  |
| Construction-commercial                        | -         | -         | -          | 39,466    | -          | 39,466     |  |
| Construction-residential                       | -         | -         | 3,046      | -         | 436        | 3,482      |  |
| Consumer Loans - Auto                          | -         | 2,330     | 12,388     | -         | 6,864      | 21,582     |  |
| Finance Leases                                 | -         | 621       | 1,456      | -         | -          | 2,077      |  |
| Consumer Loans - Other                         | 89        | 1,604     | 11,026     | 327       | 1,748      | 14,794     |  |
| Total Troubled Debt Restructurings             | \$ 35,697 | \$ 87,159 | \$ 380,714 | \$ 42,820 | \$ 115,201 | \$ 661,591 |  |

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

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

| (In thousands)  | Quarter Ended<br>September 30, |            | Nine-Month Period Ended<br>September 30, |            |
|---|--------------------------------|------------|--|------------|
|   | 2016                           | 2015       | 2016                                     | 2015       |
| Beginning balance of TDRs                             | \$ 670,991                     | \$ 634,761 | \$ 661,591                               | \$ 694,453 |
| New TDRs  | 15,596                         | 30,044     | 66,075                                   | 95,840     |
| Increases to existing TDRs - additional disbursements | 517                            | 309        | 1,573                                    | 644        |
| Charge-offs post modification (1)                     | (5,445)                        | (5,327)    | (15,899)                                 | (58,707)   |
| Sales, net of charge-offs                             | -                              | -          | -  | (44,048)   |
| Foreclosures  | (5,567)                        | (6,139)    | (12,967)                                 | (16,391)   |
| Removed from the TDR classification                   | -                              | -          | (3,031)                                  | -          |
| Reclassification from loans held for sale (2)         | -                              | 40,005     | -  | 40,005     |
| Paid-off and partial payments                         | (19,774)                       | (11,690)   | (41,024)                                 | (29,833)   |
| Ending balance of TDRs                                | \$ 656,318                     | \$ 681,963 | \$ 656,318                               | \$ 681,963 |

- (1) For the nine-month period ended September 30, 2015, includes \$45.3 million of charge offs related to TDRs included in the bulk sale of assets completed in the second quarter of 2015.
- (2) 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 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 nonperforming loan.

TDR loans are classified as either accrual or nonaccrual loans. Loans in accrual status may remain in accrual status when their contractual terms have been modified in a TDR if the loan had demonstrated performance prior to the restructuring and payment in full under the restructured terms is expected. Otherwise, loans on non-accrual and restructured as a TDR will remain on nonaccrual status until the borrower has proven the ability to perform under the modified structure, generally for a minimum of six months, and there is evidence that such payments can and are likely to continue as agreed. Performance prior to the restructuring, or significant events that coincide with the restructuring, are included in assessing whether the borrower can meet the new terms and may result in the loan being returned to accrual status at the time of the restructuring or after a shorter performance period. If the borrower's ability to meet the revised payment schedule is uncertain, the loan remains classified as a non-accrual loan. Loan modifications increase the Corporation's interest income by returning a non-performing loan to performing status, if applicable, increase cash flows by providing for payments to be made by the borrower, and limit increases in foreclosure and OREO costs. The Corporation continues to consider a modified loan as an impaired loan for purposes of estimating the allowance for loan and lease losses. A TDR loan that specifies an interest rate that at the time of the restructuring is greater than or equal to the rate the Corporation is willing to accept for a new loan with comparable risk may not be reported as a TDR, or an impaired loan in the calendar years subsequent to the restructuring, if it is in compliance with its modified terms. During the first nine months of 2016, the Corporation removed a \$3.0 million



loan from the TDR classification as the borrower is no longer experiencing financial difficulties, and the loan was refinanced at market terms and does not contain any concession to the borrower.

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

| (In thousands)                        | <b>As of September 30, 2016</b> |                       |                   |
|---------------------------------------|---------------------------------|-----------------------|-------------------|
|                                       | <b>Accrual</b>                  | <b>Nonaccrual (1)</b> | <b>Total TDRs</b> |
| Non-FHA/VA Residential Mortgage loans | \$ 296,840                      | \$ 81,881             | \$ 378,721        |
| Commercial Mortgage Loans             | 28,699                          | 15,273                | 43,972            |
| Commercial and Industrial Loans       | 58,004                          | 92,886                | 150,890           |
| Construction Loans:                   |                                 |                       |                   |
| Land                                  | 1,205                           | 1,675                 | 2,880             |
| Construction-commercial               | -                               | 36,953                | 36,953            |
| Construction-residential              | -                               | 357                   | 357               |
| Consumer Loans - Auto                 | 16,561                          | 8,462                 | 25,023            |
| Finance Leases                        | 2,437                           | 139                   | 2,576             |
| Consumer Loans - Other                | 12,173                          | 2,773                 | 14,946            |
| Total Troubled Debt Restructurings    | \$ 415,919                      | \$ 240,399            | \$ 656,318        |

- (1) Included in non-accrual loans are \$121.3 million in loans that are performing under the terms of the restructuring agreement but are reported in non-accrual status until the restructured loans meet the criteria of sustained payment performance under the revised terms for reinstatement to accrual status and are deemed fully collectible.

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

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



TDR loans exclude restructured residential mortgage loans that are guaranteed by the U.S. federal government (i.e., FHA/VA loans) totaling \$67.9 million as of September 30, 2016 (December 31, 2015 - \$77.6 million). The Corporation excludes FHA/VA guaranteed loans from TDR loans statistics given that, in the event that the borrower defaults on the loan, the principal and interest (at the specified debenture rate) are guaranteed by the U.S. government; therefore, the risk of loss on these types of loans is very low. The Corporation does not consider loans with U.S. federal government guarantees to be impaired loans for the purpose of calculating the allowance for loan and lease losses.

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

| (Dollars in thousands)                | Number of contracts | Quarter Ended September 30, 2016                 |   |
|---------------------------------------|---------------------|--|---|
|                                       |                     | Pre-modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment |
| Troubled Debt Restructurings:         |                     |  |   |
| Non-FHA/VA Residential Mortgage loans | 55                  | \$ 8,631   | \$ 8,449  |
| Commercial Mortgage Loans             | 5                   | 679  | 712   |
| Commercial and Industrial Loans       | 2                   | 1,432  | 1,432   |
| Construction Loans:                   |                     |  |   |
| Land                                  | 4                   | 158  | 155   |
| Consumer Loans - Auto                 | 189                 | 3,262  | 3,262   |
| Finance Leases                        | 11                  | 295  | 295   |
| Consumer Loans - Other                | 257                 | 1,269  | 1,291   |
| Total Troubled Debt Restructurings    | 523                 | \$ 15,726  | \$ 15,596   |

| (Dollars in thousands)                | Number of contracts | Nine-Month Period Ended September 30, 2016       |   |
|---------------------------------------|---------------------|--|---|
|                                       |                     | Pre-modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment |
| Troubled Debt Restructurings:         |                     |  |   |
| Non-FHA/VA Residential Mortgage loans | 167                 | \$ 25,040  | \$ 24,040   |
| Commercial Mortgage Loans             | 8                   | 3,351  | 3,380   |
| Commercial and Industrial Loans       | 21                  | 21,693   | 21,693  |
| Construction Loans:                   |                     |  |   |
| Land                                  | 4                   | 158  | 155   |
| Consumer Loans - Auto                 | 612                 | 10,961   | 10,961  |
| Finance Leases                        | 59                  | 1,477  | 1,477   |
| Consumer Loans - Other                | 862                 | 4,312  | 4,369   |
| Total Troubled Debt Restructurings    | 1,733               | \$ 66,992  | \$ 66,075   |



(Dollars in thousands)

**Quarter Ended September 30, 2015**

|                                       |                                | <b>Pre-Modification<br/>Outstanding<br/>Recorded<br/>Investment</b> | <b>Post-Modification<br/>Outstanding<br/>Recorded<br/>Investment</b> |
|---------------------------------------|--------------------------------|---|--|
|                                       | <b>Number of<br/>contracts</b> |   |  |
| Troubled Debt Restructurings:         |                                |   |  |
| Non-FHA/VA Residential Mortgage loans | 98                             | \$ 19,901   | \$ 19,481  |
| Commercial Mortgage Loans             | 4                              | 7,380   | 5,719  |
| Construction Loans:                   |                                |   |  |
| Land                                  | 1                              | 109   | 109  |
| Consumer Loans - Auto                 | 203                            | 3,352   | 3,297  |
| Finance Leases                        | 19                             | 521   | 418  |
| Consumer Loans - Other                | 197                            | 1,026   | 1,020  |
| Total Troubled Debt Restructurings    | 522                            | \$ 32,289   | \$ 30,044  |

(Dollars in thousands)

**Nine-Month Period Ended September 30, 2015**

|                                       |                                | <b>Pre-Modification<br/>Outstanding<br/>Recorded<br/>Investment</b> | <b>Post-Modification<br/>Outstanding<br/>Recorded<br/>Investment</b> |
|---------------------------------------|--------------------------------|---|--|
|                                       | <b>Number of<br/>contracts</b> |   |  |
| Troubled Debt Restructurings:         |                                |   |  |
| Non-FHA/VA Residential Mortgage loans | 350                            | \$ 60,043   | \$ 57,882  |
| Commercial Mortgage Loans             | 13                             | 20,332  | 18,781   |
| Commercial and Industrial Loans       | 3                              | 2,997   | 2,579  |
| Construction Loans:                   |                                |   |  |
| Land                                  | 7                              | 603   | 600  |
| Consumer Loans - Auto                 | 547                            | 8,739   | 8,564  |
| Finance Leases                        | 43                             | 1,215   | 1,056  |
| Consumer Loans - Other                | 929                            | 6,432   | 6,378  |
| Total Troubled Debt Restructurings    | 1,892                          | \$ 100,361  | \$ 95,840  |

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

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

| (Dollars in thousands)                | Quarter Ended September 30, |                        |                           |                        |
|---------------------------------------|-----------------------------|------------------------|---------------------------|------------------------|
|                                       | 2016                        |                        | 2015                      |                        |
|                                       | Number<br>of<br>contracts   | Recorded<br>Investment | Number<br>of<br>contracts | Recorded<br>Investment |
| Non-FHA/VA Residential Mortgage loans | 14                          | \$ 1,707               | 23                        | \$ 3,744               |
| Consumer Loans - Auto                 | 5                           | 68                     | 1                         | 10                     |
| Consumer Loans - Other                | 22                          | 93                     | 51                        | 219                    |
| Finance Leases                        | 1                           | 30                     | 3                         | 145                    |
| Total                                 | 42                          | \$ 1,898               | 78                        | \$ 4,118               |

| (Dollars in thousands)                | Nine-Month Period Ended September 30, |                        |                           |                        |
|---------------------------------------|---------------------------------------|------------------------|---------------------------|------------------------|
|                                       | 2016                                  |                        | 2015                      |                        |
|                                       | Number<br>of<br>contracts             | Recorded<br>Investment | Number<br>of<br>contracts | Recorded<br>Investment |
| Non-FHA/VA Residential Mortgage loans | 35                                    | \$ 4,863               | 50                        | \$ 7,646               |
| Commercial and Industrial Loans       | -                                     | -                      | 4                         | 5,745                  |
| Consumer Loans - Auto                 | 45                                    | 702                    | 8                         | 50                     |
| Consumer Loans - Other                | 89                                    | 339                    | 141                       | 589                    |
| Finance Leases                        | 2                                     | 43                     | 6                         | 185                    |
| Total                                 | 171                                   | \$ 5,947               | 209                       | \$ 14,215              |

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

restructuring. In the periods following the calendar year in which a loan was restructured, the A note may no longer be reported as a TDR loan if it is in accrual status, is in compliance with its modified terms, and yields a market rate (as determined and documented at the time of the restructuring).

The recorded investment in loans held for investment restructured using the A/B note restructure workout strategy was approximately \$38.0 million as of September 30, 2016. The following table provides additional information about the volume of this type of loan restructuring and the effect on the allowance for loan and lease losses in the first nine months of 2016 and 2015:

| (In thousands)  | <b>September 30, 2016</b> | <b>September 30, 2015</b> |
|---|---------------------------|---------------------------|
| Principal balance deemed collectible at end of period | \$ 38,004                 | \$ 40,632                 |
| Amount charged off                                    | \$ -                      | \$ -                      |
| Charges to the provision for loan losses              | \$ 2,660                  | \$ 185                    |
| Allowance for loan losses at end of period            | \$ 3,521                  | \$ 916                    |

Of the loans comprising the \$38.0 million that have been deemed collectible, approximately \$37.9 million were placed in accrual status as the borrowers have exhibited a period of sustained performance. These loans continue to be individually evaluated for impairment purposes.



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

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

| (In thousands)   | <b>Residential<br/>Mortgage<br/>Loans</b> | <b>Commercial<br/>Mortgage<br/>Loans</b> | <b>Commercial<br/>&amp; Industrial<br/>Loans</b> | <b>Construction<br/>Loans</b> | <b>Consumer<br/>Loans</b> | <b>Total</b> |
|--|---|--|--|-------------------------------|---------------------------|--------------|
| <b>Quarter ended</b>   |   |  |  |                               |                           |              |
| <b>September 30, 2016</b>                                    |   |  |  |                               |                           |              |
| <b>Allowance for loan<br/>and lease losses:</b>              |   |  |  |                               |                           |              |
| Beginning balance  | \$ 38,955                                 | \$ 69,799                                | \$ 69,789  | \$ 2,747                      | \$ 53,164                 | \$ 234,454   |
| Charge-offs  | (8,514)                                   | (13,730)                                 | (10,587)   | (19)                          | (13,716)                  | (46,566)     |
| Recoveries   | 972                                       | 335                                      | 929  | 140                           | 2,303                     | 4,679        |
| Provision (release)  | 4,553                                     | (152)                                    | 5,597  | 2,480                         | 9,025                     | 21,503       |
| Ending balance   | \$ 35,966                                 | \$ 56,252                                | \$ 65,728  | \$ 5,348                      | \$ 50,776                 | \$ 214,070   |
| Ending balance:<br>specific reserve for<br>impaired loans    | \$ 9,667                                  | \$ 25,907                                | \$ 28,668  | \$ 3,004                      | \$ 5,436                  | \$ 72,682    |
| Ending balance:<br>purchased<br>credit-impaired loans<br>(1) | \$ 6,638                                  | \$ 219                                   | \$ -   | \$ -                          | \$ -                      | \$ 6,857     |
| Ending balance:<br>general allowance                         | \$ 19,661                                 | \$ 30,126                                | \$ 37,060  | \$ 2,344                      | \$ 45,340                 | \$ 134,531   |
| <b>Loans held for<br/>investment:</b>                        |   |  |  |                               |                           |              |
| Ending balance   | \$ 3,299,942                              | \$ 1,545,014                             | \$ 2,167,011                                     | \$ 124,298                    | \$ 1,727,389              | \$ 8,863,654 |
| Ending balance:<br>impaired loans                            | \$ 444,039                                | \$ 198,500                               | \$ 178,174                                       | \$ 47,707                     | \$ 44,434                 | \$ 912,854   |
| Ending balance:<br>purchased<br>credit-impaired loans        | \$ 165,014                                | \$ 3,127                                 | \$ -   | \$ -                          | \$ -                      | \$ 168,141   |
| Ending balance:<br>loans with general<br>allowance           | \$ 2,690,889                              | \$ 1,343,387                             | \$ 1,988,837                                     | \$ 76,591                     | \$ 1,682,955              | \$ 7,782,659 |

| (In thousands) | <b>Residential<br/>Mortgage<br/>Loans</b> | <b>Commercial<br/>Mortgage<br/>Loans</b> | <b>Commercial<br/>&amp; Industrial<br/>Loans</b> | <b>Construction<br/>Loans</b> | <b>Consumer<br/>Loans</b> | <b>Total</b> |
|----------------|---|--|--|-------------------------------|---------------------------|--------------|
|----------------|---|--|--|-------------------------------|---------------------------|--------------|

**Nine-Month Period  
Ended September  
30, 2016**  
**Allowance for loan  
and lease losses:**

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

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|  |              |              |              |            |              |              |
|--|--------------|--------------|--------------|------------|--------------|--------------|
| Beginning balance  | \$ 39,570    | \$ 68,211    | \$ 68,768    | \$ 3,519   | \$ 60,642    | \$ 240,710   |
| Charge-offs  | (27,352)     | (15,742)     | (16,260)     | (623)      | (41,490)     | (101,467)    |
| Recoveries   | 2,159        | 414          | 1,885        | 301        | 6,526        | 11,285       |
| Provision  | 21,589       | 3,369        | 11,335       | 2,151      | 25,098       | 63,542       |
| Ending balance   | \$ 35,966    | \$ 56,252    | \$ 65,728    | \$ 5,348   | \$ 50,776    | \$ 214,070   |
| Ending balance:<br>specific reserve for<br>impaired loans    | \$ 9,667     | \$ 25,907    | \$ 28,668    | \$ 3,004   | \$ 5,436     | \$ 72,682    |
| Ending balance:<br>purchased<br>credit-impaired loans<br>(1) | \$ 6,638     | \$ 219       | \$ -         | \$ -       | \$ -         | \$ 6,857     |
| Ending balance:<br>general allowance                         | \$ 19,661    | \$ 30,126    | \$ 37,060    | \$ 2,344   | \$ 45,340    | \$ 134,531   |
| <b>Loans held for<br/>investment:</b>                        |              |              |              |            |              |              |
| Ending balance   | \$ 3,299,942 | \$ 1,545,014 | \$ 2,167,011 | \$ 124,298 | \$ 1,727,389 | \$ 8,863,654 |
| Ending balance:<br>impaired loans                            | \$ 444,039   | \$ 198,500   | \$ 178,174   | \$ 47,707  | \$ 44,434    | \$ 912,854   |
| Ending balance:<br>purchased<br>credit-impaired loans        | \$ 165,014   | \$ 3,127     | \$ -         | \$ -       | \$ -         | \$ 168,141   |
| Ending balance:<br>loans with general<br>allowance           | \$ 2,690,889 | \$ 1,343,387 | \$ 1,988,837 | \$ 76,591  | \$ 1,682,955 | \$ 7,782,659 |

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

| (In thousands)  | Residential<br>Mortgage<br>Loans | Commercial<br>Mortgage<br>Loans | Commercial<br>& Industrial<br>Loans | Construction<br>Loans | Consumer<br>Loans | Total        |
|---|----------------------------------|---------------------------------|-------------------------------------|-----------------------|-------------------|--------------|
| <b>Quarter ended<br/>September 30, 2015</b>               |                                  |                                 |                                     |                       |                   |              |
| <b>Allowance for loan<br/>and lease losses:</b>           |                                  |                                 |                                     |                       |                   |              |
| Beginning balance   | \$ 33,783                        | \$ 49,092                       | \$ 63,900                           | \$ 11,865             | \$ 62,878         | \$ 221,518   |
| Charge-offs   | (5,094)                          | (3,677)                         | (1,267)                             | (103)                 | (15,926)          | (26,067)     |
| Recoveries  | 214                              | 20                              | 327                                 | 176                   | 1,602             | 2,339        |
| Provision (release)                                       | 6,958                            | 6,668                           | 3,807                               | (139)                 | 13,882            | 31,176       |
| Ending balance  | \$ 35,861                        | \$ 52,103                       | \$ 66,767                           | \$ 11,799             | \$ 62,436         | \$ 228,966   |
| Ending balance:<br>specific reserve for<br>impaired loans | \$ 18,705                        | \$ 4,886                        | \$ 17,540                           | \$ 2,128              | \$ 8,600          | \$ 51,859    |
| Ending balance:<br>purchased<br>credit-impaired loans     | \$ 3,061                         | \$ 102                          | \$ -                                | \$ -                  | \$ -              | \$ 3,163     |
| Ending balance:<br>general allowance                      | \$ 14,095                        | \$ 47,115                       | \$ 49,227                           | \$ 9,671              | \$ 53,836         | \$ 173,944   |
| <b>Loans held for<br/>investment:</b>                     |                                  |                                 |                                     |                       |                   |              |
| Ending balance  | \$ 3,330,089                     | \$ 1,562,538                    | \$ 2,222,324                        | \$ 163,956            | \$ 1,861,555      | \$ 9,140,462 |
| Ending balance:<br>impaired loans                         | \$ 459,311                       | \$ 104,046                      | \$ 174,983                          | \$ 66,123             | \$ 38,250         | \$ 842,713   |
| Ending balance:<br>purchased<br>credit-impaired loans     | \$ 172,927                       | \$ 3,158                        | \$ -                                | \$ -                  | \$ -              | \$ 176,085   |
| Ending balance:<br>loans with general<br>allowance        | \$ 2,697,851                     | \$ 1,455,334                    | \$ 2,047,341                        | \$ 97,833             | \$ 1,823,305      | \$ 8,121,664 |

| (In thousands)  | Residential<br>Mortgage<br>Loans | Commercial<br>Mortgage<br>Loans | Commercial<br>& Industrial<br>Loans | Construction<br>Loans | Consumer<br>Loans | Total      |
|---|----------------------------------|---------------------------------|-------------------------------------|-----------------------|-------------------|------------|
| <b>Nine-Month Period<br/>Ended September<br/>30, 2015</b> |                                  |                                 |                                     |                       |                   |            |
| <b>Allowance for loan<br/>and lease losses:</b>           |                                  |                                 |                                     |                       |                   |            |
| Beginning balance   | \$ 27,301                        | \$ 50,894                       | \$ 63,721                           | \$ 12,822             | \$ 67,657         | \$ 222,395 |
| Charge-offs   | (13,815)                         | (54,115)                        | (30,090)                            | (4,787)               | (48,221)          | (151,028)  |
| Recoveries  | 584                              | 6,515                           | 3,386                               | 2,379                 | 6,323             | 19,187     |
| Provision   | 21,791                           | 48,809                          | 29,750                              | 1,385                 | 36,677            | 138,412    |
| Ending balance  | \$ 35,861                        | \$ 52,103                       | \$ 66,767                           | \$ 11,799             | \$ 62,436         | \$ 228,966 |
| Ending balance:<br>specific reserve for                   | \$ 18,705                        | \$ 4,886                        | \$ 17,540                           | \$ 2,128              | \$ 8,600          | \$ 51,859  |

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

|                                   |    |           |    |           |    |           |    |         |    |           |    |           |
|-----------------------------------|----|-----------|----|-----------|----|-----------|----|---------|----|-----------|----|-----------|
| impaired loans                    |    |           |    |           |    |           |    |         |    |           |    |           |
| Ending balance:                   |    |           |    |           |    |           |    |         |    |           |    |           |
| purchased                         | \$ | 3,061     | \$ | 102       | \$ | -         | \$ | -       | \$ | 3,163     |    |           |
| credit-impaired loans             |    |           |    |           |    |           |    |         |    |           |    |           |
| Ending balance:                   | \$ | 14,095    | \$ | 47,115    | \$ | 49,227    | \$ | 9,671   | \$ | 53,836    | \$ | 173,944   |
| general allowance                 |    |           |    |           |    |           |    |         |    |           |    |           |
| <b>Loans held for investment:</b> |    |           |    |           |    |           |    |         |    |           |    |           |
| Ending balance                    | \$ | 3,330,089 | \$ | 1,562,538 | \$ | 2,222,324 | \$ | 163,956 | \$ | 1,861,555 | \$ | 9,140,462 |
| Ending balance:                   | \$ | 459,311   | \$ | 104,046   | \$ | 174,983   | \$ | 66,123  | \$ | 38,250    | \$ | 842,713   |
| impaired loans                    |    |           |    |           |    |           |    |         |    |           |    |           |
| Ending balance:                   |    |           |    |           |    |           |    |         |    |           |    |           |
| purchased                         | \$ | 172,927   | \$ | 3,158     | \$ | -         | \$ | -       | \$ | -         | \$ | 176,085   |
| credit-impaired loans             |    |           |    |           |    |           |    |         |    |           |    |           |
| Ending balance:                   |    |           |    |           |    |           |    |         |    |           |    |           |
| loans with general allowance      | \$ | 2,697,851 | \$ | 1,455,334 | \$ | 2,047,341 | \$ | 97,833  | \$ | 1,823,305 | \$ | 8,121,664 |

As discussed in Note 6, under the heading “Bulk Sale of Assets,” during the second quarter of 2015, the Corporation completed the sale of commercial and construction loans with a book value of \$147.5 million, mostly comprised of non-performing and adversely classified loans. This transaction resulted in charge-offs of approximately \$61.4 million.

The Corporation incorporated the charge-offs information from the second quarter 2015 bulk sale in its measurement of credit impairment for loans collectively measured. In the second quarter of 2015, the total bulk sale charge offs were included in the determination of historical loss rates with no reduction for the additional market discount related to the bulk sale resolution. In the past, the Corporation had separated the market component of the loss. The decision to include total charge-offs, with no qualitative adjustment for the steep discount on this bulk sale, considered the potential use of similar credit resolution strategies in the future in light of the current economic conditions in Puerto Rico. The effect of this position resulted in an increase of \$15.5 million in the related allowance in the second quarter of 2015. During the third quarter of 2015, the Corporation further refined its methodology by allocating the second quarter 2015 bulk sale losses over an estimated realization period of eight quarters, which would reflect a more typical loss resolution pattern. Management believes that this loss estimation process is more indicative of the current experience related to the average period for a loan to migrate to asset classification categories and the eventual charge-off.

As of September 30, 2016, the Corporation maintained a \$2.1 million reserve for unfunded loan commitments (\$0.5 million as of September 30, 2015) mainly related to an outstanding adversely classified floor plan relationship. The reserve for unfunded loan commitments is an estimate of the losses inherent in off-balance sheet loan commitments to borrowers that are experiencing financial difficulties at the balance sheet date. It is calculated by multiplying an estimated loss factor by an estimated probability of funding, and then by the period-end amounts for unfunded commitments. The reserve for unfunded loan commitments is included as part of accounts payable and other liabilities in the consolidated statement of financial condition.

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



**NOTE 8 – LOANS HELD FOR SALE**

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

| (In thousands)             | <b>September 30, 2016</b> | <b>December 31, 2015</b> |
|----------------------------|---------------------------|--------------------------|
| Residential mortgage loans | \$ 48,700                 | \$ 27,734                |
| Construction loans         | 8,079                     | 8,135                    |
| Total                      | \$ 56,779                 | \$ 35,869                |

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

**NOTE 9 – OTHER REAL ESTATE OWNED**

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

| (In thousands)                 | <b>September 30,<br/>2016</b> | <b>December 31,<br/>2015</b> |
|--------------------------------|-------------------------------|------------------------------|
| <b>OREO</b>                    |                               |                              |
| OREO balances, carrying value: |                               |                              |
| Residential (1)                | \$ 45,887                     | \$ 43,563                    |
| Commercial                     | 81,038                        | 87,849                       |
| Construction                   | 12,521                        | 15,389                       |
| Total                          | \$ 139,446                    | \$ 146,801                   |

- (1) Excludes \$15.1 million and \$8.9 million as of September 30, 2016 and December 31, 2015, respectively, of foreclosures that meet the conditions of ASC 310-40 and are presented as a receivable (other assets) in the statement of financial condition.

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

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

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

of the Corporation's interest rate risk management activities is to reduce the variability of earnings caused by changes in interest rates.

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

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

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

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

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

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

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

|  | <b>Notional Amounts <sup>(1)</sup></b>  |  |
|--|---|--|
|  | <b>As of<br/>September 30,<br/>2016</b> | <b>As of<br/>December 31,<br/>2015</b> |
|  | <b>(In thousands)</b>                   |  |
| <b>Undesignated economic hedges:</b>   |   |  |
| Interest rate contracts:               |   |  |
| Written interest rate cap agreements   | \$ 91,510                               | \$ 120,816                             |
| Purchased interest rate cap agreements | 91,510                                  | 120,816                                |
| Forward Contracts:                     |   |  |
| Sale of TBA GNMA MBS pools             | 45,000                                  | 30,000                                 |
|  | \$ 228,020                              | \$ 271,632                             |

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

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

|  | <b>Asset Derivatives</b>                                     |  | <b>Liability Derivatives</b>                             |  |
|--|--|--|--|--|
|  | <b>Statement of<br/>Financial<br/>Condition<br/>Location</b> | <b>September 30,<br/>2016<br/>Fair Value</b> | <b>Statement of Financial<br/>Condition<br/>Location</b> | <b>September 30,<br/>2015<br/>Fair Value</b> |
|  |  | <b>Value</b>                                 |  | <b>Value</b>                                 |
| <b>Undesignated economic hedges:</b>   |  |  |  |  |
| Interest rate contracts:               |  |  |  |  |
| Written interest rate cap agreements   | Other assets   | \$ -   | Accounts payable and other liabilities                   | \$ 191                                       |
| Purchased interest rate cap agreements | Other assets   | 191  | Accounts payable and other liabilities                   | 798  |
| Forward Contracts:                     |  |  |  |  |
| Sales of TBA GNMA MBS pools            | Other assets   | 4  | Accounts payable and other liabilities                   | 144  |
|  |  | \$ 195                                       |  | 806  |
|  |  |  | Accounts payable and other liabilities                   | 144  |
|  |  |  |  | 123  |
|  |  |  |  | \$ 335                                       |
|  |  |  |  | \$ 921                                       |

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



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

| (In thousands)                                     | Location of Gain or (loss)<br>Recognized in Income on<br>Derivatives | Gain (or<br>Loss)<br>Quarter<br>Ended<br>September<br>30,<br>2016 2015 |        | Gain (or<br>Loss)<br>Nine-Month<br>Period Ended<br>September<br>30,<br>2016 2015 |       |
|--|--|--|--------|--|-------|
|  |  |  |        |  |       |
| <b>Undesignated economic hedges:</b>               |  |  |        |  |       |
| Interest rate contracts:                           |  |  |        |  |       |
| Written and purchased interest rate cap agreements | Interest income - Loans  | \$ 5   | \$144  | \$ (2)   | \$144 |
| Forward contracts:                                 |  |  |        |  |       |
| Sales of TBA GNMA MBS pools                        | Mortgage banking activities  | 219  | (279)  | (17)   | (97)  |
| Total gain (loss) on derivatives                   |  | \$ 224   | (\$35) | \$ (19)  | \$ 47 |

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

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

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

**Offsetting of Financial Assets and Derivative Assets**

|   | Gross<br>Amounts<br>of<br>Recognized<br>Assets | Gross<br>Amounts<br>Offset in the<br>Statement of<br>Financial<br>Position | Net<br>Amounts<br>of<br>Assets<br>Presented<br>in the<br>Statement<br>of<br>Financial<br>Position | Gross Amounts<br>Not Offset in the<br>Statement of<br>Financial Position |                    |               |
|---|--|--|---|--|--------------------|---------------|
|   |  |  |   | Financial<br>Instruments   | Cash<br>Collateral | Net<br>Amount |
| <b>As of September 30, 2016</b><br>(In thousands) |  |  |   |  |                    |               |
| <b>Description</b>                                |  |  |   |  |                    |               |
| Derivatives                                       | \$ 191   | \$ -   | \$ 191  | \$ (191)   | \$ -               | \$ -          |
| Securities purchased under agreements to resell   | 200,000  | (200,000)  | -   | -  | -                  | -             |
| Total   | \$ 200,191                                     | \$ (200,000)   | \$ 191  | \$ (191)   | \$ -               | \$ -          |

|                                | Gross<br>Amounts<br>of<br>Recognized<br>Assets | Gross<br>Amounts<br>Offset in the<br>Statement of<br>Financial<br>Position | Net<br>Amounts<br>of<br>Assets<br>Presented<br>in the | Gross Amounts<br>Not Offset in the<br>Statement of<br>Financial Position |                    |               |
|--------------------------------|--|--|---|--|--------------------|---------------|
|                                |  |  |   | Financial<br>Instruments   | Cash<br>Collateral | Net<br>Amount |
| <b>As of December 31, 2015</b> |  |  |   |  |                    |               |

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

**Position Statement  
of  
Financial  
Position**

(In thousands)

**Description**

|   |            |              |        |          |      |      |
|---|------------|--------------|--------|----------|------|------|
| Derivatives                                     | \$ 806     | \$ -         | \$ 806 | \$ (806) | \$ - | \$ - |
| Securities purchased under agreements to resell | 200,000    | (200,000)    | -      | -        | -    | -    |
| Total   | \$ 200,806 | \$ (200,000) | \$ 806 | \$ (806) | \$ - | \$ - |

## Offsetting of Financial Liabilities and Derivative Liabilities

| As of September 30, 2016<br>(In thousands)     | Gross<br>Amounts<br>of<br>Recognized<br>Liabilities | Gross<br>Amounts<br>Offset in<br>the<br>Statement<br>of Financial<br>Position | Net<br>Amounts<br>of<br>Liabilities<br>Presented<br>in the<br>Statement<br>of<br>Financial<br>Position | Gross Amounts<br>Not Offset in the<br>Statement of<br>Financial Position |                    |               |
|--|---|---|--|--|--------------------|---------------|
|  |   |   |  | Financial<br>Instruments   | Cash<br>Collateral | Net<br>Amount |
| <b>Description</b>                             |   |   |  |  |                    |               |
| Securities sold under agreements to repurchase | \$ 500,000  | \$ (200,000)  | \$ 300,000   | \$ (300,000)   | \$ -               | \$ -          |

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

**NOTE 12 – GOODWILL AND OTHER INTANGIBLES**

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

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

In connection with the acquisition of the FirstBank-branded credit card loan portfolio in the second quarter of 2012, the Corporation recognized a purchased credit card relationship intangible of \$24.5 million, which is being amortized over the remaining estimated life of 5.2 years on an accelerated basis based on the estimated attrition rate of the purchased credit card accounts, which reflects the pattern in which the economic benefits of the intangible asset are consumed. These benefits are consumed as the revenue stream generated by the cardholder relationship is realized.

The core deposit intangible acquired in the February 2015 Doral Bank transaction amounted to \$5.8 million (\$4.6 million as of September 30, 2016).

In the first quarter of 2016, FirstBank Insurance Agency acquired certain insurance customer accounts and related customer records and recognized an insurance customer relationship intangible of \$1.1 million (\$1.0 million as of September 30, 2016), which is being amortized over the next 6.3 years on a straight-line basis. The list of accounts acquired has a direct relationship to the previous mortgage loan portfolio acquisitions from Doral Bank and Doral Financial in 2015 and 2014.

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

|                                     | <b>As of<br/>September 30,<br/>2016</b> | <b>As of<br/>December 31,<br/>2015</b> |
|-------------------------------------|---|--|
| (Dollars in thousands)              |   |  |
| Core deposit intangible:            |   |  |
| Gross amount, beginning of period   | \$ 51,664                               | \$ 45,844                              |
| Addition as a result of acquisition | -                                       | 5,820                                  |
| Accumulated amortization            | (43,974)                                | (42,498)                               |

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|  |    |          |    |           |
|--|----|----------|----|-----------|
| Net carrying amount                            | \$ | 7,690    | \$ | 9,166     |
| Remaining amortization period                  |    | 8.3      |    | 9.0 years |
| Purchased credit card relationship intangible: |    |          |    |           |
| Gross amount                                   | \$ | 24,465   | \$ | 24,465    |
| Accumulated amortization                       |    | (13,237) |    | (11,146)  |
| Net carrying amount                            | \$ | 11,228   | \$ | 13,319    |
| Remaining amortization period                  |    | 5.2      |    | 5.8 years |
| Insurance Customer relationship intangible:    |    |          |    |           |
| Gross amount                                   | \$ | 1,067    | \$ | -         |
| Accumulated amortization                       |    | (102)    |    | -         |
| Net carrying amount                            | \$ | 965      | \$ | -         |
| Remaining amortization period                  |    | 6.3      |    | -         |

For the quarter and nine-month period ended September 30, 2016, the amortization expense of core deposit intangibles amounted to \$0.5 million and \$1.5 million, respectively, (2015 - \$0.6 million and \$1.5 million, respectively). For the quarter and nine-month period ended September 30, 2016, the amortization expense of the purchased credit card relationship intangible amounted to \$0.7 million and \$2.1 million, respectively, (2015 - \$0.8 million and \$2.3 million, respectively). For the quarter and nine-month period ended September 30, 2016, the amortization expense of insurance customer relationship intangible amounted to \$38 thousand and \$0.1 million, respectively.

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

|                |    | <b>Amount</b>  |
|----------------|----|----------------|
|                |    | (In thousands) |
| 2016           | \$ | 1,226          |
| 2017           |    | 4,495          |
| 2018           |    | 3,519          |
| 2019           |    | 3,067          |
| 2020           |    | 2,851          |
| 2021 and after |    | 4,725          |

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

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

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

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

### GNMA

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

### Trust-Preferred Securities

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

II variable rate common securities, were used by FBP Statutory Trust II to purchase \$128.9 million aggregate principal amount of the Corporation's Junior Subordinated Deferrable Debentures. The debentures are presented in the Corporation's consolidated statement of financial condition as Other Borrowings, net of related issuance costs. The variable rate trust-preferred securities are fully and unconditionally guaranteed by the Corporation. The Junior Subordinated Deferrable Debentures issued by the Corporation in April 2004 and in September 2004 mature on June 17, 2034 and September 20, 2034, respectively; however, under certain circumstances, the maturity of Junior Subordinated Deferrable Debentures may be shortened (such shortening would result in a mandatory redemption of the variable rate trust-preferred securities). During the first quarter of 2016, the Corporation completed the repurchase of \$10 million 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, which is reflected in the statement of income as a "Gain on early extinguishment of debt." During the second quarter of 2015, the Corporation issued 852,831 shares of the Corporation's common stock in exchange for \$5.3 million of trust preferred securities (FBP Statutory Trust I), which enabled the Corporation to cancel \$5.5 million of the carrying value of the debentures underlying the purchased trust preferred securities. The Collins Amendment to the Dodd-Frank Wall Street Reform and Consumer Protection Act eliminates certain trust-preferred securities from Tier 1 Capital; however, these instruments may remain in Tier 2 capital until the instruments are redeemed or mature. Under the indentures, the Corporation has the right, from time to time, and without causing an event of default, to defer payments of interest on the Junior Subordinated Debentures by extending the interest payment period at any time and from time to time during the term of the subordinated debentures for up to twenty consecutive quarterly periods. During the second quarter of 2016, the Corporation received approval from the Federal Reserve and paid \$31.2 million for all the accrued but deferred interest payments plus the interest for the second quarter on the Corporation's subordinated



debentures associated with its trust preferred securities. Subsequently, the Corporation received approval and paid the interest for the third quarter of 2016 amounting to \$1.8 million. As of September 30, 2016, the Corporation is current on all interest payments due related to its subordinated debt. 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.

### Grantor Trusts

During 2004 and 2005, a third party to the Corporation, referred to in this subsection as the seller, established a series of statutory trusts to effect the securitization of mortgage loans and the sale of trust certificates. The seller initially provided the servicing for a fee, which is senior to the obligations to pay trust certificate holders. The seller then entered into a sales agreement through which it sold and issued the trust certificates in favor of the Corporation's banking subsidiary. Currently, the Bank is the sole owner of the trust certificates; the servicing of the underlying residential mortgages that generate the principal and interest cash flows is performed by another third party, which receives a servicing fee. The securities are variable rate securities indexed to 90-day LIBOR plus a spread. The principal payments from the underlying loans are remitted to a paying agent (servicer), who then remits interest to the Bank; interest income is shared to a certain extent with the FDIC, which has an interest only strip ("IO") tied to the cash flows of the underlying loans and is entitled to receive the excess of the interest income less a servicing fee over the variable rate income that the Bank earns on the securities. This IO is limited to the weighted-average coupon on the securities. The FDIC became the owner of the IO upon its intervention of the seller, a failed financial institution. No recourse agreement exists and the risks from losses on non-accruing loans and repossessed collateral are absorbed by the Bank as the sole holder of the certificates. As of September 30, 2016, the amortized cost and fair value of Grantor Trusts amounted to \$30.6 million and \$22.1 million, respectively, with a weighted average yield of 2.37%.

### Investment in unconsolidated entity

On February 16, 2011, FirstBank sold an asset portfolio consisting of performing and non-performing construction, commercial mortgage and commercial and industrial loans with an aggregate book value of \$269.3 million to CPG/GS, an entity organized under the laws of the Commonwealth of Puerto Rico and majority owned by PRLP Ventures LLC ("PRLP"), a company created by Goldman, Sachs & Co. and Caribbean Property Group. In connection with the sale, the Corporation received \$88.5 million in cash and a 35% interest in CPG/GS, and made a loan in the amount of \$136.1 million representing seller financing provided by FirstBank. The loan has a seven-year maturity and bears variable interest at 30-day LIBOR plus 300 basis points and is secured by a pledge of all of the acquiring entity's assets as well as the PRLP's 65% ownership interest in CPG/GS. As of September 30, 2016, the carrying amount of the loan was \$6.8 million, which was included in the Corporation's Commercial and Industrial loans held for investment portfolio. FirstBank's equity interest in CPG/GS is accounted for under the equity method. When applying the equity method, the Bank follows the Hypothetical Liquidation Book Value method ("HLBV") to determine its share of CPG/GS's earnings or loss. The loss recorded in 2014 reduced to zero the carrying amount of the Bank's investment in CPG/GS. No negative investment needs to be reported as the Bank has no legal obligation or commitment to provide further financial support to this entity; thus, no further losses have been or will be recorded on this investment. Any potential increase in the carrying value of the investment in CPG/GS, under the HLBV method, would depend

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

FirstBank also provided an \$80 million advance facility to CPG/GS to fund unfunded commitments and costs to complete projects under construction, which was fully disbursed in 2011, and a \$20 million working capital line of credit to fund certain expenses of CPG/GS. The working capital line expired in September 2016 and no amount is outstanding. During 2012, CPG/GS repaid the outstanding balance of the advance facility to fund unfunded commitments, and the funds became available for rewithdrawal under a one-time revolver agreement. This facility bears variable interest at 30-day LIBOR plus 300 basis points. As of September 30, 2016, the carrying value of the revolver agreement was \$11.4 million, which was included in the Corporation's commercial and industrial loans held for investment portfolio.

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

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

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

### Servicing Assets

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

The changes in servicing assets are shown below:

| (In thousands)                     | Quarter Ended<br>September 30, |           | Nine-Month Period Ended<br>September 30, |           |
|------------------------------------|--------------------------------|-----------|--|-----------|
|                                    | 2016                           | 2015      | 2016                                     | 2015      |
| Balance at beginning of period     | \$ 25,044                      | \$ 23,519 | \$ 24,282                                | \$ 22,838 |
| Capitalization of servicing assets | 1,420                          | 1,242     | 3,878                                    | 3,789     |
| Amortization                       | (817)                          | (758)     | (2,424)                                  | (2,409)   |
| Adjustment to fair value           | (263)                          | (23)      | (387)                                    | (170)     |
| Other (1)                          | 91                             | (20)      | 126                                      | (88)      |
| Balance at end of period           | \$ 25,475                      | \$ 23,960 | \$ 25,475                                | \$ 23,960 |

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

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

Changes in the impairment allowance were as follows:

| (In thousands)                 | Quarter Ended<br>September 30, |        | Nine-Month Period Ended<br>September 30, |        |
|--------------------------------|--------------------------------|--------|--|--------|
|                                | 2016                           | 2015   | 2016                                     | 2015   |
| Balance at beginning of period | \$ 260                         | \$ 202 | \$ 136                                   | \$ 55  |
| Temporary impairment charges   | 266                            | 41     | 460                                      | 227    |
| Recoveries                     | (3)                            | (18)   | (73)                                     | (57)   |
| Balance at end of period       | \$ 523                         | \$ 225 | \$ 523                                   | \$ 225 |

The components of net servicing income are shown below:

| (In thousands)                                  | Quarter Ended<br>September 30, |          | Nine-Month Period Ended<br>September 30, |          |
|---|--------------------------------|----------|--|----------|
|   | 2016                           | 2015     | 2016                                     | 2015     |
| Servicing fees                                  | \$ 1,930                       | \$ 1,796 | \$ 5,657                                 | \$ 5,340 |
| Late charges and prepayment penalties           | 200                            | 179      | 505                                      | 546      |
| Adjustment for loans repurchased                | 91                             | (20)     | 126                                      | (88)     |
| Other (1)                                       | -                              | (22)     | (1)                                      | (125)    |
| Servicing income, gross                         | 2,221                          | 1,933    | 6,287                                    | 5,673    |
| Amortization and impairment of servicing assets | (1,080)                        | (781)    | (2,811)                                  | (2,579)  |
| Servicing income, net                           | \$ 1,141                       | \$ 1,152 | \$ 3,476                                 | \$ 3,094 |

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

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

|  | Maximum | Minimum |
|--|---------|---------|
| <b>Nine-Month Period Ended September 30, 2016:</b> |         |         |
| <b>Constant prepayment rate:</b>                   |         |         |
| Government-guaranteed mortgage loans               | 7.6%    | 6.1%    |
| Conventional conforming mortgage loans             | 8.0%    | 6.5%    |
| Conventional non-conforming mortgage loans         | 14.1%   | 10.6%   |
| <b>Discount rate:</b>                              |         |         |
| Government-guaranteed mortgage loans               | 12.0%   | 11.5%   |
| Conventional conforming mortgage loans             | 10.0%   | 9.5%    |
| Conventional non-conforming mortgage loans         | 14.3%   | 13.8%   |
| <b>Nine-Month Period Ended September 30, 2015:</b> |         |         |
| <b>Constant prepayment rate:</b>                   |         |         |
| Government-guaranteed mortgage loans               | 9.2%    | 7.9%    |
| Conventional conforming mortgage loans             | 9.0%    | 7.9%    |
| Conventional non-conforming mortgage loans         | 14.4%   | 12.9%   |
| <b>Discount rate:</b>                              |         |         |
| Government-guaranteed mortgage loans               | 11.5%   | 11.5%   |
| Conventional conforming mortgage loans             | 9.5%    | 9.5%    |
| Conventional non-conforming mortgage loans         | 13.8%   | 13.8%   |

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

|  | <b>(Dollars in thousands)</b> |               |
|--|-------------------------------|---------------|
| Carrying amount of servicing assets                            | \$                            | 25,475        |
| Fair value   | \$                            | 27,937        |
| Weighted-average expected life (in years)                      |                               | 8.42          |
| <b>Constant prepayment rate (weighted-average annual rate)</b> |                               | <b>6.34%</b>  |
| Decrease in fair value due to 10% adverse change               | \$                            | 734           |
| Decrease in fair value due to 20% adverse change               | \$                            | 1,435         |
| <b>Discount rate (weighted-average annual rate)</b>            |                               | <b>11.18%</b> |
| Decrease in fair value due to 10% adverse change               | \$                            | 1,311         |
| Decrease in fair value due to 20% adverse change               | \$                            | 2,515         |

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

**NOTE 14 – DEPOSITS**

The following table summarizes deposit balances:

| (In thousands)                         | <b>September 30,<br/>2016</b> | <b>December 31,<br/>2015</b> |
|--|-------------------------------|------------------------------|
| Type of account:                       |                               |                              |
| Non-interest bearing checking accounts | \$ 1,473,528                  | \$ 1,336,559                 |
| Savings accounts                       | 2,458,634                     | 2,459,186                    |
| Interest-bearing checking accounts     | 1,153,096                     | 1,088,651                    |
| Certificates of deposit                | 2,337,547                     | 2,356,245                    |
| Brokered CDs                           | 1,558,508                     | 2,097,483                    |
|  | \$ 8,981,313                  | \$ 9,338,124                 |

Brokered CDs mature as follows:

| (In thousands)                  | <b>September 30,<br/>2016</b> |
|---------------------------------|-------------------------------|
| Three months or less            | \$ 343,396                    |
| Over three months to six months | 255,574                       |
| Over six months to one year     | 350,362                       |
| One to three years              | 524,386                       |
| Three to five years             | 84,605                        |
| Over five years                 | 185                           |
| Total                           | \$ 1,558,508                  |

The following are the components of interest expense on deposits:

| (In thousands)                        | <b>Quarter Ended<br/>September 30,<br/>2016</b> | <b>2015</b> | <b>Nine-Month Period Ended<br/>September 30,<br/>2016</b> | <b>2015</b> |
|---------------------------------------|---|-------------|---|-------------|
| Interest expense on deposits          | \$ 16,130                                       | \$ 15,947   | \$ 49,104   | \$ 48,402   |
| Accretion of premium from acquisition | (43)  | (156)       | (181)   | (441)       |
| Amortization of broker placement fees | 655   | 1,060       | 2,300   | 3,564       |
| Interest expense on deposits          | \$ 16,742                                       | \$ 16,851   | \$ 51,223   | \$ 51,525   |

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

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

| (Dollars in thousands)                                      | <b>September 30, 2016</b> | <b>December 31, 2015</b> |
|---|---------------------------|--------------------------|
| Repurchase agreements, interest ranging from 1.96% to 3.84% |                           |                          |
| (December 31, 2015- 1.96% to 3.41%) (1)(2)                  | \$ 600,000                | \$ 700,000               |

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

(2) As of September 30, 2016, includes \$500 million with an average rate of 3.56% that lenders have the right to call before their contractual maturities at various dates beginning on October 11, 2016. In addition, \$400 million is tied to variable rates.

Repurchase agreements mature as follows:

|                           | <b>September 30, 2016</b> |         |
|---------------------------|---------------------------|---------|
|                           | (In thousands)            |         |
| One month to three months | \$                        | 300,000 |
| One year to three years   |                           | 100,000 |
| Over five years           |                           | 200,000 |
| Total                     | \$                        | 600,000 |

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

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

| (Dollars in thousands)<br>Counterparty | Amount     | Weighted-Average<br>Maturity (In Months) |
|--|------------|--|
| Citigroup Global Markets               | \$ 300,000 | 1  |
| Dean Witter / Morgan Stanley           | 100,000    | 13                                       |
| JP Morgan Chase                        | 200,000    | 64                                       |
|  | \$ 600,000 |  |





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

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

| (Dollars in thousands)  | <b>September 30,<br/>2016</b> | <b>December 31,<br/>2015</b> |
|---|-------------------------------|------------------------------|
| Fixed-rate advances from FHLB, with a weighted-average interest rate of 1.40% (December 31, 2015 - 1.30%) | \$ 355,000                    | \$ 455,000                   |

Advances from FHLB mature as follows:

| (In thousands)               | <b>September 30, 2016</b> |         |
|------------------------------|---------------------------|---------|
| Over six months to one year  | \$                        | 200,000 |
| Over one year to three years |                           | 25,000  |
| Over three to four years     |                           | 130,000 |
| Total                        | \$                        | 355,000 |

As of September 30, 2016, the Corporation had additional capacity of approximately \$1.1 billion on this credit facility based on collateral pledged at the FHLB, including a haircut reflecting the perceived risk associated with holding the collateral.

**NOTE 17 – OTHER BORROWINGS**

Other borrowings consist of:

| (In thousands)   | <b>September 30,<br/>2016</b> | <b>December 31,<br/>2015</b> |
|--|-------------------------------|------------------------------|
| Junior subordinated debentures due in 2034, interest-bearing at a floating rate of 2.75% over 3-month LIBOR (3.61% as of September 30, 2016 and 3.28% as of December 31, 2015) | \$ 97,630                     | \$ 97,626                    |
| Junior subordinated debentures due in 2034,  |                               |                              |

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interest-bearing at a floating rate of 2.50%  
 over 3-month LIBOR (3.36% as of September 30, 2016  
 and 3.07% as of December 31, 2015) (1)

|    |         |    |         |
|----|---------|----|---------|
|    | 118,557 |    | 128,866 |
| \$ | 216,187 | \$ | 226,492 |

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

## NOTE 18 – STOCKHOLDERS' EQUITY

### *Common Stock*

As of September 30, 2016 and December 31, 2015, the Corporation had 2,000,000,000 authorized shares of common stock with a par value of \$0.10 per share. As of September 30, 2016 and December 31, 2015, there were 218,605,179 and 216,051,128 shares issued, respectively, and 217,387,647 and 215,088,698 shares outstanding, respectively. On July 30, 2009, the Corporation announced the suspension of common and preferred stock dividends effective with the preferred dividend for the month of August 2009. Refer to Note 3 for information about transactions related to common stock under the Omnibus Plan.

### *Preferred Stock*

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

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

### *Treasury stock*

During the first nine months of 2016 and 2015, the Corporation withheld an aggregate of 255,102 shares and 181,649 shares, respectively, of the common stock paid to certain senior officers as additional compensation and vested restricted stock to cover employees' payroll and income tax withholding liabilities; these shares are held as treasury shares. As of September 30, 2016 and December 31, 2015, the Corporation had 1,217,532 and 962,430 shares held as treasury stock, respectively.

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

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The Banking Law of the Commonwealth of Puerto Rico requires that a minimum of 10% of FirstBank's net income for the year be transferred to legal surplus until such surplus equals the total of paid-in-capital on common and preferred stock. Amounts transferred to the legal surplus account from the retained earnings account are not available for distribution to the Corporation, including for payment as dividends to the stockholders, without the prior consent of the Puerto Rico Commissioner of Financial Institutions. The Puerto Rico Banking Law provides that, when the expenditures of a Puerto Rico commercial bank are greater than receipts, the excess of the expenditures over receipts shall be charged against the undistributed profits of the bank, and the balance, if any, shall be charged against the reserve fund, as a reduction thereof. If there is no reserve fund sufficient to cover such balance in whole or in part, the outstanding amount shall be charged against the capital account and the Bank cannot pay dividends until it can replenish the reserve fund to an amount of at least 20% of the original capital contributed. During the fourth quarter of 2015, \$2.8 million was transferred to the legal surplus reserve. FirstBank's legal surplus reserve, included as part of retained earnings in the Corporation's statement of financial condition, amounted to \$42.8 million as of September 30, 2016. There were no transfers to the legal surplus reserve during the first nine months of 2016.

## NOTE 19 - INCOME TAXES

Income tax expense includes Puerto Rico and USVI income taxes as well as applicable U.S. federal and state taxes. The Corporation is subject to Puerto Rico income tax on its income from all sources. As a Puerto Rico corporation, First BanCorp. is treated as a foreign corporation for U.S. and USVI income tax purposes and is generally subject to U.S. and USVI income tax only on its income from sources within the U.S. and USVI or income effectively connected with the conduct of a trade or business in those regions. Any 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 in Puerto Rico mainly by investing in government obligations and mortgage-backed securities exempt from U.S. and Puerto Rico income taxes and by doing business through an International Banking Entity ("IBE") unit of the Bank, and through the Bank's subsidiary, FirstBank Overseas Corporation, whose interest income and gain on sales is exempt from Puerto Rico income taxation. The IBE and FirstBank Overseas Corporation were created under the International Banking Entity Act of Puerto Rico, which provides for total Puerto Rico tax exemption on net income derived by IBEs operating in Puerto Rico on the specific activities identified in the IBE Act. An IBE that operates as a unit of a bank pays income taxes at the corporate standard rates to the extent that the IBE's net income exceeds 20% of the bank's total net taxable income.

As of September 30, 2016, the Corporation's deferred tax assets, net of a valuation allowance of \$201.7 million, amounted to \$290.9 million and management concluded, based upon the assessment of all positive and negative evidence, that it is more likely than not that the Corporation will generate sufficient taxable income within the applicable NOL carry-forward periods to realize such amount.

The Corporation recorded an income tax expense of \$10.4 million and \$23.7 million in the third quarter and the first nine months of 2016, respectively, compared to an income tax expense of \$4.5 million and \$2.7 million for the same periods in 2015. The change in income tax expense in the third quarter of 2016, when compared to the third quarter of 2015, is mainly driven by higher taxable income. For the nine-month period ended September 30, 2016, the Corporation calculated the provision for income taxes by applying the estimated annual effective tax rate for the full fiscal year to ordinary income or loss. In the computation of the consolidated worldwide estimated annual effective tax rate, ASC 740-270 requires the exclusion of legal entities with pre-tax losses from which a tax benefit cannot be

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recognized. The consolidated worldwide estimated annual effective tax rate, excluding entities with pre-tax losses from which a tax benefit cannot be recognized, was 24% for the nine-month period ended September 30, 2016, compared to 17% for the same period in 2015. The increase in the estimated effective tax rate for the nine month period ended September 30, 2016, when compared to the same period in 2015, reflects the impact in 2015 of a release in the valuation allowance resulting from the bargain purchase gain, which generated a deferred tax liability. As required by ASC 740-270, changes in the valuation allowance related to the current year are included in the computation of the estimated effective tax rate for the year. The effective tax rate including all entities for the first nine months of 2016 was 25%, compared to 30% for the same period in 2015.

As of September 30, 2016, the Corporation did not have Unrecognized Tax Benefits (“UTBs”) recorded on its books. Audit periods remain open for review until the statute of limitations has passed. The statute of limitations under the 2011 PR code is 4 years; the statute of limitations for income taxes purposes for each of the Virgin Islands and U.S. is three years after a tax return is due or filed, whichever is later. The completion of an audit by the taxing authorities or the expiration of the statute of limitations for a given audit period could result in an adjustment to the Corporation’s liability for income taxes. Any such adjustment could be material to the results of operations for any given quarterly or annual period based, in part, upon the results of operations for the given period. For Virgin Islands and U.S. income tax purposes, all tax years subsequent to 2011 remain open to examination. The 2012 U.S. federal tax return is currently under examination by the IRS. For Puerto Rico tax purposes, all tax years subsequent to 2011 remain open to examination.

## NOTE 20 – FAIR VALUE

### *Fair Value Measurement*

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

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

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

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

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



*Investment securities available for sale*

The fair value of investment securities was the market value based on quoted market prices (as is the case with equity securities, Treasury notes, and non-callable U.S. Agency debt securities), when available (Level 1), or, when available, market prices for identical or comparable assets (as is the case with MBS and callable U.S. agency debt) that are based on observable market parameters, including benchmark yields, reported trades, quotes from brokers or dealers, issuer spreads, bids, offers and reference data including market research operations (Level 2). Observable prices in the market already consider the risk of nonperformance. During the first nine months of 2016, the Corporation recorded OTTI charges of \$6.3 million on certain Puerto Rico Government debt securities, specifically bonds of the GDB and the Puerto Rico Public Buildings Authority. The credit impairment loss was based on the probability of default and loss severity in the event of default in consideration of the latest information available about the Puerto Rico Government's financial condition. Refer to Note 4 - Investment Securities, for significant assumptions used to determine the credit impairment portion, including default rates and recovery rates, which are unobservable inputs. If listed prices or quotes are not available, fair value is based upon models that use unobservable inputs due to the limited market activity of the instrument, as is the case with certain private label mortgage-backed securities held by the Corporation (Level 3).

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

(loan-to-value, state, origination date, property type, occupancy loan purpose, documentation type, debt-to-income ratio, and other) to provide an estimate of default and loss severity.

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

### *Derivative instruments*

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

Although most of the derivative instruments are fully collateralized, a credit spread is considered for those that are not secured in full. The cumulative mark-to-market effect of credit risk in the valuation of derivative instruments for the quarter and nine-month periods ended September 30, 2016 and 2015 was immaterial.

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

| (In thousands)                         | As of September 30, 2016      |           |         |               | As of December 31, 2015       |           |         |               |
|--|-------------------------------|-----------|---------|---------------|-------------------------------|-----------|---------|---------------|
|  | Fair Value Measurements Using |           |         |               | Fair Value Measurements Using |           |         |               |
|  | Level 1                       | Level 2   | Level 3 | at Fair Value | Level 1                       | Level 2   | Level 3 | at Fair Value |
| <b>Assets:</b>                         |                               |           |         |               |                               |           |         |               |
| Securities available for sale :        |                               |           |         |               |                               |           |         |               |
| Equity securities                      | \$ 419                        | \$ -      | \$ -    | \$ 419        | \$ -                          | \$ -      | \$ -    | \$ -          |
| U.S. Treasury Securities               | 7,514                         | -         | -       | 7,514         | 7,497                         | -         | -       | 7,497         |
| Noncallable U.S. agency debt           | -                             | 366,838   | -       | 366,838       | -                             | 315,467   | -       | 315,467       |
| Callable U.S. agency debt and MBS      | -                             | 1,419,951 | -       | 1,419,951     | -                             | 1,509,807 | -       | 1,509,807     |
| Puerto Rico government obligations     | -                             | 24,653    | 2,167   | 26,820        | -                             | 26,327    | 1,890   | 28,217        |
| Private label MBS                      | -                             | -         | 22,211  | 22,211        | -                             | -         | 25,307  | 25,307        |
| Other investments                      | -                             | -         | 100     | 100           | -                             | -         | 100     | 100           |
| Derivatives, included in assets:       |                               |           |         |               |                               |           |         |               |
| Purchased interest rate cap agreements | -                             | 191       | -       | 191           | -                             | 806       | -       | 806           |
| Forward contracts                      | -                             | 4         | -       | 4             | -                             | -         | -       | -             |
| <b>Liabilities:</b>                    |                               |           |         |               |                               |           |         |               |
| Derivatives, included in liabilities:  |                               |           |         |               |                               |           |         |               |

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

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|                                     |   |     |   |     |   |     |   |     |
|-------------------------------------|---|-----|---|-----|---|-----|---|-----|
| Written interest rate cap agreement | - | 191 | - | 191 | - | 798 | - | 798 |
| Forward contracts                   | - | 144 | - | 144 | - | 123 | - | 123 |

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

| <b>Level 3 Instruments Only</b><br>(In thousands) | <b>Quarter Ended September 30,</b>  |   |
|---|---|---|
|   | <b>2016</b><br><b>Securities</b><br><b>Available For Sale<sup>(1)</sup></b> | <b>2015</b><br><b>Securities</b><br><b>Available For Sale<sup>(1)</sup></b> |
| Beginning balance                                 | \$ 26,020   | \$ 31,640   |
| Total gains or (losses) (realized/unrealized):    |   |   |
| Included in earnings                              | -   | (231)   |
| Included in other comprehensive income            | (477)   | 345   |
| Principal repayments and amortization             | (1,065)   | (2,046)   |
| Ending balance                                    | \$ 24,478   | \$ 29,708   |

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

| <b>Level 3 Instruments Only</b><br>(In thousands) | <b>Nine-Month Period Ended September 30,</b>                                |   |
|---|---|---|
|   | <b>2016</b><br><b>Securities</b><br><b>Available For Sale<sup>(1)</sup></b> | <b>2015</b><br><b>Securities</b><br><b>Available For Sale<sup>(1)</sup></b> |
| Beginning balance                                 | \$ 27,297   | \$ 36,212   |
| Total gains or (losses) (realized/unrealized):    |   |   |
| Included in earnings                              | (387)   | (628)   |
| Included in other comprehensive income            | 1,339   | 1,489   |
| Purchases   | -   | 100   |
| Principal repayments and amortization             | (3,771)   | (7,465)   |
| Ending balance                                    | \$ 24,478   | \$ 29,708   |

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

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

| (In thousands)                                   | September 30, 2016 |                      |                                |  |
|--|--------------------|----------------------|--------------------------------|--|
|  | Fair Value         | Valuation Technique  | Unobservable Input             | Range  |
| <b>Investment securities available-for-sale:</b> |                    |                      |                                |  |
| Private label MBS                                | \$ 22,130          | Discounted cash flow | Discount rate                  | 13.3%<br>6.5%<br>-22.5%                      |
|  |                    |                      | Prepayment rate                | (Weighted Average<br>13.7%)<br>0.2%<br>-9.1% |
|  |                    |                      | Projected cumulative loss rate | (Weighted Average<br>4.0%)                   |
| Puerto Rico Government Obligations               | 2,167              | Discounted cash flow | Prepayment rate                | 3.00%  |

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

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

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

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

| <b>Level 3 Instruments Only</b><br>(In thousands)                                    | <b>Changes in<br/>Unrealized Losses<br/>(Quarter ended<br/>September 30,<br/>2016)<br/>Securities<br/>Available For Sale</b> | <b>Changes in<br/>Unrealized Losses<br/>(Quarter ended<br/>September 30, 2015)<br/>Securities<br/>Available For Sale</b> |
|--|--|--|
| <b>Changes in unrealized losses relating to assets still held at reporting date:</b> |  |  |
| Net impairment losses on available-for-sale investment securities (credit component) | \$ -   | \$ (231)   |

| <b>Level 3 Instruments Only</b><br>(In thousands)                                    | <b>Changes in<br/>Unrealized Losses<br/>(Nine-Month Period<br/>Ended September 30,<br/>2016)<br/>Securities<br/>Available For Sale</b> | <b>Changes in<br/>Unrealized Losses<br/>(Nine-Month Period<br/>Ended September 30,<br/>2015)<br/>Securities<br/>Available For Sale</b> |
|--|--|--|
| <b>Changes in unrealized losses relating to assets still held at reporting date:</b> |  |  |
| Net impairment losses on available-for-sale investment securities (credit component) | \$ (387)   | \$ (628)   |

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

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

|  | Carrying value as of September 30, 2016 |         |            | (Losses) recorded for the Quarter Ended | (Losses) recorded for the Nine-Month Period Ended |
|--|---|---------|------------|---|---|
|  | Level 1                                 | Level 2 | Level 3    | September 30, 2016                      | September 30, 2016                                |
|  | (In thousands)                          |         |            |   |   |
| Loans receivable <sup>(1)</sup>          | \$ -                                    | \$ -    | \$ 426,444 | \$ (13,912)                             | \$ (41,621)                                       |
| OREO <sup>(2)</sup>                      | -                                       | -       | 139,446    | (1,702)                                 | (6,580)   |
| Mortgage servicing rights <sup>(3)</sup> | -                                       | -       | 25,475     | (263)                                   | (387)   |

- (1) Consist mainly of impaired commercial and construction loans. The impairment was generally measured based on the fair value of the collateral. The fair value was derived from external appraisals that take into consideration prices in observed transactions involving similar assets in similar locations but adjusted for specific characteristics and assumptions of the collateral (e.g. absorption rates), which are not market observable.
- (2) The fair value was derived from appraisals that take into consideration prices in observed transactions involving similar assets in similar locations but adjusted for specific characteristics and assumptions of the properties (e.g. absorption rates and net operating income of income producing properties), which are not market observable. Losses were related to market valuation adjustments after the transfer of the loans to the OREO portfolio.
- (3) Fair value adjustments to mortgage servicing rights were mainly due to assumptions associated with mortgage prepayment rates. The Corporation carries its mortgage servicing rights at the lower of cost or market, measured at fair value on a non-recurring basis. Assumptions for the value of mortgage servicing rights include: Prepayment rate of 6.34%, Discount Rate of 11.18%.

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

|  | Carrying value as of September 30, 2015 |         |            | (Losses) recorded for the Quarter Ended | (Losses) recorded for the Nine-Month Period Ended |
|--|---|---------|------------|---|---|
|  | Level 1                                 | Level 2 | Level 3    | September 30, 2015                      | September 30, 2015                                |
|  | (In thousands)                          |         |            |   |   |
|  | \$ -                                    | \$ -    | \$ 332,688 | \$ (7,864)                              | \$ (22,431)                                       |

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

|                                  |   |   |         |         |         |
|----------------------------------|---|---|---------|---------|---------|
| Loans receivable<br>(1)          |   |   |         |         |         |
| OREO (2)                         | - | - | 124,442 | (4,025) | (8,790) |
| Mortgage<br>servicing rights (3) | - | - | 23,960  | (23)    | (170)   |
| Loans Held For<br>Sale (4)       | - | - | 8,027   | -       | -       |

- (1) Consist mainly of impaired commercial and construction loans. The impairment was generally measured based on the fair value of the collateral. The fair value was derived from external appraisals that take into consideration prices in observed transactions involving similar assets in similar locations but adjusted for specific characteristics and assumptions of the collateral (e.g. absorption rates), which are not market observable.
- (2) The fair value was derived from appraisals that take into consideration prices in observed transactions involving similar assets in similar locations but adjusted for specific characteristics and assumptions of the properties (e.g. absorption rates and net operating income of income producing properties), which are not market observable. Losses were related to market valuation adjustments after the transfer of the loans to the OREO portfolio.
- (3) Fair value adjustments to the mortgage servicing rights were mainly due to assumptions associated with mortgage prepayments rates. The Corporation carries its mortgage servicing rights at the lower of cost or market, measured at fair value on a non-recurring basis. Assumptions for the value of mortgage servicing rights include: Prepayment Rate of 9.32%, Discount Rate of 10.64%.
- (4) The value of these loans was derived from external appraisals, adjusted for specific characteristics of the loans.



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

|                           |   | <b>September 30, 2016</b>   |
|---------------------------|---|---|
|                           | <b>Method</b>   | <b>Inputs</b>   |
| Loans                     | Income, Market,<br>Comparable Sales,<br>Discounted Cash Flows | External appraised values; probability weighting of broker price opinions; management assumptions regarding market trends or other relevant factors |
| OREO                      | Income, Market,<br>Comparable Sales,<br>Discounted Cash Flows | External appraised values; probability weighting of broker price opinions; management assumptions regarding market trends or other relevant factors |
| Mortgage servicing rights | Discounted Cash Flow  | Weighted average prepayment rate of 6.34%; weighted average discount rate of 11.18%   |

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

*Cash and due from banks and money market investments*

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

*Investment securities held to maturity*

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

*Other equity securities*

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

*Loans receivable, including loans held for sale*

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

### *Deposits*

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

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

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

### *Securities sold under agreements to repurchase*

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

### *Advances from FHLB*

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

### *Other borrowings*

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

The following tables present the carrying value and the estimated fair value of financial instruments as of September 30, 2016 and December 31, 2015:

|  | <b>Total<br/>Carrying<br/>Amount in<br/>Statement of<br/>Financial<br/>Condition<br/>September<br/>30, 2016</b> | <b>Fair Value<br/>Estimate<br/>September<br/>30, 2016</b> | <b>Level 1</b> | <b>Level 2</b> | <b>Level 3</b> |
|--|---|---|----------------|----------------|----------------|
| (In thousands)                                 |   |   |                |                |                |
| <b>Assets:</b>                                 |   |   |                |                |                |
| Cash and due from banks and money              |   |   |                |                |                |
| market investments                             | \$ 528,943  | \$ 528,943  | \$ 528,943     | \$ -           | \$ -           |
| Investment securities available                |   |   |                |                |                |
| for sale                                       | 1,843,853   | 1,843,853   | 7,933          | 1,811,442      | 24,478         |
| Investment securities held to maturity         | 156,190   | 132,241   | -              | -              | 132,241        |
| Other equity securities                        | 28,717  | 28,717  | -              | 28,717         | -              |
| Loans held for sale                            | 56,779  | 60,283  | -              | 50,497         | 9,786          |
| Loans held for investment                      | 8,863,654   |   |                |                |                |
| Less: allowance for loan and lease losses      | (214,070)   |   |                |                |                |
| Loans held for investment, net of allowance    | \$ 8,649,584  | 8,462,434   | -              | -              | 8,462,434      |
| Derivatives, included in assets                | 195   | 195   | -              | 195            | -              |
| <b>Liabilities:</b>                            |   |   |                |                |                |
| Deposits                                       | 8,981,313   | 9,003,706   | -              | 9,003,706      | -              |
| Securities sold under agreements to repurchase | 600,000   | 646,505   | -              | 646,505        | -              |
| Advances from FHLB                             | 355,000   | 356,925   | -              | 356,925        | -              |
| Other borrowings                               | 216,187   | 174,997   | -              | -              | 174,997        |
| Derivatives, included in liabilities           | 335   | 335   | -              | 335            | -              |

|                | <b>Total<br/>Carrying<br/>Amount in<br/>Statement of<br/>Financial<br/>Condition<br/>December 31,<br/>2015</b> | <b>Fair Value<br/>Estimate<br/>December<br/>31, 2015</b> | <b>Level 1</b> | <b>Level 2</b> | <b>Level 3</b> |
|----------------|--|--|----------------|----------------|----------------|
| (In thousands) |  |  |                |                |                |

**Assets:**

Cash and due from banks and money

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|  |              |            |            |           |           |
|--|--------------|------------|------------|-----------|-----------|
| market investments                             | \$ 752,458   | \$ 752,458 | \$ 752,458 | \$ -      | \$ -      |
| Investment securities available                |              |            |            |           |           |
| for sale                                       | 1,886,395    | 1,886,395  | 7,497      | 1,851,601 | 27,297    |
| Investment securities held to maturity         | 161,483      | 131,544    | -          | -         | 131,544   |
| Other equity securities                        | 32,169       | 32,169     | -          | 32,169    | -         |
| Loans held for sale                            | 35,869       | 36,844     | -          | 28,709    | 8,135     |
| Loans held for investment                      | 9,112,382    |            |            |           |           |
| Less: allowance for loan and lease losses      | (240,710)    |            |            |           |           |
| Loans held for investment, net of allowance    | \$ 8,871,672 | 8,768,152  | -          | -         | 8,768,152 |
| Derivatives, included in assets                | 806          | 806        | -          | 806       | -         |
| <b>Liabilities:</b>                            |              |            |            |           |           |
| Deposits                                       | 9,338,124    | 9,334,073  | -          | 9,334,073 | -         |
| Securities sold under agreements to repurchase | 700,000      | 752,048    | -          | 752,048   | -         |
| Advances from FHLB                             | 455,000      | 453,182    | -          | 453,182   | -         |
| Other borrowings                               | 226,492      | 142,846    | -          | -         | 142,846   |
| Derivatives, included in liabilities           | 921          | 921        | -          | 921       | -         |

## NOTE 21 – SUPPLEMENTAL CASH FLOW INFORMATION

Supplemental cash flow information is as follows:

|  | <b>Nine-Month Period Ended</b> |             |
|--|--------------------------------|-------------|
|  | <b>September 30, 2016</b>      |             |
|  | <b>2016</b>                    | <b>2015</b> |
|  | (In thousands)                 |             |
| Cash paid for:   |                                |             |
| Interest on borrowings   | \$ 104,031                     | \$ 70,016   |
| Income tax   | 1,878                          | 3,404       |
| Non-cash investing and financing activities:                                       |                                |             |
| Additions to other real estate owned   | 37,606                         | 44,415      |
| Additions to auto and other repossessed assets                                     | 42,934                         | 57,901      |
| Capitalization of servicing assets   | 3,878                          | 3,789       |
| Loan securitizations   | 238,599                        | 213,391     |
| Loans held for investment transferred to held for sale                             | 10,332                         | -           |
| Loans held for sale transferred to held for investment                             | 1,321                          | -           |
| Trust preferred securities exchanged for new common stock issued:                  |                                |             |
| Trust preferred securities exchanged   | -                              | 5,303       |
| New common stock issued  | -                              | 5,628       |
| Fair value of assets acquired (liabilities assumed) in the Doral Bank transaction: |                                |             |
| Loans  | -                              | 311,410     |
| Premises and equipment, net  | -                              | 5,450       |
| Core Deposit intangible  | -                              | 5,820       |
| Deposits   | -                              | (523,517)   |

## NOTE 22 – SEGMENT INFORMATION

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

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

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

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





The following table presents information about the reportable segments:

| (In thousands)                                   | <b>Mortgage<br/>Banking</b> | <b>Consumer<br/>(Retail)<br/>Banking</b> | <b>Commercial<br/>and<br/>Corporate</b> | <b>Treasury<br/>and<br/>Investments</b> | <b>United<br/>States<br/>Operations</b> | <b>Virgin<br/>Islands<br/>Operations</b> | <b>Total</b> |
|--|-----------------------------|--|---|---|---|--|--------------|
| <b>For the quarter ended September 30, 2016:</b> |                             |  |   |   |   |  |              |
| Interest income                                  | \$ 34,605                   | \$ 44,455                                | \$ 28,981                               | \$ 12,529                               | \$ 13,944                               | \$ 9,059                                 | \$ 113,534   |
| Net (charge) credit for transfer of funds        | (12,074)                    | 2,810                                    | (6,700)                                 | 15,839                                  | 125                                     | -  | 4,000        |
| Interest expense                                 | -                           | (6,323)                                  | -                                       | (14,487)                                | (3,811)                                 | (774)                                    | (25,395)     |
| Net interest income                              | 22,531                      | 40,942                                   | 22,281                                  | 13,881                                  | 10,258                                  | 8,285                                    | 118,178      |
| (Provision) release for loan and lease losses    | (3,860)                     | (8,655)                                  | (8,162)                                 | -                                       | 2,024                                   | (2,850)                                  | (12,443)     |
| Non-interest income                              | 5,222                       | 11,292                                   | 985                                     | 6,154                                   | 884                                     | 1,609                                    | 28,146       |
| Direct non-interest expenses                     | (8,864)                     | (27,100)                                 | (11,871)                                | (914)                                   | (7,556)                                 | (7,097)                                  | (63,492)     |
| Segment income (loss)                            | \$ 15,029                   | \$ 16,479                                | \$ 3,233                                | \$ 19,121                               | \$ 5,610                                | \$ (53)                                  | \$ 59,919    |
| Average earning assets                           | \$2,549,358                 | \$1,973,424                              | \$2,410,037                             | \$2,565,019                             | \$1,252,271                             | \$604,150                                | \$11,354,289 |

| (In thousands)                                   | <b>Mortgage<br/>Banking</b> | <b>Consumer<br/>(Retail)<br/>Banking</b> | <b>Commercial<br/>and<br/>Corporate</b> | <b>Treasury<br/>and<br/>Investments</b> | <b>United<br/>States<br/>Operations</b> | <b>Virgin<br/>Islands<br/>Operations</b> | <b>Total</b> |
|--|-----------------------------|--|---|---|---|--|--------------|
| <b>For the quarter ended September 30, 2015:</b> |                             |  |   |   |   |  |              |
| Interest income                                  | \$ 36,180                   | \$ 48,528                                | \$ 32,636                               | \$ 11,500                               | \$ 11,229                               | \$ 9,739                                 | \$ 149,812   |
| Net (charge) credit for transfer of funds        | (12,629)                    | 4,335                                    | (4,058)                                 | 8,563                                   | 3,789                                   | -  | 12,000       |
| Interest expense                                 | -                           | (5,869)                                  | -                                       | (14,305)                                | (3,931)                                 | (778)                                    | (24,983)     |
| Net interest income                              | 23,551                      | 46,994                                   | 28,578                                  | 5,758                                   | 11,087                                  | 8,961                                    | 124,829      |
| (Provision) release for loan and lease losses    | (6,750)                     | (13,946)                                 | (11,355)                                | -                                       | 1,307                                   | (432)                                    | (33,176)     |
| Non-interest income                              | 3,982                       | 11,759                                   | 647                                     | (174)                                   | 778                                     | 1,766                                    | 18,757       |
| Direct non-interest expenses                     | (8,977)                     | (32,669)                                 | (10,896)                                | (1,103)                                 | (6,914)                                 | (7,441)                                  | (68,090)     |
| Segment income                                   | \$ 11,806                   | \$ 12,138                                | \$ 6,974                                | \$ 4,481                                | \$ 6,258                                | \$ 2,854                                 | \$ 44,511    |
| Average earning assets                           | \$2,642,388                 | \$1,959,951                              | \$2,760,788                             | \$2,531,084                             | \$1,048,451                             | \$644,769                                | \$11,597,411 |

| (In thousands)                                    | <b>Mortgage<br/>Banking</b> | <b>Consumer<br/>(Retail)<br/>Banking</b> | <b>Commercial<br/>and<br/>Corporate</b> | <b>Treasury<br/>and<br/>Investments</b> | <b>United<br/>States<br/>Operations</b> | <b>Virgin<br/>Islands<br/>Operations</b> | <b>Total</b> |
|---|-----------------------------|--|---|---|---|--|--------------|
| <b>Nine-Month Period Ended September 30, 2016</b> |                             |  |   |   |   |  |              |
| Interest income                                   | \$ 104,865                  | \$ 135,655                               | \$ 93,915                               | \$ 39,206                               | \$ 40,091                               | \$ 27,606                                | \$ 341,338   |
| Net (charge) credit for transfer of funds         | (37,673)                    | 10,546                                   | (18,212)                                | 44,226                                  | 1,113                                   | -  | 9,000        |
| Interest expense                                  | -                           | (18,765)                                 | -                                       | (45,828)                                | (11,214)                                | (2,477)                                  | (78,284)     |
| Net interest income                               | 67,192                      | 127,436                                  | 75,703                                  | 37,604                                  | 29,990                                  | 25,129                                   | 303,054      |
| (Provision) release for loan and lease losses     | (21,608)                    | (24,451)                                 | (17,730)                                | -                                       | 1,563                                   | (1,316)                                  | (66,542)     |
| Non-interest income                               | 14,381                      | 35,318                                   | 2,459                                   | 3,815                                   | 2,799                                   | 5,621                                    | 64,393       |

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|                              |           |           |           |           |           |          |
|------------------------------|-----------|-----------|-----------|-----------|-----------|----------|
| Direct non-interest expenses | (29,828)  | (87,218)  | (33,194)  | (3,462)   | (23,070)  | (20,757) |
| Segment income               | \$ 30,137 | \$ 51,085 | \$ 27,238 | \$ 37,957 | \$ 11,282 | \$ 8,677 |

|                        |              |              |              |              |              |            |
|------------------------|--------------|--------------|--------------|--------------|--------------|------------|
| Average earning assets | \$ 2,576,194 | \$ 1,989,426 | \$ 2,489,268 | \$ 2,774,118 | \$ 1,188,463 | \$ 613,666 |
|------------------------|--------------|--------------|--------------|--------------|--------------|------------|

| (In thousands)                                    | <b>Mortgage<br/>Banking</b> | <b>Consumer<br/>(Retail)<br/>Banking</b> | <b>Commercial<br/>and<br/>Corporate</b> | <b>Treasury<br/>and<br/>Investments</b> | <b>United<br/>States<br/>Operations</b> | <b>Virgin<br/>Islands<br/>Operations</b> |
|---|-----------------------------|--|---|---|---|--|
| <b>Nine-Month Period Ended September 30, 2015</b> |                             |  |   |   |   |  |
| Interest income                                   | \$ 106,352                  | \$ 147,395                               | \$ 100,192                              | \$ 36,276                               | \$ 34,477                               | \$ 29,237                                |
| Net (charge) credit for transfer of funds         | (36,212)                    | 12,816                                   | (11,746)                                | 23,936                                  | 11,206                                  | -  |
| Interest expense                                  | -                           | (17,379)                                 | -                                       | (44,834)                                | (12,326)                                | (2,337)                                  |
| Net interest income                               | 70,140                      | 142,832                                  | 88,446                                  | 15,378                                  | 33,357                                  | 26,900                                   |
| (Provision) release for loan and lease losses     | (21,657)                    | (36,588)                                 | (84,170)                                | -                                       | 6,715                                   | (2,712)                                  |
| Non-interest income (loss)                        | 11,866                      | 35,504                                   | 2,350                                   | (13,046)                                | 2,032                                   | 6,008                                    |
| Direct non-interest expenses                      | (26,270)                    | (96,690)                                 | (30,013)                                | (3,487)                                 | (21,293)                                | (24,892)                                 |
| Segment income (loss)                             | \$ 34,079                   | \$ 45,058                                | \$ (23,387)                             | \$ (1,155)                              | \$ 20,811                               | \$ 5,304                                 |
| Average earning assets                            | \$ 2,601,892                | \$ 1,956,352                             | \$ 2,947,562                            | \$ 2,683,313                            | \$ 1,001,860                            | \$ 640,027                               |

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

|                               | Quarter Ended<br>September 30, |           | Nine-Month Period Ended<br>September 30, |           |
|-------------------------------|--------------------------------|-----------|--|-----------|
|                               | 2016                           | 2015      | 2016                                     | 2015      |
| <b>Net income :</b>           |                                |           |  |           |
| Total segment income          | \$ 59,419                      | \$ 44,511 | \$ 166,376                               | \$ 80,710 |
| Other non-interest income     | -                              | -         | -  | 13,443    |
| (1)                           |                                |           |  |           |
| Other operating expenses (2)  | (24,901)                       | (25,277)  | (73,315)                                 | (85,159)  |
| Income before income taxes    | 34,518                         | 19,234    | 93,061                                   | 8,994     |
| Income tax expense            | (10,444)                       | (4,476)   | (23,690)                                 | (2,664)   |
| Total consolidated net income | \$ 24,074                      | \$ 14,758 | \$ 69,371                                | \$ 6,330  |

**Average assets:**

|   |               |               |               |               |
|---|---------------|---------------|---------------|---------------|
| Total average earning assets for segments | \$ 11,354,259 | \$ 11,587,431 | \$ 11,631,135 | \$ 11,831,006 |
| Average non-earning assets                | 926,043       | 925,723       | 927,732       | 916,817       |
| Total consolidated average assets         | \$ 12,280,302 | \$ 12,513,154 | \$ 12,558,867 | \$ 12,747,823 |

- (1) The bargain purchase gain on the acquisition of assets and assumption of deposits from Doral Bank in 2015 is presented as Other non-interest income in the table above.
- (2) Expenses pertaining to corporate administrative functions that support the operating segments but are not specifically attributable to or managed by any segment are not included in the reported financial results of the operating segments. The unallocated corporate expenses include certain general and administrative expenses and related depreciation and amortization expenses.

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

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

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

The Corporation submitted its Capital Plan setting forth its plans for how to improve its capital positions to comply with the Written Agreement over time. In addition to the Capital Plan, the Corporation submitted to its regulators a liquidity and brokered CD plan, including a contingency funding plan, a non-performing asset reduction plan, a budget and profit plan, a strategic plan, and a plan for the reduction of classified and special mention assets. As of September 30, 2016, the Corporation had completed all of the items included in the Capital Plan and is continuing to work on reducing non-performing loans. The Written Agreement also requires the submission to the regulators of quarterly progress reports.

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

The Basel III rules require the Corporation to maintain an additional capital conservation buffer of 2.5% to avoid limitations on both (i) capital distributions (e.g. repurchases of capital instruments or dividend or interest payments on capital instruments) and (ii) discretionary bonus payments to executive officers and heads of major business lines. The phase-in of the capital conservation buffer began on January 1, 2016 with a first year requirement of 0.625% of additional Common Equity Tier 1 Capital (“CET1”), which will be progressively increased over a four-year period, increasing by that same percentage amount on each subsequent January 1 until it reaches the fully phased-in 2.5% CET1 requirement on January 1, 2019.

Under the fully phased-in Basel III rules, in order to be considered adequately capitalized, the Corporation will be required to maintain: (i) a minimum CET1 capital to risk-weighted assets ratio of at least 4.5%, plus the 2.5% “capital conservation buffer,” resulting in a required minimum CET1 ratio of at least 7%, (ii) a minimum ratio of total Tier 1 capital to risk-weighted assets of at least 6.0%, plus the 2.5% capital conservation buffer, resulting in a required minimum Tier 1 capital ratio of 8.5%, (iii) a minimum ratio of total Tier 1 plus Tier 2 capital to risk-weighted assets of at least 8.0%, plus the 2.5% capital conservation buffer, resulting in a required minimum total capital ratio of 10.5%, and (iv) a required minimum leverage ratio of 4%, calculated as the ratio of Tier 1 capital to average on-balance sheet (non-risk adjusted) assets.

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

In March 2016, the FDIC adopted a final rule (“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 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 \$0.8 million in the third quarter 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.

#### Other Recent Regulatory Developments

In May 2016, the federal banking agencies proposed regulations governing incentive-based compensation practices at covered banking institutions. These proposed rules are intended to better align the financial rewards for covered employees with an institution's long-term safety and soundness. Portions of these proposed rules would apply to the Corporation and FirstBank. Those applicable provisions would generally (i) prohibit types and features of incentive-based compensation arrangements that encourage inappropriate risk because they are "excessive" or "could lead to material financial loss" at the banking institution; (ii) require incentive-based compensation arrangements to adhere to three basic principles: (1) a balance between risk and reward; (2) effective risk management and controls; 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.

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

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

|   | <b>Regulatory Requirements</b> |              |  |              |  |              |
|---|--------------------------------|--------------|--|--------------|--|--------------|
|   | <b>Actual</b>                  |              | <b>For Capital Adequacy<br/>Purposes</b> |              | <b>To be<br/>Well-Capitalized-Regular<br/>Thresholds</b> |              |
|   | <b>Amount</b>                  | <b>Ratio</b> | <b>Amount</b>                            | <b>Ratio</b> | <b>Amount</b>  | <b>Ratio</b> |
| (Dollars in thousands)  |                                |              |  |              |  |              |
| <b>As of September 30, 2016</b>                                 |                                |              |  |              |  |              |
| Total Capital (to<br>Risk-Weighted Assets)                      |                                |              |  |              |  |              |
| First BanCorp.  | \$ 1,892,493                   | 21.27%       | \$ 711,754                               | 8.0%         | N/A  | N/A          |
| FirstBank   | \$ 1,843,533                   | 20.73%       | \$ 711,460                               | 8.0%         | \$ 889,325   | 10.0%        |
| Common Equity Tier 1<br>Capital<br>(to Risk-Weighted<br>Assets) |                                |              |  |              |  |              |
| First BanCorp.  | \$ 1,569,482                   | 17.64%       | \$ 400,362                               | 4.5%         | N/A  | N/A          |
| FirstBank   | \$ 1,496,670                   | 16.83%       | \$ 400,196                               | 4.5%         | \$ 578,061   | 6.5%         |
| Tier I Capital (to<br>Risk-Weighted Assets)                     |                                |              |  |              |  |              |
| First BanCorp.  | \$ 1,569,482                   | 17.64%       | \$ 533,816                               | 6.0%         | N/A  | N/A          |
| FirstBank   | \$ 1,730,264                   | 19.46%       | \$ 533,595                               | 6.0%         | \$ 711,460   | 8.0%         |
| Leverage ratio  |                                |              |  |              |  |              |
| First BanCorp.  | \$ 1,569,482                   | 13.04%       | \$ 481,357                               | 4.0%         | N/A  | N/A          |
| FirstBank   | \$ 1,730,264                   | 14.40%       | \$ 480,751                               | 4.0%         | \$ 600,939   | 5.0%         |
| <b>As of December 31, 2015</b>                                  |                                |              |  |              |  |              |
| Total Capital (to<br>Risk-Weighted Assets)                      |                                |              |  |              |  |              |
| First BanCorp.  | \$ 1,828,559                   | 20.01%       | \$ 731,164                               | 8.0%         | N/A  | N/A          |
| FirstBank   | \$ 1,802,711                   | 19.73%       | \$ 730,824                               | 8.0%         | \$ 913,530   | 10.0%        |
| Common Equity Tier 1<br>Capital<br>(to Risk-Weighted<br>Assets) |                                |              |  |              |  |              |
| First BanCorp.  | \$ 1,546,678                   | 16.92%       | \$ 411,280                               | 4.5%         | N/A  | N/A          |
| FirstBank   | \$ 1,493,478                   | 16.35%       | \$ 411,088                               | 4.5%         | \$ 593,794   | 6.5%         |
| Tier I Capital (to<br>Risk-Weighted Assets)                     |                                |              |  |              |  |              |
| First BanCorp.  | \$ 1,546,678                   | 16.92%       | \$ 548,373                               | 6.0%         | N/A  | N/A          |
| FirstBank   | \$ 1,685,656                   | 18.45%       | \$ 548,118                               | 6.0%         | \$ 730,824   | 8.0%         |
| Leverage ratio  |                                |              |  |              |  |              |
| First BanCorp.  | \$ 1,546,678                   | 12.22%       | \$ 506,322                               | 4.0%         | N/A  | N/A          |
| FirstBank   | \$ 1,685,656                   | 13.33%       | \$ 505,648                               | 4.0%         | \$ 632,060   | 5.0%         |



The Corporation enters into financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments may include commitments to extend credit and commitments to sell mortgage loans at fair value. As of September 30, 2016, commitments to extend credit amounted to approximately \$1.1 billion, of which \$631.5 million relates to credit card loans. Commercial and Financial standby letters of credit amounted to approximately \$46.7 million. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any conditions established in the contract. Commitments generally have fixed expiration dates or other termination clauses. Since certain commitments are expected to expire without being drawn upon, the total commitment amount does not necessarily represent future cash requirements. For most of the commercial lines of credit, the Corporation has the option to reevaluate the agreement prior to additional disbursements. In the case of credit cards and personal lines of credit, the Corporation can cancel the unused credit facility at any time and without cause. Generally, the Corporation does not enter into interest rate lock agreements with prospective borrowers in connection with its mortgage banking activities.

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

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

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

**Statements of Financial Condition**

|  | <b>As of September 30,<br/>2016</b> | <b>As of<br/>December 31,<br/>2015</b> |
|--|-------------------------------------|--|
|  | (In thousands)                      |  |
| <b>Assets</b>  |                                     |  |
| Cash and due from banks                              | \$ 29,074                           | \$ 29,103                              |
| Money market investments                             | 6,111                               | 6,111                                  |
| Other investment securities                          | 285                                 | 285                                    |
| Loans held for investment, net                       | 236                                 | 266                                    |
| Investment in First Bank Puerto Rico, at equity      | 1,960,090                           | 1,888,036                              |
| Investment in First Bank Insurance Agency, at equity | 9,991                               | 14,382                                 |
| Investment in FBP Statutory Trust I                  | 2,929                               | 2,929                                  |
| Investment in FBP Statutory Trust II                 | 3,561                               | 3,866                                  |
| Other assets   | 4,354                               | 4,632                                  |
| Total assets   | \$ 2,016,631                        | \$ 1,949,610                           |
| <b>Liabilities and Stockholders' Equity</b>          |                                     |  |
| Liabilities:   |                                     |  |
| Other borrowings                                     | \$ 216,187                          | \$ 226,492                             |
| Accounts payable and other liabilities               | 558                                 | 28,984                                 |
| Total liabilities                                    | 216,745                             | 255,476                                |
| Stockholders' equity                                 | 1,799,886                           | 1,694,134                              |
| Total liabilities and stockholders' equity           | \$ 2,016,631                        | \$ 1,949,610                           |

## Statements of Income

|   | Quarter Ended<br>September 30, |           | Nine-Month Period Ended<br>September 30, |           |
|---|--------------------------------|-----------|--|-----------|
|   | 2016                           | 2015      | 2016                                     | 2015      |
|   | (In thousands)                 |           | (In thousands)                           |           |
| <b>Income:</b>  |                                |           |  |           |
| Interest income on money market investments   | \$ 5                           | \$ 5      | \$ 15                                    | \$ 15     |
| Dividend income from subsidiaries   | 1,822                          | -         | 39,980                                   | -         |
| Other income  | 58                             | 58        | 181                                      | 439       |
|   | 1,885                          | 63        | 40,176                                   | 454       |
| <b>Expense:</b>   |                                |           |  |           |
| Other borrowings  | 1,817                          | 1,861     | 5,777                                    | 5,521     |
| Other operating expenses  | 685                            | 643       | 2,313                                    | 2,000     |
|   | 2,502                          | 2,504     | 8,090                                    | 7,521     |
| Gain on early extinguishment of debt  | -                              | -         | 4,217                                    | -         |
| <b>(Loss) income before income taxes and equity<br/>in undistributed earnings of subsidiaries</b> |                                |           |  |           |
|   | (617)                          | (2,441)   | 36,303                                   | (7,067)   |
| <b>Equity in undistributed earnings of subsidiaries</b>   | 24,691                         | 17,199    | 33,068                                   | 13,397    |
| <b>Net income</b>   | \$ 24,074                      | \$ 14,758 | \$ 69,371                                | \$ 6,330  |
| Other Comprehensive (loss) income, net of tax   | (12,157)                       | 16,709    | 32,109                                   | 13,681    |
| Comprehensive income  | \$ 11,917                      | \$ 31,467 | \$ 101,480                               | \$ 20,011 |

## NOTE 25 – SUBSEQUENT EVENTS

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

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

### SELECTED FINANCIAL DATA

| (In thousands, except for per share and financial ratios)                       | Quarter ended      |                    | Nine-Mo                         |
|---|--------------------|--------------------|---------------------------------|
|   | September 30, 2016 | September 30, 2015 | Period Ended September 30, 2016 |
| <b>Condensed Income Statements:</b>   |                    |                    |                                 |
| Total interest income   | \$ 143,573         | \$ 149,812         | \$ 441,338                      |
| Total interest expense  | 25,395             | 24,883             | 78,284                          |
| Net interest income   | 118,178            | 124,929            | 363,054                         |
| Provision for loan and lease losses   | 21,503             | 31,176             | 63,542                          |
| Non-interest income   | 26,146             | 18,758             | 64,393                          |
| Non-interest expenses   | 88,303             | 93,277             | 270,844                         |
| Income before income taxes  | 34,518             | 19,234             | 93,061                          |
| Income tax expense  | (10,444)           | (4,476)            | (23,690)                        |
| Net income  | 24,074             | 14,758             | 69,371                          |
| Net income attributable to common stockholders                                  | 24,074             | 14,758             | 69,371                          |
| <b>Per Common Share Results:</b>  |                    |                    |                                 |
| Net earnings per share-basic  | \$ 0.11            | \$ 0.07            | \$ 0.33                         |
| Net earnings per share-diluted  | \$ 0.11            | \$ 0.07            | \$ 0.32                         |
| Cash dividends declared   | \$ -               | \$ -               | \$ -                            |
| Average shares outstanding  | 212,927            | 211,820            | 212,682                         |
| Average shares outstanding diluted  | 216,578            | 213,783            | 215,259                         |
| Book value per common share   | \$ 8.11            | \$ 7.74            | \$ 8.11                         |
| Tangible book value per common share (1)  | \$ 7.89            | \$ 7.50            | \$ 7.89                         |
| <b>Selected Financial Ratios (In Percent):</b>                                  |                    |                    |                                 |
| <b>Profitability:</b>   |                    |                    |                                 |
| Return on Average Assets  | 0.78               | 0.47               | 0.74                            |
| Interest Rate Spread  | 3.81               | 3.98               | 3.84                            |
| Net Interest Margin   | 4.06               | 4.19               | 4.09                            |
| Interest Rate Spread - tax equivalent basis (2)                                 | 3.89               | 4.12               | 3.96                            |
| Net Interest Margin - tax equivalent basis (2)                                  | 4.15               | 4.33               | 4.21                            |
| Return on Average Total Equity  | 5.35               | 3.49               | 5.28                            |
| Return on Average Common Equity   | 5.46               | 3.57               | 5.39                            |
| Average Total Equity to Average Total Assets                                    | 14.58              | 13.39              | 13.98                           |
| Tangible common equity ratio (1)  | 14.27              | 12.63              | 14.27                           |
| Dividend payout ratio   | -                  | -                  | -                               |
| Efficiency ratio (3)  | 61.18              | 64.92              | 63.36                           |
| <b>Asset Quality:</b>   |                    |                    |                                 |
| Allowance for loan and lease losses to total loans held for investment          | 2.42               | 2.50               | 2.42                            |
| Net charge-offs (annualized) to average loans (4) (5)                           | 1.90               | 1.04               | 1.35                            |
| Provision for loan and lease losses to net charge-offs (6)                      | 51.34              | 131.39             | 70.46                           |
| Non-performing assets to total assets (4)                                       | 6.16               | 4.81               | 6.16                            |
| Non-performing loans held for investment to total loans held for investment (4) | 6.39               | 5.17               | 6.39                            |
| Allowance to total non-performing loans held for investment (4)                 | 37.77              | 48.44              | 37.77                           |

|   |         |         |         |
|---|---------|---------|---------|
| Allowance to total non-performing loans held for investment,<br>excluding residential real estate loans (4) | 52.92   | 76.81   | 52.92   |
| <b>Other Information:</b>   |         |         |         |
| Common Stock Price: End of period   | \$ 5.20 | \$ 3.56 | \$ 5.20 |

|  |                  |                 |
|--|------------------|-----------------|
|  | <b>As of</b>     | <b>As of</b>    |
|  | <b>September</b> | <b>December</b> |
|  | <b>30, 2016</b>  | <b>31, 2015</b> |

**Balance Sheet Data:**

|   |              |              |
|---|--------------|--------------|
| Loans, including loans held for sale                      | \$ 8,920,433 | \$ 9,148,251 |
| Allowance for loan and lease losses                       | 214,070      | 240,710      |
| Money market and investment securities                    | 2,038,868    | 2,299,520    |
| Intangible assets   | 47,981       | 50,583       |
| Deferred tax asset, net                                   | 290,877      | 311,263      |
| Total assets  | 12,075,253   | 12,573,019   |
| Deposits  | 8,981,313    | 9,338,124    |
| Borrowings  | 1,171,187    | 1,381,492    |
| Total preferred equity                                    | 36,104       | 36,104       |
| Total common equity                                       | 1,759,422    | 1,685,779    |
| Accumulated other comprehensive income (loss), net of tax | 4,360        | (27,749)     |
| Total equity  | 1,799,886    | 1,694,134    |

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- (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 reconciliation of these non-GAAP financial measures).
- (3) Non-interest expense 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 ("PCI") loans. However, Corporation separately tracks and reports PCI loans and excludes these from non-performing loan and non-performing asset amounts.
- (5) The ratio of net charge-offs to average loans, excluding charge-offs associated with a bulk sale of assets, was 1.03% for the nine-month period ended September 30, 2015.
- (6) The ratio of the provision for loan and lease losses to net charge-offs, excluding the impact of a bulk sale of assets, was 129% for the nine-month period ended September 30, 2015.

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

## **EXECUTIVE SUMMARY**

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

## **OVERVIEW OF RESULTS OF OPERATIONS**

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

The Corporation had net income of \$24.1 million, or \$0.11 per diluted common share, for the quarter ended September 30, 2016, compared to \$14.8 million, or \$0.07 per diluted common share, for the same period in 2015. The Corporation's financial results for the third quarters of 2016 and 2015 were impacted by several items that management believes are not reflective of core operating performance, are not expected to reoccur with any regularity or may reoccur at uncertain times and amounts, including: (i) a gain of \$6.1 million (\$5.9 million after-tax) on sales of \$198.7 million of U.S. agency mortgage-backed securities ("MBS") recorded in the third quarter of 2016, (ii) severance payments of \$0.3 million (\$0.2 million after-tax) related to permanent job discontinuance in the third quarter of 2016, and (iii) other-than-temporary impairment ("OTTI") losses on private label MBS of \$0.2 million recorded in the third quarter of 2015 (no tax benefit was recognized for the OTTI charge).

On a non-GAAP basis, excluding the gain on sales of U.S. agency MBS and severance payments in the third quarter of 2016, the adjusted net income of \$18.3 million for the third quarter of 2016 increased \$3.3 million compared to adjusted net income of \$15.0 million for the third quarter of 2015, excluding the OTTI losses on private label MBS.

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

|  | <b>Quarter Ended September 30,</b> |             |
|--|------------------------------------|-------------|
|  | <b>2016</b>                        | <b>2015</b> |
| (In thousands)                                     |                                    |             |
| Net income, as reported                            | \$ 24,074                          | \$ 14,758   |
| Adjustments:                                       |                                    |             |
| Other-than-temporary impairment on debt securities | -                                  | 231         |
| Gain on sale of investment securities              | (6,096)                            | -           |
| Severance payments                                 | 281                                | -           |
| Income tax impact of adjustments                   | 76                                 | -           |
| Adjusted net income                                | \$ 18,335                          | \$ 14,989   |
|  | 77                                 |             |

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

- Net interest income decreased \$6.8 million to \$118.2 million for the quarter ended September 30, 2016 compared to \$124.9 million for the same period in 2015. The decrease in net interest income was primarily driven by a \$5.6 million reduction in interest income on loans, including: (i) a \$4.0 million decrease in interest income on consumer loans mainly attributable to a decrease of \$144.2 million in the average balance of this portfolio, primarily auto loans, (ii) a \$0.5 million decrease in interest income on commercial and construction loans reflecting a decline of \$100.4 million in the average balance of these portfolios that resulted in a decrease of approximately \$1.0 million in interest income, partially offset by higher commercial loan yields that largely reflected the upward repricing of variable rate commercial loans tied to higher short-term interest rates, and (iii) a \$1.0 million decrease in interest income on residential mortgage loans attributable to several factors including lower cash collections on residential non-performing loans, lower accretion income on PCI loans and a decrease of \$18.0 million in the average balance of this portfolio.

In addition, net interest income was adversely impacted by a \$0.9 million decrease in interest income on investment securities, primarily reflecting the gradual reinvestment of MBS prepayments in lower yielding securities given the current interest rate environment, and a \$0.5 million increase in interest expense driven by a higher average balance of Federal Home Loan Bank ("FHLB") advances, the upward repricing of repurchase agreements, and a higher average cost on variable rate money market deposit accounts.

The net interest margin, excluding fair value adjustments, decreased 13 basis points to 4.06% for the third quarter of 2016 compared to the same period in 2015. The decline was primarily driven by lower yields on investment securities and higher funding costs as noted above. Higher rates on new brokered CDs than the rates of matured brokered CDs also contributed to the increase in the average cost of funds, primarily reflecting the current interest rate environment and, to some extent, extended maturities for purposes of interest rate risk management. In addition, the net interest margin was impacted by changes in the mix of earning assets, reflecting higher balances in investment securities and lower loan balances. For a definition and reconciliation of this non-GAAP financial measure, refer to "Net Interest Income" discussion below.

- The provision for loan and lease losses decreased \$9.7 million to \$21.5 million for the third quarter of 2016 compared to \$31.2 million for the same period in 2015. The decrease reflects a reduction of \$4.9 million in the provision for consumer loans, primarily auto loans, driven by lower charge-offs and loss severity rates and the overall decrease in the size of this portfolio. In addition, the provision for residential mortgage loans decreased by \$2.4 million, reflecting lower delinquency levels and the decrease in the size of the portfolio, and the provision for commercial and construction loans decreased by \$2.4 million, primarily related to a lower migration of loans to adverse classification categories.



Net charge-offs totaled \$41.9 million for the third quarter of 2016, or 1.90% of average loans on an annualized basis, compared to \$23.7 million, or 1.04% of average loans, for the same period in 2015. The increase reflects the impact of four large commercial loan charge-offs recorded in the third quarter of 2016 totaling \$22.9 million, of which \$18.3 million was charged against specific reserves established in prior periods. 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 \$26.1 million for the third quarter of 2016, compared to \$18.8 million for the same period in 2015. The increase was primarily related to the \$6.1 million gain on the sales of U.S. agency MBS recorded in the third quarter of 2016 and increases of \$1.2 million and \$0.7 million in revenues from the mortgage banking business and income from service charges on deposit accounts, respectively.
- Non-interest expenses decreased by \$5.0 million to \$88.3 million for the third quarter of 2016 compared to the same period in 2015. The decrease was primarily related to: (i) a \$1.7 million decrease in losses on other real estate owned (“OREO”) operations primarily due to lower required write downs to the value of OREO properties, (ii) a \$1.4 million decrease in occupancy and equipment costs reflecting reductions in depreciation and repairs expenses, (iii) a \$1.0 million decrease in the Federal Deposit Insurance Corporation (“FDIC”) insurance premium expense primarily due to the reduction in the initial base assessment rate, which became effective on July 1, 2016, as well as reductions in brokered deposits and average assets, and (iv) a \$0.9 million decrease in business promotion expenses, primarily related to reduced advertising and marketing activities. Refer to “Non-Interest Expenses” below for additional information.
- For the third quarter of 2016, the Corporation recorded an income tax expense of \$10.4 million, compared to \$4.5 million for the same period in 2015. The Corporation’s effective tax rate for the first nine months of 2016 was 25% (24% excluding entities from which a tax benefit cannot be recognized), which approximates the expected effective tax rate for the year, compared to 30% (17% excluding entities from which a tax benefit cannot be recognized) for the first nine months of 2015.

As of September 30, 2016, the Corporation had a net deferred tax asset of \$290.9 million (net of a valuation allowance of \$201.7 million). Refer to “Income Taxes” below for additional information.

- As of September 30, 2016, total assets were \$12.1 billion, a decrease of \$497.8 million from December 31, 2015. The decrease primarily reflects a \$223.5 million reduction in cash and cash equivalents, associated with liquidity used to repay maturing brokered CDs, repurchase agreements and FHLB advances, and a \$227.8 million decrease in total loans, including a \$104.2 million reduction in commercial and construction loans and a \$99.8 million decrease in consumer loans. The decrease in commercial and construction loans was mainly driven by the repayment of several large commercial loans in the first nine months of 2016, including repayments totaling \$145.3 million associated with six commercial relationships, the sale of a \$20.2 million commercial loan participation, and the four large charge-offs totaling \$22.9 million noted above, partially offset by new loan originations. In addition, total investment securities decreased by \$51.3 million, driven by the aforementioned sales of \$198.7 million of U.S. agency MBS, the maturity or call prior to scheduled maturities of \$87.4 million of U.S. agency debt securities and prepayments of \$177.4 million of U.S. agency MBS, partially offset by purchases of approximately \$405 million of debt securities and MBS issued or guaranteed by U.S. agencies. Refer to “Financial Condition and Operating Data” below for additional information.

- As of September 30, 2016, total liabilities were \$10.3 billion, a decrease of \$603.5 million, from December 31, 2015. The decrease was mainly due to a \$539.0 million decrease in brokered CDs, repayments at maturity of a \$100 million repurchase agreement and a \$100 million FHLB advance, 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 September 30, 2016, the Corporation is current on all interest payments due related to its subordinated debt. These reductions were partially offset by a \$135.0 million increase in deposits, excluding government deposits and brokered CDs, primarily reflected in the Puerto Rico region. Refer to “Risk Management – Liquidity and Capital Adequacy” below for additional information about the Corporation’s funding sources.

- As of September 30, 2016, the Corporation’s stockholders’ equity was \$1.8 billion, an increase of \$105.8 million from December 31, 2015. The increase was mainly driven by the net income of \$69.4 million for the first nine months of 2016 and an increase of approximately \$31.5 million in the fair value of available-for-sale securities recorded as part of other comprehensive income.

- The Corporation’s Total Capital, Common Equity Tier 1 Capital, Tier 1 Capital and Leverage ratios calculated under the Basel III rules were 21.27%, 17.64%, 17.64%, and 13.04%, respectively, as of September 30, 2016, compared to Total Capital, Common Equity Tier 1 Capital, Tier 1 Capital and Leverage ratios of 20.01%, 16.92%, 16.92%, and 12.22%, respectively, as of December 31, 2015. The Corporation’s tangible common equity ratio increased to 14.27% as of September 30, 2016, from 12.84% as of December 31, 2015. Refer to “Risk Management – Capital” below for additional information.

- Total loan production, including purchases, refinancings, renewals and draws from existing revolving and non-revolving commitments, was \$803.6 million for the quarter ended September 30, 2016, excluding the utilization activity on outstanding credit cards, compared to \$759.9 million for the same period in 2015. The increase was primarily related to a higher volume of commercial loan originations in Florida and an increase in residential mortgage loan originations in Puerto Rico.
- Total non-performing assets were \$744.0 million as of September 30, 2016, an increase of \$134.1 million from December 31, 2015. The increase was primarily attributable to the inflow in the first quarter of 2016 of the Corporation's exposure to commercial mortgage loans guaranteed by the Puerto Rico Tourism Development Fund ("TDF") with a book value of \$112.8 million as of September 30, 2016, the inflow in the second quarter of 2016 of a \$35.0 million commercial relationship in Puerto Rico, and the placement of bonds of the Government Development Bank for Puerto Rico (the "GDB") and the Puerto Rico Public Buildings Authority in non-performing status in the third quarter of 2016 as these entities had recently defaulted on interest due on bonds held by the Corporation as part of its available-for-sale securities portfolio. As of September 30, 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 are recorded on the Corporation's books at their aggregate fair value of \$19.5 million. The increase resulting from the inflow of large commercial loans and investment securities was partially offset by reductions in non-performing residential, consumer and OREO balances. Refer to "Risk Management - Non-accruing and Non-performing Assets" below for additional information.
- Adversely classified commercial and construction loans held for investment increased by \$24.6 million to \$546.7 million as of September 30, 2016 from \$522.1 million as of December 31, 2015, including the migration to adverse classification categories of the aforementioned \$35.0 million non-performing commercial relationship in Puerto Rico.

## **Critical Accounting Policies and Practices**

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

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

During the second quarter of 2016, the Corporation reviewed its historical accounting treatment as loans 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 transactions as investment securities rather than loans does not have a material effect on previously reported results of operations, financial condition, or cash flows and, accordingly, these financing arrangements have been accounted for and reported as held-to-maturity investment securities and not as loans since the second quarter of 2016.

## **RESULTS OF OPERATIONS**

### **Net Interest Income**

Net interest income is the excess of interest earned by First BanCorp. on its interest-earning assets over the interest incurred on its interest-bearing liabilities. First BanCorp.'s net interest income is subject to interest rate risk due to the repricing and maturity mismatch of the Corporation's assets and liabilities. Net interest income for the quarter and nine-month period ended September 30, 2016 was \$118.2 million and \$363.1 million, respectively, compared to \$124.9 million and \$377.1 million for the comparable periods in 2015, respectively. On a tax-equivalent basis, and excluding the changes in the fair value of derivative instruments, net interest income for the quarter and nine-month

period ended September 30, 2016 was \$120.7 million and \$373.8 million, respectively, compared to \$129.1 million and \$389.9 million for the comparable periods in 2015, 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 a definition and reconciliation of this non-GAAP financial measure, refer to the discussions below.

## Part I

| Quarter ended September 30,                 | Average Volume |               | Interest income <sup>(1)</sup> /<br>expense |            | Average Rate <sup>(1)</sup> |        |
|---|----------------|---------------|---|------------|-----------------------------|--------|
|   | 2016           | 2015          | 2016  | 2015       | 2016                        | 2015   |
| (Dollars in thousands)                      |                |               |   |            |                             |        |
| Interest-earning assets:                    |                |               |   |            |                             |        |
| Money market & other short-term investments | \$ 525,172     | \$ 574,162    | \$ 662                                      | \$ 410     | 0.50%                       | 0.28%  |
| Government obligations (2)                  | 785,670        | 651,184       | 5,189                                       | 5,415      | 2.63%                       | 3.30%  |
| Mortgage-backed securities                  | 1,395,189      | 1,477,223     | 8,017                                       | 9,995      | 2.29%                       | 2.68%  |
| FHLB stock                                  | 30,939         | 25,434        | 368   | 260        | 4.73%                       | 4.06%  |
| Other investments                           | 2,047          | 938           | 2   | -          | 0.39%                       | -      |
| Total investments (3)                       | 2,739,017      | 2,728,941     | 14,238                                      | 16,080     | 2.07%                       | 2.34%  |
| Residential mortgage loans                  | 3,298,546      | 3,316,518     | 44,888                                      | 45,989     | 5.41%                       | 5.50%  |
| Construction loans                          | 132,658        | 169,957       | 1,069                                       | 1,645      | 3.21%                       | 3.84%  |
| C&I and commercial mortgage loans           | 3,667,955      | 3,731,083     | 38,957                                      | 39,400     | 4.23%                       | 4.19%  |
| Finance leases                              | 228,578        | 227,912       | 4,301                                       | 4,582      | 7.49%                       | 7.98%  |
| Consumer loans                              | 1,507,101      | 1,651,970     | 42,598                                      | 46,335     | 11.24%                      | 11.13% |
| Total loans (4) (5)                         | 8,834,838      | 9,097,440     | 131,813                                     | 137,951    | 5.94%                       | 6.02%  |
| Total interest-earning assets               | \$ 11,573,855  | \$ 11,826,381 | \$ 146,051                                  | \$ 154,031 | 5.02%                       | 5.17%  |
| Interest-bearing liabilities:               |                |               |   |            |                             |        |
| Brokered CDs                                | \$ 1,670,324   | \$ 2,280,309  | \$ 5,177                                    | \$ 5,943   | 1.23%                       | 1.03%  |
| Other interest-bearing deposits             | 5,959,320      | 5,882,383     | 11,565                                      | 10,908     | 0.77%                       | 0.74%  |
| Other borrowed funds                        | 835,752        | 926,492       | 7,179                                       | 7,077      | 3.42%                       | 3.03%  |
| FHLB advances                               | 449,565        | 325,000       | 1,474                                       | 955        | 1.30%                       | 1.17%  |
| Total interest-bearing liabilities          | \$ 8,914,961   | \$ 9,414,184  | \$ 25,395                                   | \$ 24,883  | 1.13%                       | 1.05%  |
| Net interest income                         |                |               | \$ 120,656                                  | \$ 129,148 |                             |        |
| Interest rate spread                        |                |               |   |            | 3.89%                       | 4.12%  |
| Net interest margin                         |                |               |   |            | 4.15%                       | 4.33%  |

| Nine-Month Period Ended September 30,       | Average Volume |               | Interest income <sup>(1)</sup> /<br>expense |            | Average Rate <sup>(1)</sup> |        |
|---|----------------|---------------|---|------------|-----------------------------|--------|
|   | 2016           | 2015          | 2016  | 2015       | 2016                        | 2015   |
| (Dollars in thousands)                      |                |               |   |            |                             |        |
| Interest-earning assets:                    |                |               |   |            |                             |        |
| Money market & other short-term investments | \$ 794,132     | \$ 707,174    | \$ 3,006                                    | \$ 1,457   | 0.51%                       | 0.28%  |
| Government obligations (2)                  | 744,540        | 623,053       | 16,673                                      | 15,026     | 2.99%                       | 3.22%  |
| Mortgage-backed securities                  | 1,388,372      | 1,512,345     | 30,192                                      | 32,793     | 2.90%                       | 2.90%  |
| FHLB stock                                  | 31,120         | 25,445        | 1,066                                       | 812        | 4.58%                       | 4.27%  |
| Other investments                           | 1,750          | 707           | 5   | -          | 0.38%                       | -      |
| Total investments (3)                       | 2,959,914      | 2,868,724     | 50,942                                      | 50,088     | 2.30%                       | 2.33%  |
| Residential mortgage loans                  | 3,309,266      | 3,253,529     | 135,537                                     | 135,781    | 5.47%                       | 5.58%  |
| Construction loans                          | 145,881        | 170,626       | 3,985                                       | 4,743      | 3.65%                       | 3.72%  |
| C&I and commercial mortgage loans           | 3,684,450      | 3,844,012     | 118,753                                     | 121,721    | 4.31%                       | 4.23%  |
| Finance leases                              | 229,561        | 228,978       | 13,045                                      | 13,700     | 7.59%                       | 8.00%  |
| Consumer loans                              | 1,539,844      | 1,689,270     | 129,853                                     | 140,733    | 11.26%                      | 11.14% |
| Total loans (4) (5)                         | 8,909,002      | 9,186,415     | 401,173                                     | 416,678    | 6.01%                       | 6.06%  |
| Total interest-earning assets               | \$ 11,868,916  | \$ 12,055,139 | \$ 452,115                                  | \$ 466,766 | 5.09%                       | 5.18%  |
| Interest-bearing liabilities:               |                |               |   |            |                             |        |
| Brokered CDs                                | \$ 1,907,199   | \$ 2,483,295  | \$ 17,041                                   | \$ 18,592  | 1.19%                       | 1.00%  |
| Other interest-bearing deposits             | 5,964,129      | 5,894,230     | 34,182                                      | 32,933     | 0.77%                       | 0.75%  |
| Other borrowed funds                        | 914,205        | 1,009,129     | 22,645                                      | 22,518     | 3.31%                       | 2.98%  |
| FHLB advances                               | 453,175        | 325,000       | 4,416                                       | 2,833      | 1.30%                       | 1.17%  |
| Total interest-bearing liabilities          | \$ 9,238,708   | \$ 9,711,654  | \$ 78,284                                   | \$ 76,876  | 1.13%                       | 1.06%  |
| Net interest income                         |                |               | \$ 373,831                                  | \$ 389,890 |                             |        |
| Interest rate spread                        |                |               |   |            | 3.96%                       | 4.12%  |
| Net interest margin                         |                |               |   |            | 4.21%                       | 4.32%  |

(1) On an adjusted tax-equivalent basis. The adjusted tax-equivalent yield was estimated by dividing the interest rate spread on exempt assets by 1 less the Puerto Rico statutory tax rate of 39.0% and adding to it the cost of interest-bearing liabilities. The tax-equivalent adjustment recognizes the income tax savings when comparing taxable and tax-exempt assets. Management believes that it is a standard practice in the banking industry to present net interest income, interest rate spread and net interest margin on a fully tax-equivalent basis. Therefore, management believes these measures provide useful information to investors by allowing them to make peer comparisons. Changes in the fair value of derivatives are excluded from interest income and interest expense because the changes in valuation do not affect interest paid or received.

- (2) Government obligations include debt issued by government-sponsored agencies.
- (3) Unrealized gains and losses on available-for-sale securities are excluded from the average volumes.
- (4) Average loan balances include the average of non-performing loans.
- (5) Interest income on loans includes \$2.4 million and \$2.6 million for the quarters ended September 30, 2016 and 2015, respectively, and \$7.6 million and \$7.8 million for the nine-month periods ended September 30, 2016 and 2015, respectively, of income from prepayment penalties and late fees related to the Corporation's loan portfolio.



## Part II

| (In thousands)                                    | Quarter ended September<br>30,<br>2016 compared to 2015<br>Increase (decrease) |            |            | Nine-Month Period Ended<br>September 30,<br>2016 compared to 2015<br>Increase (decrease) |            |             |
|---|--|------------|------------|--|------------|-------------|
|   | Due to:  |            |            | Due to:  |            |             |
|   | Volume   | Rate       | Total      | Volume   | Rate       | Total       |
| Interest income on interest-earning assets:       |  |            |            |  |            |             |
| Money market & other short-term investments       | \$ (48)  | \$ 300     | \$ 252     | \$ 199   | \$ 1,350   | \$ 1,549    |
| Government obligations                            | 988  | (1,214)    | (226)      | 2,837  | (1,190)    | 1,647       |
| Mortgage-backed securities                        | (539)  | (1,439)    | (1,978)    | (2,681)  | 80         | (2,601)     |
| FHLB stock  | 61   | 47         | 108        | 192  | 62         | 254         |
| Other investments                                 | -  | 2          | 2          | -  | 5          | 5           |
| Total investments                                 | 462  | (2,304)    | (1,842)    | 547  | 307        | 854         |
| Residential mortgage loans                        | (279)  | (822)      | (1,101)    | 2,373  | (2,617)    | (244)       |
| Construction loans                                | (329)  | (247)      | (576)      | (673)  | (85)       | (758)       |
| C&I and commercial mortgage loans                 | (719)  | 276        | (443)      | (5,050)  | 2,082      | (2,968)     |
| Finance leases                                    | 6  | (287)      | (281)      | 41   | (696)      | (655)       |
| Consumer loans                                    | (4,124)  | 387        | (3,737)    | (12,479)   | 1,599      | (10,880)    |
| Total loans                                       | (5,445)  | (693)      | (6,138)    | (15,788)   | 283        | (15,505)    |
| Total interest income                             | (4,983)  | (2,997)    | (7,980)    | (15,241)   | 590        | (14,651)    |
| Interest expense on interest-bearing liabilities: |  |            |            |  |            |             |
| Brokered CDs                                      | (1,739)  | 973        | (766)      | (4,731)  | 3,180      | (1,551)     |
| Other interest-bearing deposits                   | 138  | 519        | 657        | 404  | 845        | 1,249       |
| Other borrowed funds                              | (741)  | 843        | 102        | (2,230)  | 2,357      | 127         |
| FHLB advances                                     | 396  | 123        | 519        | 1,221  | 362        | 1,583       |
| Total interest expense                            | (1,946)  | 2,458      | 512        | (5,336)  | 6,744      | 1,408       |
| Change in net interest income                     | \$ (3,037)   | \$ (5,455) | \$ (8,492) | \$ (9,905)   | \$ (6,154) | \$ (16,059) |

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 gain on sales of investments held by the Corporation's international banking entities ("IBEs") are tax-exempt under the Puerto Rico tax law (refer to "Income Taxes" below for additional information). To facilitate the comparison of all interest data related to these assets, the interest income has been converted to an adjusted taxable equivalent basis. The tax equivalent yield was estimated by dividing the interest rate spread on exempt assets by 1 less the Puerto Rico statutory tax rate as adjusted for changes to enacted tax rates (39.0%) and adding to it the average cost of interest-bearing liabilities. The computation considers the interest expense disallowance required by Puerto Rico tax law.

The presentation of net interest income excluding the effects of the changes in the fair value of the derivative instruments ("valuations") provides additional information about the Corporation's net interest income and facilitates

comparability and analysis. The changes in the fair value of the derivative instruments have no effect on interest due or interest earned on interest-bearing liabilities or interest-earning assets, respectively, or on interest payments exchanged with interest rate swap counterparties.

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

(Dollars in thousands)

|   | <b>Quarter Ended</b> |                  | <b>Nine-Month</b> |
|---|----------------------|------------------|-------------------|
|   | <b>September</b>     | <b>September</b> | <b>September</b>  |
|   | <b>30, 2016</b>      | <b>30, 2015</b>  | <b>30, 2016</b>   |
| Interest Income - GAAP  | \$ 143,573           | \$ 149,812       | \$ 441,338        |
| Unrealized (gain) loss on derivative instruments  | (5)                  | (144)            | 1                 |
| Interest income excluding valuations  | 143,568              | 149,668          | 441,339           |
| Tax-equivalent adjustment   | 2,483                | 4,363            | 10,776            |
| Interest income on a tax-equivalent basis excluding valuations                              | 146,051              | 154,031          | 452,115           |
| Interest Expense - GAAP   | 25,395               | 24,883           | 78,284            |
| Net interest income - GAAP  | \$ 118,178           | \$ 124,929       | \$ 363,054        |
| Net interest income excluding valuations  | \$ 118,173           | \$ 124,785       | \$ 363,055        |
| Net interest income on a tax-equivalent basis excluding valuations                          | \$ 120,656           | \$ 129,148       | \$ 373,831        |
| <b>Average Balances</b>   |                      |                  |                   |
| Loans and leases  | \$ 8,834,838         | \$ 9,097,440     | \$ 8,909,002      |
| Total securities, other short-term investments and interest-bearing cash balances           | 2,739,017            | 2,728,941        | 2,959,914         |
| Average Interest-Earning Assets   | \$ 11,573,855        | \$ 11,826,381    | \$ 11,868,916     |
| Average Interest-Bearing Liabilities  | \$ 8,914,961         | \$ 9,414,184     | \$ 9,238,708      |
| <b>Average Yield/Rate</b>   |                      |                  |                   |
| Average yield on interest-earning assets - GAAP   | 4.94%                | 5.03%            | 4.97%             |
| Average rate on interest-bearing liabilities - GAAP   | 1.13%                | 1.05%            | 1.13%             |
| Net interest spread - GAAP  | 3.81%                | 3.98%            | 3.84%             |
| Net interest margin - GAAP  | 4.06%                | 4.19%            | 4.09%             |
| Average yield on interest-earning assets excluding valuations                               | 4.93%                | 5.02%            | 4.97%             |
| Average rate on interest-bearing liabilities excluding valuations                           | 1.13%                | 1.05%            | 1.13%             |
| Net interest spread excluding valuations  | 3.80%                | 3.97%            | 3.84%             |
| Net interest margin excluding valuations  | 4.06%                | 4.19%            | 4.09%             |
| Average yield on interest-earning assets on a tax-equivalent basis and excluding valuations | 5.02%                | 5.17%            | 5.09%             |
| Average rate on interest-bearing liabilities excluding valuations                           | 1.13%                | 1.05%            | 1.13%             |
| Net interest spread on a tax-equivalent basis and excluding valuations                      | 3.89%                | 4.12%            | 3.96%             |
| Net interest margin on a tax-equivalent basis and excluding valuations                      | 4.15%                | 4.33%            | 4.21%             |

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

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

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

For the quarter and nine-month period ended September 30, 2016, net interest income decreased \$6.8 million to \$118.2 million, and \$14.0 million to \$363.1 million, respectively, compared to the same periods in 2015. The \$6.8 million decrease in net interest income for the third quarter of 2016, compared to the same period in 2015 was primarily due to:

- A \$4.0 million decrease in interest income on consumer loans and finance leases mainly attributable to the decrease of \$144.2 million in the average balance of this portfolio, primarily auto loans.
- A \$1.0 million decrease in interest income on residential mortgage loans attributable to lower cash collections on residential non-performing loans, lower accretion income on PCI loans and the decrease of \$18.0 million in the average balance of this portfolio.
- A \$0.5 million decrease in interest income on commercial and construction loans, reflecting the decline of \$100.4 million in the average balance of these portfolios that resulted in a decrease of approximately \$1.0 million in interest income, partially

offset by higher yields on variable rate commercial loans that largely reflected the upward repricing of loans tied to short-term interest rates.

- A \$0.9 million decrease in interest income on investment securities, primarily reflecting the gradual reinvestment of MBS prepayments in lower yielding securities given the current interest rate environment.
- A \$0.5 million increase in interest expense driven by: (i) a \$0.5 million increase in interest expense on FHLB advances primarily attributable to \$130.0 million of advances obtained during the fourth quarter of 2015 with maturities of four years and at an average cost of 1.64%, (ii) a \$0.7 million increase in interest expense on non-brokered deposits reflecting higher costs on variable money market deposit accounts and the growth and pricing of new and renewed retail CDs in the current interest rate environment, and (iii) a \$0.1 million increase in interest expense on repurchase agreements reflecting the upward repricing of the agreements, almost entirely offset by the effect of the \$100 million repurchase agreement that matured in mid-July 2016 that carried a cost of 2.50%. These increases were partially offset by a \$0.8 million decrease in the interest expense on brokered CDs mainly related to the effect of the \$610.0 million decrease in the average balance, which more than offset higher costs due to both higher market interest rates, and, to a lesser extent, longer terms on new issuances compared to maturing CDs.

The \$14.0 million decrease in net interest income for the first nine months of 2016, compared to the same period in 2015 was primarily due to:

- An \$11.5 million decrease in interest income on consumer loans and finance leases mainly attributable to the decrease of \$148.8 million in the average balance of this portfolio, primarily auto loans.
- A \$2.2 million decrease in interest income on commercial and construction loans, primarily reflecting a decline of \$184.3 million in the average balance of these portfolios that resulted in a decrease of approximately \$3.0 million in interest income and the adverse impact of large commercial relationships classified as non-performing in 2016. Partially offsetting these variances were higher prepayments in 2016 that resulted in an increase of \$1.5 million in prepayment penalties and deferred fees amortization and the upward repricing of variable commercial loans tied to short-term interest rates.
- A \$1.4 million increase in interest expense, primarily reflecting: (i) a \$1.6 million increase in interest expense on FHLB advances primarily attributable to the aforementioned \$130.0 million of advances obtained during the fourth quarter of 2015, and (ii) a \$1.2 million increase in interest expense on non-brokered deposits attributable to a \$69.9 million increase in the average balance, the higher pricing of new and renewed retail CDs at current market interest rates, and higher costs on variable rate money market deposit accounts. These increases were partially offset by a \$1.5 million decrease in the interest expense on brokered CDs mainly related to the effect of the \$576.1 million decrease in the average balance that offset higher costs on new issuances. Over the past 12 months, the Corporation repaid \$1.5

billion of maturing brokered CDs with an all-in cost of 0.93% and new issuances amounted to \$753.4 million with an all-in cost of 1.16%.

- A \$0.3 million decrease in interest income on investment securities, primarily reflecting the gradual reinvestment of MBS prepayments in lower yielding securities given the current interest rate environment.

Partially offset by:

- A \$1.5 million increase in interest income on interest-bearing cash balances, due to the increase in fed fund rates in December 2015 and the \$87.0 million increase in the average balance.

The net interest margin, excluding fair value adjustments, decreased by 13 basis points to 4.06% for the third quarter of 2016 compared to the same period in 2015, and decreased by 9 basis points to 4.09% for the first nine months of 2016 compared to the same period in 2015. The decrease in net interest margin for both periods was primarily driven by lower yields on investment securities and higher funding costs as noted above as well as changes in the mix of earnings assets reflecting higher balances in investment securities and lower loan balances.

On an adjusted tax-equivalent basis, net interest income for the quarter ended September 30, 2016 decreased by \$8.5 million to \$120.7 million when compared to the same period in 2015 and by \$16.1 million to \$373.8 million for the first nine months of 2016 compared to the same period in 2015. In addition to the facts discussed above, the decrease also includes reductions of \$1.9 million for the quarter and \$2.2 million for the nine-month period in the tax-equivalent adjustment attributable to a lower volume of tax-exempt assets.

### Provision for Loan and Lease Losses

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

For the third quarter ended September 30, 2016, the Corporation recorded a provision for loan and lease losses of \$21.5 million compared to \$31.2 million for the same period in 2015. The \$9.7 million decrease in the provision was driven by:

- A \$4.9 million decrease in the provision for consumer loans, primarily auto loans, driven by lower charge-offs and loss severity rates and the overall decrease in the size of this portfolio.
- A \$2.4 million decrease in the provision for residential mortgage loans, reflecting lower delinquency and non-performing loan levels and the decrease in the size of the portfolio.
- A \$2.4 million decrease in the provision for commercial and construction loans, primarily reflecting a lower migration of loans to adverse classification categories. During the third quarter of 2015, the Corporation classified as impaired its exposure to commercial mortgage loans guaranteed by the TDF and increased the associated specific reserves. As noted below, the Corporation recorded in the third quarter of 2016 charge-offs of \$13.7 million associated with two of the three facilities guaranteed by the TDF, of which \$12.8 million was charged against specific reserves established in prior periods.

For the nine-month period ended September 30, 2016, the Corporation recorded a provision for loan and lease losses of \$—63.5 million compared to \$138.4 million for the same period in 2015. The provision for the first nine months of 2015 included a charge of \$46.9 million associated with a bulk sale of assets.

On June 5, 2015, the Corporation completed the bulk sale of commercial and construction loans with a book value of \$147.5 million (principal balance of \$196.5 million), comprised mostly of non-performing and adversely classified loans, as well as OREO with a book value of \$2.9 million in a cash transaction. The sale price of this bulk sale was \$87.3 million. Approximately \$15.3 million of reserves had been allocated to the loans. This transaction resulted in

total charge-offs of \$61.4 million and an incremental pre-tax loss of \$48.7 million, including \$0.9 million in professional service fees directly attributable to this bulk sale.

Excluding the impact of the bulk sale of assets in 2015, the provision of \$63.5 million for the first nine months of 2016 decreased by \$28.0 million compared to the provision of \$91.5 million for the same period in 2015. The \$28.0 million decrease in the provision, as compared to the 2015 adjusted provision, was driven by:

- A \$16.2 million decrease in the provision for commercial and construction loans primarily due to the impact in 2015 of a \$15.5 million charge to the adjusted provision as a result of the incorporation of the \$61.4 million of net charge-offs from the bulk sale in the historical loss rates used to estimate the general reserve for commercial loans collectively evaluated for impairment and lower migration of loans to adversely classified categories as noted above, partially offset by a \$1.6 million decrease in loan loss recoveries in Florida.
- An \$11.6 million decrease in the provision for consumer loans, primarily reflecting lower levels of charge-offs, declining loss severity rates on auto loans and the overall decrease in the size of these portfolios. Consumer loans net charge-offs decreased by \$6.9 million for the first nine months of 2016 compared to the same period in 2015.

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



**Non-Interest Income**

|  | <b>Quarter Ended</b> |             | <b>Nine-Month Period</b>   |             |
|--|----------------------|-------------|----------------------------|-------------|
|  | <b>September 30,</b> |             | <b>Ended September 30,</b> |             |
|  | <b>2016</b>          | <b>2015</b> | <b>2016</b>                | <b>2015</b> |
|  | (In thousands)       |             |                            |             |
| Service charges on deposit accounts  | \$ 5,788             | \$ 5,082    | \$ 17,206                  | \$ 14,856   |
| Mortgage banking activities  | 5,485                | 4,270       | 15,131                     | 12,651      |
| Insurance income   | 1,363                | 1,265       | 6,175                      | 5,809       |
| Other operating income   | 7,414                | 8,372       | 22,247                     | 24,882      |
| Non-interest income before net gain (loss) on investments,<br>gain on early extinguishment of debt, and bargain<br>purchase gain | 20,050               | 18,989      | 60,759                     | 58,198      |
| Net gain on sale of investments  | 6,096                | -           | 6,104                      | -           |
| OTTI on debt securities  | -                    | (231)       | (6,687)                    | (13,484)    |
| Net gain (loss) on investments   | 6,096                | (231)       | (583)                      | (13,484)    |
| Bargain purchase gain  | -                    | -           | -                          | 13,443      |
| Gain on early extinguishment of debt   | -                    | -           | 4,217                      | -           |
| Total  | \$ 26,146            | \$ 18,758   | \$ 64,393                  | \$ 58,157   |

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; and net gains and losses on investments and impairments.

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

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

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

The other operating income category is composed of miscellaneous fees such as debit, credit card and point of sale (POS) interchange fees, 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 September 30, 2016, the Corporation still has Floating Rate Junior Subordinated Debentures ("subordinated debt") outstanding in the aggregate amount of \$216.2 million.

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

Non-interest income for the third quarter of 2016 amounted to \$26.1 million, compared to \$18.8 million for the third quarter of 2015. The increase in non-interest income of \$7.4 million was primarily due to the following:

- A \$6.1 million gain on sales of U.S. agency MBS totaling \$198.7 million that carried an average yield of 2.36%.
- A \$1.2 million increase in revenues from the mortgage banking business, driven by a \$0.9 million increase in gain on sales of residential mortgage loans in the secondary market, mainly associated with a higher volume of sales and a \$0.3 million increase related to lower losses on to-be-announced (“TBAs”) MBS forward contracts. Loans sold in the secondary market to U.S. government-sponsored entities amounted to \$127.9 million with a related gain of \$4.6 million in the third quarter of 2016, compared to \$117.0 million with a related gain of \$3.7 million in the comparable period of 2015.
- A \$0.7 million increase in income from service charges on deposit accounts primarily reflecting the implementation in November 2015 of new service and transactional fees on certain products and higher corporate cash management fees.
- The impact in the third quarter of 2015 of a \$0.2 million OTTI charge on private label MBS.

Partially offset by:

- A \$1.0 million decrease in “other operating income” in the table above, reflecting a \$1.5 million decrease in fees from merchant transactions due to the sale of merchant contracts completed in the fourth quarter of 2015 (a reduction of approximately \$1.1 million in processing costs, depreciation and other expenses related to the sale of merchant contracts was reflected in non-interest expenses), partially offset by increases in debit card and ATM fees.

Non-interest income for the nine-month period ended September 30, 2016 amounted to \$64.4 million, compared to \$58.2 million for the same period in 2015. The \$6.2 million increase in non-interest income was primarily due to:

- A \$6.8 million decrease in OTTI charges on debt securities. During the first half 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 GDB and the Puerto Rico Public Buildings Authority. This was the third OTTI charge on these securities recorded since June 30, 2015, as OTTI charges of \$12.9 million and \$3.0 million were booked in the second and fourth quarters of 2015, respectively. Refer to Note 4 of the Corporation's unaudited consolidated financial statements for the quarter ended September 30, 2016 for additional information about the determination of this charge. As noted above, these bonds were placed in non-performing status in the third quarter of 2016 as these entities had recently defaulted on interest due on bonds held by the Corporation.
- 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 \$2.4 million increase in service charges on deposits, primarily associated with the full period impact of deposits assumed from Doral Bank late in February 2015, as well as the aforementioned implementation of new service and transactional fees on certain products in November 2015.
- A \$2.5 million increase in revenues from the mortgage banking business, driven by a \$3.1 million increase in gain on sales of residential mortgage loans in the secondary market associated with both a higher volume of sales and market expectations of lower long-term interest rates that resulted in higher gain margins, partially offset by a \$1.0 million increase in losses on TBAs MBS forward contracts. Loans sold in the secondary market to U.S. government-sponsored entities amounted to \$347.1 million with a related gain of \$13.2 million in the first nine months of 2016, compared to \$323.5 million with a related gain of \$10.1 million in the comparable period of 2015. In addition, loan servicing fees increased by \$0.3 million commensurate with the increase in the servicing portfolio.
- A \$0.4 million increase in insurance commission income.

Partially offset by:

- The impact in 2015 of the \$13.4 million bargain purchase gain on assets acquired and deposits assumed from Doral.
- A \$2.6 million decrease in “other operating income” in the table above, reflecting a \$5.3 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 a \$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 the second quarter of 2016, a \$0.4 million fee income recorded in the first quarter of 2016 related to a terminated credit agreement in which the Bank was committed to purchase a loan participation and higher debit cards and ATM fee income.
- 

### Non-Interest Expenses

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

|   | Quarter Ended<br>September 30, |           | Nine-Month Period<br>Ended September 30, |            |
|---|--------------------------------|-----------|--|------------|
|   | 2016                           | 2015      | 2016                                     | 2015       |
|   | (In thousands)                 |           |  |            |
| Employees' compensation and benefits                  | \$ 38,005                      | \$ 37,284 | \$ 113,841                               | \$ 110,883 |
| Occupancy and equipment                               | 13,888                         | 15,248    | 41,114                                   | 44,656     |
| Insurance and supervisory fees                        | 5,604                          | 6,590     | 20,013                                   | 20,246     |
| Taxes, other than income taxes                        | 3,927                          | 3,065     | 11,475                                   | 9,197      |
| Professional service fees:                            |                                |           |  |            |
| Collections, appraisals and other credit-related fees | 2,267                          | 2,269     | 7,546                                    | 9,493      |
| Outsourcing technology services                       | 5,124                          | 4,549     | 14,829                                   | 14,042     |
| Other professional fees                               | 3,281                          | 3,891     | 10,400                                   | 21,397     |
| Credit and debit card processing expenses             | 3,546                          | 4,283     | 10,102                                   | 12,185     |
| Business promotion                                    | 3,169                          | 4,097     | 11,220                                   | 10,899     |
| Communications  | 1,711                          | 2,189     | 5,244                                    | 5,842      |
| Net loss on OREO and OREO operations                  | 2,603                          | 4,345     | 9,134                                    | 11,847     |
| Other   | 5,178                          | 5,467     | 15,926                                   | 17,117     |
| Total   | \$ 88,303                      | \$ 93,277 | \$ 270,844                               | \$ 287,804 |

Non-interest expenses decreased by \$5.0 million to \$88.3 million for the third quarter of 2016 compared to \$93.3 million for the third quarter of 2015. The decrease of \$5.0 million in non-interest expenses was principally attributable to:

- A \$1.7 million decrease in losses on OREO operations, primarily reflecting a \$2.2 million decrease in write downs to the value of OREO properties, partially offset by a \$0.5 million increase in OREO-related expenses such as repairs and property taxes.
- A \$1.4 million decrease in occupancy and equipment costs reflecting reductions in depreciation and repairs expenses, including a reduction of approximately \$0.4 million related to the depreciation of POS terminals sold as part of the sale of merchant contracts in the fourth quarter of 2015.
- A \$1.0 million decrease in the FDIC insurance premium expense, included as part of “Insurance and supervisory fees” in the table above, primarily due to the reduction in the initial base assessment rate as well as reductions in brokered deposits and average assets. In March 2016, the FDIC adopted a final rule (“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 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 \$0.8 million in the third quarter 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.

- A \$0.9 million decrease in business promotion expenses, primarily related to reduced advertising and marketing activities.
- A \$0.7 million decrease in processing expenses, mainly due to the sale of merchant contracts in the fourth quarter of 2015.
- A \$0.5 million decrease in communication expenses, including reductions in postage and telephone expenses.
- A \$0.3 million decrease in other operating expenses, including reductions of \$0.7 million in supplies and printing costs, \$0.3 million in losses and expenses related to non-real estate repossessed assets, and \$0.1 million in the amortization of intangible assets. These variances were partially offset by a \$0.9 million increase in charges to the provision for unfunded loan commitments and letters of credit, primarily related to a higher unused balance on an adversely classified floor plan revolving credit facility.

Partially offset by:

- A \$0.9 million increase in taxes, other than income taxes, primarily due to the 4% sales tax on designated professional services effective in Puerto Rico since October 1, 2015.
- A \$0.7 million increase in employees' compensation, including \$0.3 million related to severance payments on job discontinuance recorded in the third quarter of 2016 and a \$0.3 million increase in stock-based compensation.

Non-interest expenses decreased by \$17.0 million to \$270.8 million for the first nine months of 2016 compared to \$287.8 million for the same period in 2015. Non-interest expenses include for the first nine months of 2016 the aforementioned severance payments on job discontinuance of \$0.3 million and for the first nine months of 2015 costs of \$4.6 million related to the conversion of loan and deposit accounts acquired from Doral to the FirstBank systems, which was completed in the second quarter of 2015, and \$1.2 million of expenses and losses associated with the bulk sale of assets. Excluding the aforementioned items, adjusted non-interest expenses of \$270.6 million for the first nine months of 2016 decreased by \$11.4 million compared to adjusted non-interest expenses of \$282.0 million for the same

period in 2015. The decrease of \$11.4 million in adjusted non-interest expenses was principally attributable to:

- A \$7.5 million decrease in professional service fees, as compared to the 2015 adjusted professional service fees, primarily reflecting the impact in 2015 of interim servicing costs of \$3.6 million related to loans and deposits acquired from Doral Bank and \$1.3 million of professional service fees incurred with respect to special projects and strategic, stress testing and capital planning matters. In addition, collections, appraisals and other credit-related professional service fees related to troubled loan resolution efforts decreased by \$1.9 million.
- A \$3.4 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 \$2.1 million decrease in processing expenses, mainly due to the sale of merchant contracts in the fourth quarter of 2015.
- A \$2.5 million decrease in losses on OREO operations, as compared to the 2015 adjusted losses on OREO operations, primarily reflecting a \$2.0 million decrease in write downs to the value of OREO properties and a \$0.7 million decrease in OREO-operating expenses, including lower property taxes, and a \$0.7 million increase in rental income associated with both a higher inventory of income-producing properties and increased activity. These decreases were partially offset by the impact in the first half of 2015 of a \$1.2 million gain realized at the time of sale of certain commercial OREO properties.
- A \$0.9 million decrease in other operating expenses, as compared to the 2015 adjusted other operating expenses, including reductions of \$1.8 million in supplies and printing costs, \$0.2 million in losses and expenses related to non-real estate repossessed assets, and \$0.1 million in the amortization of intangible assets. These variances were partially offset by a \$1.3 million increase in charges to the provision for unfunded loan commitments and letters of credit, primarily related to a higher unused balance on an adversely classified floor plan revolving credit facility.

Partially offset by:



- A \$2.8 million increase in adjusted employees' compensation, mainly due to merit salary increases, the full period impact of personnel costs associated with branches acquired from Doral Bank in February 2015, and higher stock-based compensation, partially offset by decreases in incentive-based compensation.
- A \$2.3 million increase in taxes, other than income taxes, mainly related to the increase in the sales tax rate from 7% to 11.5% effective since July 1, 2015 and the 4% sales tax on designated professional services effective since October 1, 2015.

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

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

As of September 30, 2016, the Corporation's deferred tax assets, net of a valuation allowance of \$201.7 million, amounted to \$290.9 million and management concluded, based upon the assessment of all positive and negative evidence, that it is more likely than not that the Corporation will generate sufficient taxable income within the applicable NOL carry-forward periods to realize such amount.

The Corporation recorded an income tax expense of \$10.4 million and \$23.7 million in the third quarter and the first nine months of 2016, respectively, compared to an income tax expense of \$4.5 million and \$2.7 million, for the same periods in 2015. The change in income tax expense in the third quarter of 2016, when compared to the third quarter of 2015, is mainly driven by higher taxable income. For the nine-month period ended September 30, 2016, the Corporation calculated the provision for income taxes by applying the estimated annual effective tax rate for the full fiscal year to ordinary income or loss. In the computation of the consolidated worldwide estimated annual effective tax rate, ASC 740-270 requires the exclusion of legal entities with pre-tax losses from which a tax benefit cannot be recognized. The consolidated worldwide estimated annual effective tax rate, excluding entities with pre-tax losses from which a tax benefit cannot be recognized, was 24% for the nine-month period ended September 30, 2016, compared to 17% for the same period in 2015. The increase in the estimated effective tax rate for the nine month period ended September 30, 2016, when compared to the same period in 2015, reflects the impact in 2015 of a release in the valuation allowance resulting from the bargain purchase gain, which generated a deferred tax liability. As required by ASC 740-270, changes in the valuation allowance related to the current year are included in the computation of the estimated effective tax rate for the year. The effective tax rate including all entities for the first nine months of 2016 was 25%, compared to 30% for the same period in 2015.

**FINANCIAL CONDITION AND OPERATING DATA ANALYSIS****Assets**

The Corporation's total assets were \$12.1 billion as of September 30, 2016, a decrease of \$497.8 million when compared to \$12.6 billion as of December 31, 2015. The decrease was mainly due to (i) a \$223.5 million reduction in cash and cash equivalents, associated with liquidity used to repay maturing brokered CDs, repurchase agreements and FHLB advances, (ii) a \$227.8 million decrease in total loans before allowance, including a \$104.2 million reduction in commercial and construction loans and a \$99.8 million decrease in consumer loans, and (iii) a \$51.3 million decrease in investment securities, mainly driven by sales and prepayments of U.S. agencies MBS as further discussed below.

**Loan Portfolio**

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

| (In thousands)                       | <b>September 30,<br/>2016</b> | <b>December 31,<br/>2015</b> |
|--------------------------------------|-------------------------------|------------------------------|
| Residential mortgage loans           | \$ 3,299,942                  | \$ 3,344,719                 |
| Commercial loans:                    |                               |                              |
| Commercial mortgage loans            | 1,545,014                     | 1,537,806                    |
| Construction loans                   | 124,298                       | 156,195                      |
| Commercial and Industrial loans      | 2,167,011                     | 2,246,513                    |
| Total commercial loans               | 3,836,323                     | 3,940,514                    |
| Finance leases                       | 229,577                       | 229,165                      |
| Consumer loans                       | 1,497,812                     | 1,597,984                    |
| Total loans held for investment      | 8,863,654                     | 9,112,382                    |
| Less:                                |                               |                              |
| Allowance for loan and lease losses  | (214,070)                     | (240,710)                    |
| Total loans held for investment, net | \$ 8,649,584                  | \$ 8,871,672                 |
| Loans held for sale                  | 56,779                        | 35,869                       |
| Total loans, net                     | \$ 8,706,363                  | \$ 8,907,541                 |

As of September 30, 2016, the Corporation's total loans held for investment, before allowance, amounted to \$8.9 billion, down \$227.8 million when compared to December 31, 2015. The decline primarily reflects a \$104.2 million decrease in the commercial and construction loan portfolio, a \$99.8 million decrease in consumer and finance leases, and a \$23.8 million decrease in the residential mortgage loans portfolio. The decrease in the commercial and construction loan portfolio was mainly driven by the repayment of large commercial loans during the first nine months of 2016, including repayments totaling \$145.3 million associated with six commercial relationships, the sale of a \$20.2 million commercial loan participation, and the four large charge-offs totaling \$22.9 million noted above, partially offset by new loan originations. Most of the decrease was in the Puerto Rico and Virgin Islands regions, partially offset by the growth of all portfolios in the Florida region.

As shown in the table above, as of September 30, 2016, the loans held for investment portfolio was comprised of commercial loans (43%), residential real estate loans (37%), and consumer and finance leases (20%). Of the total gross loan portfolio held for investment of \$8.9 billion as of September 30, 2016, approximately 78% has 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 table:

| <b><u>As of September 30, 2016</u></b> | <b>Puerto Rico</b> | <b>Virgin Islands</b> | <b>United States</b> | <b>Total</b> |
|--|--------------------|-----------------------|----------------------|--------------|
|  |                    |                       | (In thousands)       |              |
| Residential mortgage loans             | \$ 2,505,623       | \$ 319,855            | \$ 474,464           | \$ 3,299,942 |
| Commercial mortgage loans              | 1,181,682          | 76,462                | 286,870              | 1,545,014    |
| Construction loans                     | 43,917             | 45,736                | 34,645               | 124,298      |
| Commercial and Industrial loans        | 1,596,242          | 119,931               | 450,838              | 2,167,011    |
| Total commercial loans                 | 2,821,841          | 242,129               | 772,353              | 3,836,323    |
| Finance leases                         | 229,577            | -                     | -                    | 229,577      |
| Consumer loans                         | 1,401,750          | 48,918                | 47,144               | 1,497,812    |
| Total loans held for investment, gross | \$ 6,958,791       | \$ 610,902            | \$ 1,293,961         | \$ 8,863,654 |
| Loans held for sale                    | 43,262             | 461                   | 13,056               | 56,779       |
| Total loans                            | \$ 7,002,053       | \$ 611,363            | \$ 1,307,017         | \$ 8,920,433 |

| <b><u>As of December 31, 2015</u></b>  | <b>Puerto Rico</b> | <b>Virgin Islands</b> | <b>United States</b> | <b>Total</b> |
|--|--------------------|-----------------------|----------------------|--------------|
|  |                    |                       | (In thousands)       |              |
| 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 | \$ | 7,332,274 | \$ | 690,476 | \$ | 1,125,501 | \$ | 9,148,251 |
|-------------|----|-----------|----|---------|----|-----------|----|-----------|

*Residential Real Estate Loans*

As of September 30, 2016, the Corporation's residential real estate loan portfolio held for investment decreased by \$44.8 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 the Puerto Rico and Virgin Islands regions decreased during the first nine months of 2016 by \$70.3 million and \$8.1 million, respectively, partially offset by an increase of \$33.6 million in Florida.

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

*Commercial and Construction Loans*

As of September 30, 2016, the Corporation's commercial and construction loan portfolio held for investment decreased by \$104.2 million to \$3.8 billion, as compared to the balance as of December 31, 2015. The reduction primarily reflects the aforementioned repayments of six large commercial relationships totaling \$145.3 million comprised of a \$34.3 million commercial credit facility in Puerto Rico, a \$60.0 million credit facility of a government-related entity in the Virgin Islands, and four commercial relationships in Florida totaling \$51.0 million. Furthermore, the decrease also reflects the sale of a \$20.2 million commercial loan participation in the Puerto Rico region and the aforementioned four large charge-offs totaling \$22.9 million recorded in the third quarter of 2016.

As of September 30, 2016, the Corporation had \$134.0 million outstanding (book value of \$126.2 million) in credit facilities, excluding investment securities, extended to the Puerto Rico Government, its municipalities and public corporations, compared to \$153.2 million outstanding as of December 31, 2015. Approximately \$91.4 million of the granted credit facilities outstanding (\$83.7 million book value) consisted of loans to public corporations, including a direct exposure to the Puerto Rico Electric Power Authority ("PREPA") with an outstanding balance of \$74.6 million (\$66.8 million book value) as of September 30, 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 are recorded on a cost-recovery basis. In addition, the Corporation had \$35.7 million of credit facilities extended to municipalities in Puerto Rico, excluding investment securities, which in most cases are supported by assigned property tax revenues. Municipalities' revenues are independent of the Puerto Rico central government. These municipalities are required by law to levy special property taxes in such amounts as are required for the payment of all of their respective general obligation bonds and loans. Late in 2015, the GDB and the Municipal Revenue Collection Center (CRIM) signed a deed of trust. Through this deed, the GDB, as fiduciary, is bound to keep the CRIM funds separate from any other deposits and must distribute the funds pursuant to applicable law. The CRIM

funds are deposited at another depository financial institution in Puerto Rico. 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.

Furthermore, as of September 30, 2016, the Corporation had \$128.0 million outstanding (book value of \$112.8 million) in financings 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. 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 \$1.6 million of interest payments received on loans guaranteed by the TDF since late March 2016 have been applied against principal. As of the date of filing of this Form 10-Q, the largest of these three facilities is current on contractual payments as its operations are generating the cash flows to cover payments. The Corporation has been receiving partial payments from the other two facilities since their operations are insufficient to cover the entire contractual payments 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 \$13.7 million were recorded in the third quarter of 2016, of which \$12.8 million was charged against specific reserves established in prior periods. These loans have been adversely classified since the third quarter of 2015. The Corporation’s collections of principal and interest from the TDF in the first half of 2016 amounted to \$0.6 million compared to \$5.3 million in the entire 2015 year.

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”), which gives Puerto Rico’s governor emergency powers to deal with Puerto Rico’s challenging fiscal situation, including the ability to declare a moratorium on all bonds and other payments. On June 30, 2016, pursuant to Act 21, the Puerto Rico governor ordered a moratorium on the payment of \$780 million of the Puerto Rico Government’s general obligations and the debt of certain other instrumentalities due on July 1, 2016. This followed a default on the principal payment of \$367 million of GDB notes due on May 1, 2016. Puerto Rico’s governor also issued an executive order intended to protect the GDB’s liquidity by allowing withdrawals only to fund necessary costs for essential services such as health, public safety and education services. Recently, the GDB defaulted on a \$28

million payment of interest due to its creditors on August 1, 2016, including interest due on GDB bonds held by the Corporation, as further discussed below.

As of September 30, 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 16% and the loans are being carried at 76% of unpaid principal balance, net of reserves and accumulated charge-offs.

As of September 30, 2016, the Corporation's total exposure to shared national credit ("SNC") loans amounted to \$803.2 million, compared to \$603.1 million as of December 31, 2015. As of September 30, 2016, approximately \$525.2 million of the SNC exposure is in Puerto Rico, including the \$66.8 million book value of the PREPA credit facility and \$72.7 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.

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 September 30, 2016 by category and geographic location is as follows:

**As of September 30, 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)  | \$ 1,568           | \$ 956                | \$ -                 | \$ 2,524     |
| Single-family, detached   | 3,509              | -                     | 7,295                | 10,804       |
| Total for residential housing projects                              | 5,077              | 956                   | 7,295                | 13,328       |
| Construction loans to individuals secured by residential properties | 823                | 1,355                 | -                    | 2,178        |
| Loans for commercial projects                                       | 7,865              | 40,353                | 27,202               | 75,420       |
| Land loans - residential  | 17,723             | 3,080                 | 148                  | 20,951       |
| Land loans - commercial   | 12,468             | -                     | -                    | 12,468       |
| Total before net deferred fees and allowance for loan losses        | \$ 43,956          | \$ 45,744             | \$ 34,645            | \$ 124,345   |
| Net deferred fees   | (39)               | (8)                   | -                    | (47)         |
| Total construction loan portfolio, gross                            | 43,917             | 45,736                | 34,645               | 124,298      |
| Allowance for loan losses   | (2,884)            | (2,463)               | (1)                  | (5,348)      |
| Total construction loan portfolio, net                              | \$ 41,033          | \$ 43,273             | \$ 34,644            | \$ 118,950   |

(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 nine-month period ended September 30, 2016:

|  |           |
|--|-----------|
| (In thousands)   |           |
| Total undisbursed funds under existing commitments   | \$ 50,437 |
| Construction loans held for investment in non-accrual status                                   | \$ 50,767 |
| Construction loans held for sale in non-accrual status   | \$ 8,079  |
| Net charge offs - Construction loans   | \$ 322    |
| Allowance for loan losses - Construction loans   | \$ 5,348  |
| Non-performing construction loans to total construction loans, including held for sale         | 44.45%    |
| Allowance for loan losses - construction loans to total construction loans held for investment | 4.30%     |
| Net charge-offs (annualized) to total average construction loans                               | 0.29%     |

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

| (In thousands)  |    |       |
|-----------------|----|-------|
| Under \$300k    | \$ | 2,956 |
| Over \$600k (1) |    | 2,121 |
|                 | \$ | 5,077 |

(1) One residential housing project in Puerto Rico.

### *Consumer Loans and Finance Leases*

As of September 30, 2016, the Corporation's consumer loan and finance lease portfolio decreased by \$99.8 million to \$1.7 billion, as compared to the portfolio balance 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 loan and finance lease portfolio decreased by \$75.8 million during the first nine months of 2016 reflecting repayments, charge-offs and a reduced activity in new loan originations. The auto loan and finance lease portfolios in Puerto Rico amounted to \$1.0 billion as of September 30, 2016, compared to \$1.1 billion as of December 31, 2015. The remaining decrease in the consumer loan portfolio was primarily related to a \$13.0 million reduction in the credit card loan portfolio balance, and a \$7.4 million decrease in boat loans.

### **Loan Production**

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

The following table provides a breakdown on First BanCorp.'s loan production, including purchases, refinancings, renewals and draws from existing revolving and non-revolving commitments for the periods indicated:

| Quarter Ended September 30, |      | Nine-Month Period Ended September 30, |      |
|-----------------------------|------|---------------------------------------|------|
| 2016                        | 2015 | 2016                                  | 2015 |
| (In thousands)              |      |                                       |      |

|                             |            |            |              |              |
|-----------------------------|------------|------------|--------------|--------------|
| Residential real estate     | \$ 199,125 | \$ 179,173 | \$ 556,181   | \$ 529,307   |
| C&I and commercial mortgage | 456,625    | 436,424    | 1,184,928    | 1,245,487    |
| Construction                | 9,006      | 3,960      | 16,975       | 27,731       |
| Finance leases              | 20,827     | 22,485     | 62,963       | 62,838       |
| Consumer                    | 199,632    | 200,037    | 577,216      | 591,625      |
| Total loan production       | \$ 885,215 | \$ 842,079 | \$ 2,398,263 | \$ 2,456,988 |

The Corporation is experiencing continued loan demand and has continued its targeted origination strategy. During the third quarter and nine-month period ended September 30, 2016, total loan originations, including purchases, refinancings, and draws from existing revolving and non-revolving commitments, amounted to approximately \$885.2 million and \$2.4 billion, respectively, compared to \$842.1 million and \$2.5 billion, respectively, for the comparable periods in 2015. These statistics exclude the \$324.8 million of loans acquired from Doral Bank in February 2015.

Residential mortgage loan originations and purchases for the quarter and nine-month period ended September 30, 2016 amounted to \$199.1 million and \$556.2 million, respectively, compared to \$179.2 million and \$529.3 million, respectively, for the comparable periods in 2015. These statistics include purchases of \$23.2 million and \$65.2 million for the quarter and nine-month period ended September 30, 2016 compared to \$22.2 million and \$68.2 million for the comparable periods in 2015. The increase of \$19.9 million in the third quarter of 2016, as compared to the same period of 2015, reflects an increase of approximately \$23.5 million in the Puerto Rico region, partially offset by decreases of \$3.1 million in Florida and \$0.5 million in the Virgin Islands.

Commercial and construction loan originations (excluding government loans) for the third quarter of 2016 and 2015 amounted to \$458.8 million and \$394.2 million, respectively, while the originations for the nine-month periods ended September 30, 2016 and 2015 remained flat at \$1.2 billion. The increase in the third quarter of 2016, compared to the same period in 2015, includes increases of \$31.5 million and \$26.2 million in Florida and Puerto Rico, respectively.

Government loan originations for the third quarter of 2016 and 2015 amounted to \$6.8 million and \$46.2 million, respectively, while the originations for the nine-month period ended on September 30, 2016 and 2015 amounted to \$32.5 million and \$71.9 million, respectively. The originations in the third quarter of 2016 were related to draws from an existing facility of a central government agency in Puerto Rico. The decrease reflects the origination in 2015 of two large facilities in the Virgin Islands totaling \$43.2 million.

Originations of auto loans (including finance leases) for the quarter and nine-month period ended September 30, 2016 amounted to \$94.2 million and \$262.2 million, respectively, compared to \$90.0 million and \$268.6 million, respectively, for the comparable periods in 2015. The prolonged economic recession in Puerto Rico continues to put pressure on new auto sales, reflecting lower consumer confidence as a result of the prolonged economic recession in Puerto Rico.

Personal loan originations, other than credit cards, for the quarter and nine-month period ended September 30, 2016 amounted to \$44.7 million and \$141.6 million, respectively, compared to \$50.3 million and \$140.2 million, respectively, for the comparable periods in 2015. The utilization activity on the outstanding credit card portfolio for the quarter and nine-month period ended September 30, 2016 amounted to approximately \$81.6 million and \$236.4 million, respectively, compared to \$82.2 million and \$245.6 million, respectively, for the comparable periods 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 September 30, 2016 amounted to \$1.8 billion, a \$42.5 million decrease 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%, (ii) U.S. agencies MBS prepayments of approximately \$177.4 million, and (iii) U.S. agency debt securities matured or called prior to maturity of \$87.4 million.

These decreases were partially offset by purchases of approximately \$405.1 million of securities issued or guaranteed by U.S. agencies during the first nine months of 2016, including: (i) \$130.8 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) \$163.7 million of U.S. agencies MBS, and (vi) a \$5.0 million bond issued by Farmer Mac. In addition, the fair value of available-for-sale U.S. agency MBS and debt securities increased by approximately \$32.2 million during the nine-month period ended September 30, 2016.

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 agencies 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 GDB bonds held by the Corporation. Similarly, the Puerto Rico Public Buildings Authority made only a partial payment on its interest payment due on October 1, 2016.

In the third quarter of 2016, as a result of the recent 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 September 30, 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 \$19.5 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 \$8.7 million carried on the Corporation's books at their aggregate fair value of \$7.3 million which are current as to contractual payments as of September 30, 2016.

As of September 30, 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 investment securities as of the indicated dates:

|  | <b>As of<br/>September<br/>30,<br/>2016</b> | <b>As of<br/>December<br/>31,<br/>2015</b> |
|--|---|--|
|  | (In thousands)                              |  |
| Money market investments   | \$ 10,108                                   | \$ 219,473                                 |
| Investment securities available for sale, at fair value:   |   |  |
| U.S. Government and agencies obligations   | 561,689                                     | 460,558                                    |
| Puerto Rico government obligations   | 26,820                                      | 28,217                                     |
| Mortgage-backed securities   | 1,254,825                                   | 1,397,520                                  |
| Other  | 519   | 100  |
|  | 1,843,853                                   | 1,886,395                                  |
| Investment securities held to maturity:  |   |  |
| Puerto Rico Municipal Bonds  | 156,190                                     | 161,483                                    |
|  | 156,190                                     | 161,483                                    |
| Other equity securities, including \$26.6 million and \$31.3 million<br>of FHLB stock as of September 30, 2016 and December 31, 2015, respectively | 28,717                                      | 32,169                                     |
| Total money market investments and investment securities   | \$ 2,038,868                                | \$ 2,299,520                               |

Mortgage-backed securities as of the indicated dates consist of:

| (In thousands)   | <b>As of<br/>September 30,<br/>2016</b> | <b>As of<br/>December 31,<br/>2015</b> |
|--|---|--|
| Available for sale:  |   |  |
| FHLMC certificates   | \$ 261,417                              | \$ 287,445                             |
| GNMA certificates  | 244,716                                 | 301,573                                |
| FNMA certificates  | 667,106                                 | 783,195                                |
| Collateralized Mortgage Obligations issued or<br>guaranteed by FHLMC or GNMA | 59,375                                  | -                                      |

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|  |    |           |    |           |
|--|----|-----------|----|-----------|
| Other mortgage pass-through certificates |    | 22,211    |    | 25,307    |
| Total mortgage-backed securities         | \$ | 1,254,825 | \$ | 1,397,520 |
|  | 98 |           |    |           |

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The carrying values of investment securities classified as available for sale and held to maturity as of September 30, 2016 by contractual maturity (excluding mortgage-backed securities and equity securities) are shown below:

| (Dollars in thousands)  | <b>Carrying<br/>Amount</b> | <b>Weighted<br/>Average Yield<br/>%</b> |
|---|----------------------------|---|
| U.S. Government and agencies obligations                            |                            |   |
| Due within one year   | \$ 17,147                  | 0.64                                    |
| Due after one year through five years                               | 499,944                    | 1.32                                    |
| Due after ten years   | 44,598                     | 0.87                                    |
|   | 561,689                    | 1.26                                    |
| Puerto Rico Government and Municipalities obligations               |                            |   |
| Due after one year through five years                               | 10,536                     | 4.43                                    |
| Due after five years through ten years                              | 11,592                     | 4.47                                    |
| Due after ten years   | 160,882                    | 4.75                                    |
|   | 183,010                    | 4.70                                    |
| Other Investment Securities   |                            |   |
| Due after one year through five years                               | 100                        | 1.50                                    |
| Total   | 744,799                    | 2.17                                    |
| Equity securities   | 419                        | 2.15                                    |
| Mortgage-backed securities  | 1,254,825                  | 2.48                                    |
| Total investment securities available for sale and held to maturity | \$ 2,000,043               | 2.36                                    |



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 September 30, 2016, the Corporation had approximately \$192.5 million in debt securities (U.S. Agencies and Puerto Rico government securities) with embedded calls and with an average yield of 1.35%. Unamortized discounts on these securities amounted to approximately \$0.2 million. 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 4 to the accompanying unaudited consolidated financial statements for additional information regarding the Corporation's investment portfolio.

## **RISK MANAGEMENT**

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

The Corporation has in place a risk management framework to monitor, evaluate and manage the principal risks assumed in conducting its activities. First BanCorp.'s business is subject to eleven broad categories of risks: (1) liquidity risk; (2) interest rate risk; (3) market risk; (4) credit risk; (5) operational risk; (6) legal and compliance risk; (7) reputational risk; (8) model risk; (9) capital risk; (10) strategic risk; and (11) information technology risk. First BanCorp. has adopted policies and procedures designed to identify and manage the risks to which the Corporation is exposed.

The Corporation's risk management policies are described below as well as in the Management's Discussion and Analysis of Financial Condition and Results of Operations section of First BanCorp.'s 2015 Annual Report on Form 10-K.

### **Liquidity Risk and Capital Adequacy**

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

business operations or unanticipated events.

The Corporation manages liquidity at two levels. The first is the liquidity of the parent company, which is the holding company that owns the banking and non-banking subsidiaries. The second is the liquidity of the banking subsidiary. As of September 30, 2016, FirstBank could not pay any dividends to the parent company except upon receipt of prior approval by the Federal Reserve Bank of New York (the “New York FED”) and the Board of Governors of the Federal Reserve System (the “Federal Reserve Board”) because of the written agreement dated June 3, 2010 (the “Written Agreement”) that the Corporation entered into with the New York FED and the Federal Reserve Board. In the second and third quarters of 2016, after receiving regulatory approvals, FirstBank paid dividends of \$31.2 million and \$1.8 million, respectively, to the Corporation sufficient to allow it to pay all accrued but deferred interest on the junior subordinated debentures associated with its trust preferred securities. It is the intent of the Corporation to request approvals in future periods to continue regularly scheduled quarterly interest payments.

The Asset and Liability Committee of the Board of Directors is responsible for establishing the Corporation’s liquidity policy as well as approving operating and contingency procedures, and monitoring liquidity on an ongoing basis. The Management Investment and Asset Liability Committee (“MIALCO”), using measures of liquidity developed by management, which involve the use of several assumptions, reviews the Corporation’s liquidity position on a monthly basis. The MIALCO oversees liquidity management, interest rate risk and other related matters.

The MIALCO, which reports to the Board of Directors’ Asset and Liability Committee, is composed of senior management officers, including the Chief Executive Officer, the Chief Financial Officer, the Chief Risk Officer, the Retail Financial Services Director, the Risk Manager of the Treasury and Investments Division, the Financial Analysis and Asset/Liability Director and the Treasurer. The Treasury and Investments Division is responsible for planning and executing the Corporation’s funding activities and strategy, monitoring liquidity availability on a daily basis and reviewing liquidity measures on a weekly basis. The Treasury and Investments Accounting and Operations area of the Comptroller’s Department is responsible for calculating the liquidity measurements used by the Treasury and Investment Division to review the Corporation’s liquidity position on a monthly basis; the Financial Analysis and Asset/Liability Director estimates the liquidity gap for longer periods.

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

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

The Corporation manages its liquidity in a proactive manner, and maintains a sound liquidity position. Multiple measures are utilized to monitor the Corporation's liquidity position, including core liquidity, basic liquidity, and time-based reserve measures. As of September 30, 2016, the estimated core liquidity reserve (which consists of cash and free liquid assets) was \$1.5 billion or 12.1% of total assets, compared to \$1.5 billion or 12.3% of total assets as of December 31, 2015. The basic liquidity ratio (which adds available secured lines of credit to the core liquidity) was approximately 20.8% of total assets, compared to 17.4% of total assets as of December 31, 2015. As of September 30, 2016, the Corporation had \$1.1 billion available for additional credit from the FHLB of New York. Unpledged liquid securities as of September 30, 2016, mainly fixed-rate MBS and U.S. agency debentures, amounted to approximately \$774.0 million. The Corporation does not rely on uncommitted inter-bank lines of credit (federal funds lines) to fund its operations and does not include them in the basic liquidity measure. As of September 30, 2016, the holding company had \$35.2 million of cash and cash equivalents. Cash and cash equivalents at the Bank level as of September 30, 2016 were approximately \$522.1 million. The Bank has \$1.6 billion in brokered CDs as of September 30, 2016, of which approximately \$949.3 million mature over the next twelve months. Liquidity at the Bank level is highly dependent on bank deposits, which fund 75% of the Bank's assets (or 62%, excluding brokered CDs).

#### *Sources of Funding*

The Corporation utilizes different sources of funding to help ensure that adequate levels of liquidity are available when needed. Diversification of funding sources is of great importance to protect the Corporation's liquidity from market disruptions. The principal sources of short-term funds are deposits, including brokered CDs, securities sold under agreements to repurchase, and lines of credit with the FHLB.

The Asset Liability Committee of the Board of Directors reviews credit availability on a regular basis. The Corporation has also sold mortgage loans as a supplementary source of funding. Long-term funding has also been obtained in the past through the issuance of notes and long-term brokered CDs. The cost of these different alternatives, among other things, is taken into consideration.

The Corporation has continued reducing the amounts of brokered CDs. As of September 30, 2016, the amount of brokered CDs had decreased \$539.0 million to \$1.6 billion from brokered CDs of \$2.1 billion as of December 31, 2015. At the same time as the Corporation focuses on reducing its reliance on brokered CDs, it is seeking to add core deposits. During the first nine months of 2016, the Corporation increased non-brokered deposits, excluding government deposits, by \$135.0 million to \$6.8 billion, primarily reflecting increases in demand deposits and savings in Puerto Rico.

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

The Corporation's principal sources of funding are:

*Brokered CDs* – A large portion of the Corporation's funding has been brokered CDs issued by FirstBank. Total brokered CDs decreased during the first nine months of 2016 by \$539.0 million to \$1.6 billion as of September 30, 2016.

The average remaining term to maturity of the retail brokered CD outstanding as of September 30, 2016 is approximately 1 year.

The use of brokered CDs has been particularly important for the growth of the Corporation. The Corporation encounters intense competition in attracting and retaining regular retail deposits in Puerto Rico. The brokered CD market is very competitive and liquid,

and has enabled the Corporation to obtain substantial amounts of funding in short periods of time. This strategy has enhanced the Corporation's liquidity position, since brokered CDs are insured by the FDIC up to regulatory limits and can be obtained faster than regular retail deposits. During the first nine months of 2016, the Corporation issued \$402.5 million in brokered CDs with an average cost of 1.16% (average life of 2 years).

The following table presents a summary of brokered CDs as of September 30, 2016:

|                                 |    | <b>Total<br/>(In thousands)</b> |
|---------------------------------|----|---------------------------------|
| Three months or less            | \$ | 343,396                         |
| Over three months to six months |    | 255,574                         |
| Over six months to one year     |    | 350,362                         |
| One to three years              |    | 524,386                         |
| Three to five years             |    | 84,605                          |
| Over five years                 |    | 185                             |
| Total                           | \$ | 1,558,508                       |

Certificates of deposit in denominations of \$100,000 or higher include brokered CDs of \$1.6 billion issued to deposit brokers in the form of large (\$100,000 or more) certificates of deposit that are generally participated out by brokers in shares of less than \$100,000 and are therefore insured by the FDIC.

*Government deposits* – As of September 30, 2016, the Corporation had \$463.5 million of Puerto Rico public sector deposits (\$391.4 million in transactional accounts and \$72.1 million in time deposits) compared to \$390.4 million as of December 31, 2015. Approximately 32% is from municipalities and 68% is from public corporations and the central government and agencies.

In addition, as of September 30, 2016, the Corporation had \$161.1 million of government deposits in the Virgin Islands, compared to \$186.9 million as of December 31, 2015.

*Retail deposits* – The Corporation's deposit products also include regular savings accounts, demand deposit accounts, money market accounts and retail CDs. Total deposits, excluding brokered CDs and government deposits, increased by \$135.0 million to \$6.8 billion from the balance of \$6.7 billion as of December 31, 2015. The higher balance reflects increases of \$212.9 million and \$6.4 million in Puerto Rico and the Virgin Islands regions, respectively, primarily increases in demand deposits and savings. These increases were partially offset by an \$84.3 million decrease in the Florida region. Refer to Note 14 in the accompanying unaudited consolidated financial statements for further details.

Refer to “Net Interest Income” above for information about average balances of interest-bearing deposits, and the average interest rate paid on deposits for the quarters and nine-month periods ended September 30, 2016 and 2015.

*Securities sold under agreements to repurchase* - The Corporation’s investment portfolio is funded in part with repurchase agreements. The Corporation’s outstanding securities sold under repurchase agreements amounted to \$800 million and \$900 million as of September 30, 2016 and December 31, 2015, respectively. During the third quarter of 2016, the Corporation repaid at maturity a \$100 million repurchase agreement that carried a cost of 2.50%. One of the Corporation’s strategies has been the use of structured repurchase agreements and long-term repurchase agreements to reduce liquidity risk and manage exposure to interest rate risk by lengthening the final maturities of its liabilities while keeping funding costs at reasonable levels. In addition to these repurchase agreements, the Corporation has been able to maintain access to credit by using cost-effective sources such as FHLB advances. Refer to Note 15 in the Corporation’s unaudited consolidated financial statements for the quarter and nine-month period ended September 30, 2016 for further details about repurchase agreements outstanding by counterparty and maturities.

As of September 30, 2016, the Corporation had \$200 million of reverse repurchase agreements with a counterparty under a master netting arrangement that provides for a right of setoff that meets the conditions of ASC 210-20-45-11 for a net presentation. These repurchase agreements and reverse repurchase agreements are presented net on the consolidated statement of financial condition.

In the fourth quarter of 2016, the Corporation used cash proceeds of \$204.8 million from the aforementioned sales of U.S. agency MBS that carried an average yield at 2.36% to repay at maturity \$300 million of repurchase agreements that carried an average cost of 3.63%.

Under the Corporation’s repurchase agreements, as is the case with derivative contracts, the Corporation is required to pledge cash or qualifying securities to meet margin requirements. To the extent that the value of securities previously pledged as collateral declines

due to changes in interest rates, a liquidity crisis or any other factor, the Corporation is required to deposit additional cash or securities to meet its margin requirements, thereby adversely affecting its liquidity.

Given the quality of the collateral pledged, the Corporation has not experienced margin calls from counterparties arising from credit-quality-related write-downs in valuations.

*Advances from the FHLB* – The Bank is a member of the FHLB system and obtains advances to fund its operations under a collateral agreement with the FHLB that requires the Bank to maintain qualifying mortgages and/or investments as collateral for advances taken. As of September 30, 2016 and December 31, 2015, the outstanding balance of FHLB advances was \$355.0 and \$455.0 million, respectively. During the third quarter of 2016, the Corporation repaid at maturity a \$100 million FHLB advance that carried a cost of 0.93%. As of September 30, 2016, the Corporation had \$1.1 billion available for additional credit on FHLB lines of credit.

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

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

The subordinated debentures are presented in the Corporation's consolidated statement of financial condition as Other Borrowings. The variable rate trust-preferred securities are fully and unconditionally guaranteed by the Corporation. The \$100 million Junior Subordinated Deferrable Debentures issued by the Corporation in April 2004 and the \$125 million issued in September 2004 mature on June 17, 2034 and September 20, 2034, respectively; however, under certain circumstances, the maturity of the subordinated debentures may be shortened (such shortening would result in a mandatory redemption of the variable rate trust-preferred securities). The Collins Amendment of the Dodd-Frank Act eliminated certain trust-preferred securities from Tier 1 Capital. Bank holding companies such as the Corporation were required to fully phase out these instruments from Tier I capital in January 1, 2016; however, they may remain in Tier 2 capital until the instruments are redeemed or mature.

As mentioned above, during the first quarter of 2016, the Corporation completed the repurchase of trust preferred securities that were being auctioned in a public sale at which the Corporation was invited to participate. The Corporation repurchased and cancelled \$10 million of trust-preferred securities of FBP Statutory Trust II, resulting in a commensurate reduction in the related subordinated debenture. The Corporation's winning bid equated to 70% of the \$10 million par value. The 30% discount, plus accrued interest, resulted in a pre-tax gain of approximately \$4.2

million. As of September 30, 2016, the Corporation still has subordinated debentures outstanding in the aggregate amount of \$216.2 million.

In 2016, after receiving regulatory approvals, the Corporation has paid \$33.0 million for all the accrued but deferred interest payments plus the interest for the second quarter and third quarter of 2016 on the Corporation's subordinated debentures associated with its trust-preferred securities. As of September 30, 2016, the Corporation is current on all interest payments due related to its subordinated debt. 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. 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.

The Corporation's principal uses of funds are for the origination of loans and the repayment of maturing deposits and borrowings. The ratio of residential real estate loans to total loans has increased over time. Commensurate with the increase in its mortgage banking activities, the Corporation has also invested in technology and personnel to enhance the Corporation's secondary mortgage market capabilities.

The enhanced capabilities improve the Corporation's liquidity profile as they allow the Corporation to derive liquidity, if needed, from the sale of mortgage loans in the secondary market. The U.S. (including Puerto Rico) secondary mortgage market is still highly liquid, in large part because of the sale of mortgages through guarantee programs of the FHA, VA, HUD, FNMA and FHLMC. During the first nine months of 2016, the Corporation sold approximately \$238.6 million of FHA/VA mortgage loans to GNMA, which packages them into mortgage-backed securities. Any regulatory actions affecting GNMA, FNMA or FHLMC could adversely affect the secondary mortgage market.



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

#### *Impact of Credit Ratings on Access to Liquidity*

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

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

The Corporation's credit as a long-term issuer is currently rated B+ by S&P and B- by Fitch. At the FirstBank subsidiary level, long-term issuer ratings are currently B1 by Moody's, six notches below their definition of investment grade, B+ by S&P, four notches below their definition of investment grade, and B- by Fitch, six notches below their definition of investment grade. The Corporation's credit ratings are dependent on a number of factors, both quantitative and qualitative, and are subject to change at any time. The disclosure of credit ratings is not a recommendation to buy, sell or hold the Corporation's securities. Each rating should be evaluated independently of any other rating.

#### *Cash Flows*

Cash and cash equivalents were \$528.9 million as of September 30, 2016, a decrease of \$223.5 million when compared to the balance as of December 31, 2015. The following discussion highlights the major activities and transactions that affected the Corporation's cash flows during the first nine months of 2016 and 2015.

#### *Cash Flows from Operating Activities*

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

For the first nine months of 2016 and 2015, net cash provided by operating activities was \$119.1 million and \$199.1 million, respectively. Net cash generated from operating activities was higher than reported net income largely as a result of adjustments for operating items such as the provision for loan and lease losses, depreciation and amortization, and impairments as well as the cash generated from sales of loans held for sale.

*Cash Flows from Investing Activities*

The Corporation's investing activities primarily relate to originating loans to be held for investment and the purchasing, selling and repaying available-for-sale and held-to-maturity investment securities. For the nine-month period ended September 30, 2016, net cash provided by investing activities was \$224.2 million, primarily reflecting principal repayments on loans held for investment and proceeds for the sale of available-for-sale securities and mortgage-backed securities prepayments.

For the first nine months of 2015, net cash provided by investing activities was \$461.6 million, primarily reflecting the net cash received in the Doral Bank transaction, proceeds from the bulk sale of assets and repayments of commercial and consumer loans.

*Cash Flows from Financing Activities*

The Corporation's financing activities primarily include the receipt of deposits and the issuance of brokered CDs, the issuance and payments of long-term debt, the issuance of equity instruments and activities related to its short-term funding. During the nine-month period ended September 30, 2016, net cash used in financing activities was \$566.8 million, mainly due to repayments of maturing brokered CDS, repurchase agreements, FHLB advances and the cash used for the repurchase and cancellation of trust preferred securities, partially offset by the increase in non-brokered deposits.

In the first nine months of 2015, net cash used in financing activities was \$495.1 million, mainly due to the repayments of maturing brokered CDs and funds used in connection with \$200 million of reverse repurchase agreements entered into in April 2015.

**Capital**

As of September 30, 2016, the Corporation's stockholders' equity was \$1.8 billion, an increase of \$105.8 million from December 31, 2015. The increase was mainly driven by the net income of \$69.4 million for the first nine months of 2016 and an increase of approximately \$31.5 million in the fair value of available-for-sale securities recorded as part of other comprehensive income. As a result of the Written Agreement with the New York FED, currently neither First BanCorp. nor FirstBank is permitted to pay dividends on capital securities without prior approval.

Set forth below are First BanCorp.'s and FirstBank's regulatory capital ratios as of September 30, 2016 and December 31, 2015:

| As of September 30, 2016  | Banking Subsidiary |                     |           |                     |                        |
|---|--------------------|---------------------|-----------|---------------------|------------------------|
|   | First BanCorp.     |                     | FirstBank |                     | To be well capitalized |
|   | Actual             | Fully Phased-in (1) | Actual    | Fully Phased-in (1) |                        |
| Total capital ratio (Total capital to risk-weighted assets)                               | 21.27%             | 20.76%              | 20.73%    | 20.23%              | 10.00%                 |
| Common Equity Tier 1 capital ratio (Common Equity Tier 1 capital to risk-weighted assets) | 17.64%             | 16.79%              | 16.83%    | 15.58%              | 6.50%                  |
| Tier 1 capital ratio (Tier 1 capital to risk-weighted assets)                             | 17.64%             | 17.19%              | 19.46%    | 18.97%              | 8.00%                  |
| Leverage ratio  | 13.04%             | 12.98%              | 14.40%    | 14.34%              | 5.00%                  |

**Banking Subsidiary**

|  | First BanCorp. | FirstBank | To be well capitalized |
|--|----------------|-----------|------------------------|
|--|----------------|-----------|------------------------|

| <b>As of December 31, 2015</b>  | <b>Actual</b> | <b>Fully<br/>Phased-in (1)</b> | <b>Actual</b> | <b>Fully<br/>Phased-in (1)</b> |        |
|---|---------------|--------------------------------|---------------|--------------------------------|--------|
| Total capital ratio (Total capital to risk-weighted assets)                               | 20.01%        | 19.44%                         | 19.73%        | 19.18%                         | 10.00% |
| Common Equity Tier 1 capital ratio (Common Equity Tier 1 capital to risk-weighted assets) | 16.92%        | 15.44%                         | 16.35%        | 14.61%                         | 6.50%  |
| Tier 1 capital ratio (Tier 1 capital to risk-weighted assets)                             | 16.92%        | 15.83%                         | 18.45%        | 17.91%                         | 8.00%  |
| Leverage ratio  | 12.22%        | 11.69%                         | 13.33%        | 13.24%                         | 5.00%  |

- (1) Certain adjustments required under Basel III rules will be phased in through the end of 2018. The ratios shown in this column are calculated assuming that the adjustments were fully phased-in and effective as of September 30, 2016 and December 31, 2015.

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

The Basel III rules require the Corporation to maintain an additional capital conservation buffer of 2.5% to avoid limitations on both (i) capital distributions (e.g., repurchases of capital instruments or dividend or interest payments on capital instruments) and (ii) discretionary bonus payments to executive officers and heads of major business lines. The phase-in of the capital conservation buffer began on January 1, 2016 with a first year requirement of 0.625% of additional Common Equity Tier 1 capital (“CET1”), which will be progressively increased over a four-year period, increasing by that same percentage amount on each subsequent January 1 until it reaches the fully phased-in 2.5% CET1 requirement on January 1, 2019.

Under the fully phased-in Basel III rules, in order to be considered adequately capitalized, the Corporation will be required to maintain: (i) a minimum CET1 capital to risk-weighted assets ratio of at least 4.5%, plus the 2.5% “capital conservation buffer,” resulting in a required minimum CET1 ratio of at least 7%, (ii) a minimum ratio of total Tier 1 capital to risk-weighted assets of at least 6.0%, plus the 2.5% capital conservation buffer, resulting in a required minimum Tier 1 capital ratio of 8.5%, (iii) a minimum ratio of total Tier 1 plus Tier 2 capital to risk-weighted assets of at least 8.0%, plus the 2.5% capital conservation buffer, resulting in a required minimum total capital ratio of 10.5%, and (iv) a required minimum leverage ratio of 4%, calculated as the ratio of Tier 1 capital to average on-balance sheet (non-risk adjusted) assets.

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

The Corporation, as an institution with more than \$10 billion but less than \$50 billion of total consolidated assets, is subject to certain requirements established by the Dodd-Frank Act, including those related to capital stress testing. The Dodd-Frank Act stress testing requirements are implemented for the Corporation through the Dodd-Frank Act stress testing requirements that apply to banking organizations with consolidated assets of more than \$10 billion and less than \$50 billion. Consistent with these requirements, the Corporation submitted its second annual company-run stress test to regulators in July 2016, which were published in October 2016. The results show that even in a severely adverse economic environment, which we are not currently in nor do we anticipate being in during the near future, the Corporation’s and the Bank’s capital ratios significantly exceed the well-capitalized thresholds throughout the nine-quarter horizon.

The tangible common equity ratio and tangible book value per common share are non-GAAP financial measures generally used by the financial community to evaluate capital adequacy. Tangible common equity is total equity less

preferred equity, goodwill, core deposit intangibles, purchased credit card relationship asset and insurance customer relationship intangible asset. Tangible assets are total assets less goodwill, core deposit intangibles, purchased credit card relationship and insurance customer relationship intangible assets. Refer to “Basis of Presentation” below for additional information.

The following table is a reconciliation of the Corporation's tangible common equity and tangible assets as of September 30, 2016 and December 31, 2015, respectively:

| (In thousands, except ratios and per share information) | <b>September 30,<br/>2016</b> | <b>December 31,<br/>2015</b> |
|---|-------------------------------|------------------------------|
| Total equity - GAAP                                     | \$ 1,799,886                  | \$ 1,694,134                 |
| Preferred equity  | (36,104)                      | (36,104)                     |
| Goodwill  | (28,098)                      | (28,098)                     |
| Purchased credit card relationship intangible           | (11,228)                      | (13,319)                     |
| Core deposit intangible                                 | (7,690)                       | (9,166)                      |
| Insurance customer relationship intangible              | (965)                         | -                            |
| <b>Tangible common equity</b>                           | <b>\$ 1,715,801</b>           | <b>\$ 1,607,447</b>          |
| <br>  |                               |                              |
| Total assets - GAAP                                     | \$ 12,075,253                 | \$ 12,573,019                |
| Goodwill  | (28,098)                      | (28,098)                     |
| Purchased credit card relationship intangible           | (11,228)                      | (13,319)                     |
| Core deposit intangible                                 | (7,690)                       | (9,166)                      |
| Insurance customer relationship intangible              | (965)                         | -                            |
| <b>Tangible assets</b>                                  | <b>\$ 12,027,272</b>          | <b>\$ 12,522,436</b>         |
| <b>Common shares outstanding</b>                        | <b>217,388</b>                | <b>215,089</b>               |
| <br>  |                               |                              |
| <b>Tangible common equity ratio</b>                     | <b>14.27%</b>                 | <b>12.84%</b>                |
| <b>Tangible book value per common share</b>             | <b>\$ 7.89</b>                | <b>\$ 7.47</b>               |

### Off -Balance Sheet Arrangements

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

As a provider of financial services, the Corporation routinely enters into commitments with off-balance sheet risk to meet the financial needs of its customers. These financial instruments may include loan commitments and standby letters of credit. These commitments are subject to the same credit policies and approval process used for on-balance sheet instruments. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the statement of financial position. As of September 30, 2016, commitments to extend credit and commercial and financial standby letters of credit amounted to approximately \$1.1 billion (including \$631.5 million pertaining to credit card loans) and \$46.7 million, respectively. Commitments to extend credit are agreements to lend to customers as long as the conditions established in the contract are met. Generally, the Corporation does not

enter into interest rate lock agreements with prospective borrowers in connection with mortgage banking activities.



**Contractual Obligations, Commitments and Contingencies**

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

|   | <b>Contractual Obligations and Commitments</b> |                     |                     |                          |                   |
|---|--|---------------------|---------------------|--------------------------|-------------------|
|   | <b>As of September 30, 2016</b>                |                     |                     |                          |                   |
| <b>Total</b>  | <b>Less than 1<br/>year</b>                    | <b>1-3 years</b>    | <b>3-5 years</b>    | <b>After 5<br/>years</b> |                   |
| (In thousands)  |  |                     |                     |                          |                   |
| Contractual obligations:                              |  |                     |                     |                          |                   |
| Certificates of deposit                               | \$ 3,896,055                                   | \$ 2,184,263        | \$ 1,426,001        | \$ 281,357               | \$ 4,434          |
| Securities sold under<br>agreements to repurchase (1) | 600,000  | 300,000             | 100,000             | -                        | 200,000           |
| Advances from FHLB                                    | 355,000  | 200,000             | 25,000              | 130,000                  | -                 |
| Other borrowings                                      | 216,187  | -                   | -                   | -                        | 216,187           |
| <b>Total contractual obligations</b>                  | <b>\$ 5,067,242</b>                            | <b>\$ 2,684,263</b> | <b>\$ 1,551,001</b> | <b>\$ 411,357</b>        | <b>\$ 420,621</b> |
| <br>Commitments to sell<br>mortgage loans             | <br>\$ 66,617                                  |                     |                     |                          |                   |
| <br>Standby letters of credit                         | <br>\$ 2,475                                   |                     |                     |                          |                   |
| Commitments to extend<br>credit:                      |  |                     |                     |                          |                   |
| Lines of credit                                       | \$ 1,041,692                                   |                     |                     |                          |                   |
| Letters of credit                                     | 44,214   |                     |                     |                          |                   |
| Construction undisbursed<br>funds                     | 50,437   |                     |                     |                          |                   |
| <b>Total commercial<br/>commitments</b>               | <b>\$ 1,136,343</b>                            |                     |                     |                          |                   |

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

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

### *Interest Rate Risk Management*

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

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

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

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

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

These simulations are highly complex, and are based on many assumptions that are intended to reflect the general behavior of the balance sheet components over the period in question. It is unlikely that actual events will match these assumptions in most cases. For this reason, the results of these forward-looking computations are only approximations of the true sensitivity of net interest income to changes in market interest rates. Several benchmark and market rate curves were used in the modeling process, primarily the LIBOR/SWAP curve, Prime, U.S. Treasury, FHLB rates, brokered CD rates, repurchase agreements rates and the mortgage commitment rate of 30 years.

The 12-month net interest income is forecasted assuming the September 30, 2016 interest rate curves remain constant. Then, net interest income is estimated under rising and falling rate scenarios. For rising rate scenarios, a gradual (ramp) parallel upward shift of the yield curve is assumed during the first twelve months (the "+200 ramp" scenario). Conversely, for the falling rate scenarios, a gradual (ramp) parallel downward shift of the yield curve is assumed during the first twelve months (the "-200 ramp" scenario). However, given the current low levels of interest rates, a full downward shift of 200 basis points would represent an unrealistic scenario. Therefore, under the falling rate scenario, rates move downward up to 200 basis points, but without reaching zero. The resulting scenario shows interest rates close to zero in most cases, reflecting a flattening yield curve instead of a parallel downward scenario.

The Libor/Swap curve for September 2016, as compared to December 2015, reflected a 30 basis points increase in the short-term horizon, between one to twelve months, while market rates decreased by 38 basis points in the medium-term, that is, between 2 to 5 years. In the long-term, that is, over a 5-year time horizon, market rates decreased by 72 basis points. The U.S. Treasury curve in the short-term increased by 2 basis points and in the medium-term horizon increased by 53 basis points as compared to December 2015 end of month levels. The long-term horizon decreased by 68 basis points as compared to December 2015 end of month levels.

The following table presents the results of the simulations as of September 30, 2016 and December 31, 2015. Consistent with prior years, these exclude non-cash changes in the fair value of derivatives:

|                       | <b>September 30, 2016</b>                 |               |                              |               | <b>December 31, 2015</b>                  |               |                              |          |
|-----------------------|---|---------------|------------------------------|---------------|---|---------------|------------------------------|----------|
|                       | <b>Net Interest Income Risk</b>           |               |                              |               | <b>Net Interest Income Risk</b>           |               |                              |          |
|                       | <b>(Projected for the next 12 months)</b> |               |                              |               | <b>(Projected for the next 12 months)</b> |               |                              |          |
|                       | <b>Static Simulation</b>                  |               | <b>Growing Balance Sheet</b> |               | <b>Static Simulation</b>                  |               | <b>Growing Balance Sheet</b> |          |
|                       | <b>Change</b>                             | <b>Change</b> | <b>Change</b>                | <b>Change</b> | <b>Change</b>                             | <b>Change</b> | <b>Change</b>                |          |
|                       |   | <b>%</b>      |                              | <b>%</b>      |   | <b>%</b>      |                              | <b>%</b> |
| (Dollars in millions) |   |               |                              |               |   |               |                              |          |
| + 200 bps ramp        | \$ 13.7                                   | 2.85%         | \$ 13.9                      | 2.81%         | \$ 12.6                                   | 2.51%         | \$ 14.2                      | 2.81%    |
| - 200 bps ramp        | \$ (5.8)                                  | (1.20)%       | \$ (9.4)                     | (1.91)%       | \$ (7.8)                                  | (1.55)%       | \$ (8.7)                     | (1.72)%  |

The Corporation continues to manage its balance sheet structure to control the overall interest rate risk. As part of the strategy to limit the interest rate risk, the Corporation has executed certain transactions that affected the simulation results. The composition of the loan portfolio has changed as compared to December 2015 end of month levels, primarily reflecting lower commercial and consumer loan balances, including repayments on six large relationships totaling \$145.3 million. However, non-performing assets increased in the first nine months of 2016 by \$134.1 million, 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 \$112.8 million as of September 30, 2016, the inflow in the second quarter of 2016 of a \$35.0 million commercial relationship in Puerto Rico, and the inflow in the third quarter of 2016 of the GDB and Puerto Rico Public Buildings Authority bonds held by the Corporation as part of its available-for-sale securities portfolio recorded at their aggregate fair value of \$19.5 million. The Corporation has continued reducing its holdings of brokered CDs, with a reduction of \$539.0 million during the first nine months of 2016, and repaid at maturity a \$100 million repurchase agreement and a \$100 million FHLB advance. Total deposits, excluding brokered CDs and government deposits, increased in the first nine months of 2016 by \$135.0 million, primarily reflecting increases in demand deposits and savings in Puerto Rico.

Taking into consideration the above-mentioned facts for modeling purposes, the net interest income for the next twelve months under a non-static balance sheet scenario is estimated to increase by \$13.9 million in the rising rate scenario when compared against the Corporation's flat or unchanged interest rate forecast scenario. Under the falling rate, non-static scenario the net interest income is estimated to decrease by \$9.4 million.

#### *Derivatives*

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

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

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

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

For detailed information regarding the volume of derivative activities (e.g. notional amounts), location and fair values of derivative instruments in the Statement of Financial Condition and the amount of gains and losses reported in the Statement of Income, refer to Note 10 in the accompanying unaudited consolidated financial statements.

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

| (In thousands)   | <b>Asset Derivatives<br/>Nine-Month Period<br/>Ended<br/>September 30, 2016</b> | <b>Liability<br/>Derivatives<br/>Nine-Month Period<br/>Ended<br/>September 30, 2016</b> |
|--|---|---|
| Fair value of contracts outstanding at the beginning of the period | \$ 806  | \$ (921)  |
| Fair value of new contracts entered into during the period         | 19  | (25)  |
| Changes in fair value during the period                            | (630)   | 611   |
| Fair value of contracts outstanding as of September 30, 2016       | \$ 195  | \$ (335)  |

### Sources of Fair Value

| (In thousands)   | <b>Payment Due by Period</b>                  |                                      |                                      |  | <b>Total Fair Value</b> |
|--|---|--------------------------------------|--------------------------------------|--|-------------------------|
| <b>As of September 30, 2016</b>                                  | <b>Maturity of<br/>Less Than<br/>One Year</b> | <b>Maturity<br/>of 1-3<br/>Years</b> | <b>Maturity<br/>of 3-5<br/>Years</b> | <b>Maturity<br/>in<br/>Excess<br/>of 5<br/>Years</b> |                         |
| Pricing from observable market inputs -<br>Asset Derivatives     | \$ 4  | \$ -                                 | \$ 191                               | \$ -   | \$ 195                  |
| Pricing from observable market inputs -<br>Liability Derivatives | (144)   | -                                    | (191)                                | -  | (335)                   |
|  | \$ (140)                                      | \$ -                                 | \$ -                                 | \$ -   | \$ (140)                |

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

As of September 30, 2016 and December 31, 2015, all of the derivative instruments held by the Corporation were considered economic undesignated hedges.

The use of derivatives involves market and credit risk. The market risk of derivatives stems principally from the potential for changes in the value of derivative contracts based on changes in interest rates. The credit risk of derivatives arises from the potential for default of the counterparty. To manage this credit risk, the Corporation deals with counterparties of good credit standing, enters into master netting agreements whenever possible and, when appropriate, obtains collateral. Master netting agreements incorporate rights of set-off that provide for the net settlement of contracts with the same counterparty in the event of default.

Refer to Note 20 of the accompanying unaudited consolidated financial statements for additional information regarding the fair value determination of derivative instruments.

### ***Credit Risk Management***

First BanCorp. is subject to credit risk mainly with respect to its portfolio of loans receivable and off-balance sheet instruments, mainly derivatives and loan commitments. Loans receivable represents loans that First BanCorp. holds for investment and, therefore, First BanCorp. is at risk for the term of the loan. Loan commitments represent commitments to extend credit, subject to specific conditions, for specific amounts and maturities. These commitments may expose the Corporation to credit risk and are subject to the same review and approval process as for loans. Refer to "Contractual Obligations and Commitments" above for further details. The credit risk of derivatives arises from the potential of the counterparty's default on its contractual obligations. To manage this credit risk, the Corporation deals with counterparties of good credit standing, enters into master netting agreements whenever possible and, when appropriate, obtains collateral. For further details and information on the Corporation's derivative credit risk exposure, refer to "Interest Rate Risk Management" above. The Corporation manages its credit risk through its credit policy, underwriting, independent loan review and quality control procedures, statistical analysis, comprehensive financial analysis, and established management committees. The Corporation also employs proactive collection and loss mitigation efforts. Furthermore, personnel performing structured loan workout functions are responsible for mitigating defaults and minimizing losses upon default within each region and for each business segment. In the case of the C&I, commercial mortgage and construction loan portfolios, the Special Asset Group ("SAG") focuses on strategies for the accelerated reduction of non-performing assets through note sales, short sales, loss mitigation programs, and sales of OREO. In addition to the management of the resolution process for problem loans, the SAG oversees collection efforts for all loans to prevent migration to the non-performing and/or adversely classified status. The SAG utilizes

relationship officers, collection specialists and attorneys. In the case of residential construction projects, the workout function monitors project specifics, such as project management and marketing, as deemed necessary.

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

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

#### ***Allowance for Loan and Lease Losses and Non-performing Assets***

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

The allowance for loan and lease losses represents the estimate of the level of reserves appropriate to absorb inherent credit losses. The amount of the allowance was determined by empirical analysis and judgments regarding the quality of each individual loan portfolio. All known relevant internal and external factors that affected loan collectability were considered, including analyses of historical charge-off experience, migration patterns, changes in economic conditions, and changes in loan collateral values. For example, factors affecting the economies of Puerto Rico, Florida (USA), the United States Virgin Islands and the British Virgin Islands may contribute to delinquencies and defaults above the Corporation's historical loan and lease losses. Such factors are subject to regular review and may change to reflect updated performance trends and expectations, particularly in times of severe stress. The process includes judgments and quantitative elements that may be subject to significant change. There is no certainty that the allowance will be adequate over time to cover credit losses in the portfolio because of continued adverse changes in the economy, market conditions, or events adversely affecting specific customers, industries or markets. To the extent actual outcomes differ from our estimates, the credit quality of our customer base materially decreases, the risk profile of a market, industry, or group of customers



changes materially, or the allowance is determined to not be adequate, additional provisions for credit losses could be required, which could adversely affect our business, financial condition, liquidity, capital, and results of operations in future periods.

The allowance for loan and lease losses provides for probable losses that have been identified with specific valuation allowances for individually evaluated impaired loans and probable losses believed to be inherent in the loan portfolio that have not been specifically identified. An internal risk rating is assigned to each business loan at the time of approval and is subject to subsequent periodic reviews by the Corporation's senior management. The allowance for loan and lease losses is reviewed on a quarterly basis as part of the Corporation's continued evaluation of its asset quality.

The ratio of the allowance for loan losses to total loans held for investment decreased to 2.42% as of September 30, 2016 compared to 2.64% as of December 31, 2015, primarily due to the four large commercial loan charge-offs totaling \$22.9 million recorded in the third quarter of 2016. The allowance to total loans for each of the Corporation's categories of loans changed as follows: the allowance to total loans for the C&I portfolio decreased from 3.06% as of December 31, 2015 to 3.03% as of September 30, 2016; the allowance to total loans for the commercial mortgage portfolio decreased from 4.44% as of December 31, 2015 to 3.64% as of September 30, 2016 impacted by the recognition in the third quarter of 2016 of charge-offs on loans guaranteed by the TDF against specific reserves established in prior periods as discussed below; the allowance to total loans for the construction loan portfolio increased from 2.25% as of December 31, 2015 to 4.30% as of September 30, 2016; the allowance to total loans for the residential mortgage portfolio decreased from 1.18% as of December 31, 2015 to 1.09% as of September 30, 2016 primarily driven by adjustments recorded early in 2016 based on the experience observed over a 12-month look-back period that showed lower than projected liquidations, loss severity rates and delinquency levels; and the allowance to total consumer and finance leases portfolio decreased from 3.32% as of December 31, 2015 to 2.94% as of September 30, 2016 driven by an improved charge-off rates trend and lower loss severity rates.

The ratio of the total allowance to non-performing loans held for investment was 37.77% as of September 30, 2016 compared to 54.36% as of December 31, 2015, primarily reflecting the migration to non-performing status in the first quarter of 2016 of the Corporation's exposure to commercial mortgage loans guaranteed by the TDF with a book value of \$112.8 million as of September 30, 2016. These loans have been adversely classified since the third quarter of 2015, and the migration of the loans to non-performing status in 2016 did not result in a significant increase to the total allowance for loan losses. During the third quarter of 2016, the Corporation recorded charge-offs of \$13.7 million on these loans, of which \$12.8 million was charged against specific reserves established in prior periods. As of September 30, 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 16% and the loans are being carried at 76% of unpaid principal balance, net of reserves and accumulated charge-offs.

Substantially all of the Corporation's loan portfolio is located within the boundaries of the U.S. economy. Whether the collateral is located in Puerto Rico, the U.S. or British Virgin Islands or the U.S. mainland (mainly in the state of Florida), the performance of the Corporation's loan portfolio and the value of the collateral supporting the transactions are dependent upon the performance of and conditions within each specific area's real estate market. The real estate

market in Puerto Rico experienced readjustments in value over the last few years driven by the loss of income due to higher unemployment, reduced demand and general adverse economic conditions. The Corporation sets adequate loan-to-value ratios upon original approval following its regulatory and credit policy standards.

As shown in the following table, the allowance for loan and lease losses amounted to \$214.1 million as of September 30, 2016, or 2.42% of total loans, compared with \$240.7 million, or 2.64% of total loans, as of December 31, 2015. Refer to the “Provision for Loan and Lease Losses” above for additional information.

| (Dollars in thousands)  | Quarter Ended<br>September 30, |            | Nine-Month Period Ended<br>September 30, |            |
|---|--------------------------------|------------|--|------------|
|   | 2016                           | 2015       | 2016                                     | 2015       |
| Allowance for loan and lease losses,<br>beginning of period   | \$ 234,454                     | \$ 221,518 | \$ 240,710                               | \$ 222,395 |
| Provision (release) for loan and lease<br>losses:   |                                |            |  |            |
| Residential Mortgage  | 4,553                          | 6,958      | 21,589                                   | 21,791     |
| Commercial Mortgage (1)   | (152)                          | 6,668      | 3,369                                    | 48,809     |
| Commercial and Industrial (2)   | 5,597                          | 3,807      | 11,335                                   | 29,750     |
| Construction (3)  | 2,480                          | (139)      | 2,151                                    | 1,385      |
| Consumer and Finance Leases   | 9,025                          | 13,882     | 25,098                                   | 36,677     |
| Provision for loan and lease losses<br>(4)  | 21,503                         | 31,176     | 63,542                                   | 138,412    |
| Charge-offs   |                                |            |  |            |
| Residential Mortgage  | (8,514)                        | (5,094)    | (27,352)                                 | (13,815)   |
| Commercial Mortgage (5)   | (13,730)                       | (3,677)    | (15,742)                                 | (54,115)   |
| Commercial and Industrial (6)   | (10,587)                       | (1,267)    | (16,260)                                 | (30,090)   |
| Construction (7)  | (19)                           | (103)      | (623)                                    | (4,787)    |
| Consumer and Finance Leases   | (13,716)                       | (15,926)   | (41,490)                                 | (48,221)   |
| Total charge offs (8)   | (46,566)                       | (26,067)   | (101,467)                                | (151,028)  |
| Recoveries:   |                                |            |  |            |
| Residential Mortgage  | 972                            | 214        | 2,159                                    | 584        |
| Commercial Mortgage (9)   | 335                            | 20         | 414                                      | 6,515      |
| Commercial and Industrial<br>(10)   | 929                            | 327        | 1,885                                    | 3,386      |
| Construction (11)   | 140                            | 176        | 301                                      | 2,379      |
| Consumer and Finance Leases   | 2,303                          | 1,602      | 6,526                                    | 6,323      |
| Total recoveries (12)   | 4,679                          | 2,339      | 11,285                                   | 19,187     |
| Net Charge-Offs   | (41,887)                       | (23,728)   | (90,182)                                 | (131,841)  |
| Allowance for loan and lease losses,<br>end of period   | \$ 214,070                     | \$ 228,966 | \$ 214,070                               | \$ 228,966 |
| Allowance for loan and lease losses<br>to period end total loans held for<br>investment   | 2.42%                          | 2.50%      | 2.42%                                    | 2.50%      |
| Net charge-offs (annualized) to<br>average loans outstanding during the<br>period   | 1.90%                          | 1.04%      | 1.35%                                    | 1.91%      |
| Net charge-offs (annualized),<br>excluding net charge-offs of \$61.4<br>million related to<br>the bulk sale of assets in 2015,<br>to average loans outstanding during | 1.90%                          | 1.04%      | 1.35%                                    | 1.03%      |

|   |       |       |       |       |
|---|-------|-------|-------|-------|
| the period  |       |       |       |       |
| Provision for loan and lease losses to net charge-offs during the period  | 0.51x | 1.31x | 0.70x | 1.05x |
| Provision for loan and lease losses to net charge-offs during the period, excluding the impact of the bulk sale of assets in 2015 | 0.51x | 1.31x | 0.70x | 1.30x |

- 
- (1) For the nine-month period ended September 30, 2015, includes a provision of \$33.8 million associated with the bulk sale of assets.
- (2) For the nine-month period ended September 30, 2015, includes a provision of \$10.8 million associated with the bulk sale of assets.
- (3) For the nine-month period ended September 30, 2015, includes a provision of \$2.4 million associated with the bulk sale of assets.
- (4) For the nine-month period ended September 30, 2015, includes a provision of \$46.9 million associated with the bulk sale of assets.
- (5) For the nine-month period ended September 30, 2015, includes charge-offs of \$43.2 million associated with the bulk sale of assets.
- (6) For the nine-month period ended September 30, 2015, includes charge-offs of \$22.6 million associated with the bulk sale of assets.
- (7) For the nine-month period ended September 30, 2015, includes charge-offs of \$4.1 million associated with the bulk sales of assets.
- (8) For the nine-month period ended September 30, 2015, includes charge-offs of \$69.8 million associated with the bulk sale of assets.
- (9) For the nine-month period ended September 30, 2015, includes recoveries of \$5.6 million associated with the bulk sale of assets.
- (10) For the nine-month period ended September 30, 2015, includes recoveries of \$2.0 million associated with the bulk sale of assets.
- (11) For the nine-month period ended September 30, 2015, includes recoveries of \$0.8 million associated with the bulk sale of assets.
- (12) For the nine-month period ended September 30, 2015, includes recoveries of \$8.4 million associated with the bulk sale of assets.

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

| (In thousands)                    | As of<br>September 30, 2016 |  | As of<br>December 31, 2015 |  |
|-----------------------------------|-----------------------------|--|----------------------------|--|
|                                   | Amount                      | Percent of loans<br>in each category<br>to total loans | Amount                     | Percent of loans<br>in each category<br>to total loans |
| Residential mortgage              | \$ 35,966                   | 37%  | \$ 39,570                  | 36%  |
| Commercial mortgage loans         | 56,252                      | 17%  | 68,211                     | 16%  |
| Construction loans                | 5,348                       | 1%   | 3,519                      | 2%   |
| Commercial and Industrial loans   | 65,728                      | 25%  | 68,768                     | 26%  |
| Consumer loans and finance leases | 50,776                      | 20%  | 60,642                     | 20%  |
|                                   | \$ 214,070                  | 100%   | \$ 240,710                 | 100%   |

The following table sets forth information concerning the composition of the Corporation's allowance for loan and lease losses as of September 30, 2016 and December 31, 2015 by loan category and by whether the allowance and related provisions were calculated individually or through a general valuation allowance.

#### As of September 30, 2016

| (Dollars in thousands)                                       | Residential<br>Mortgage<br>Loans | Commercial<br>Mortgage<br>Loans | C&I<br>Loans | Construction<br>Loans | Consumer<br>and<br>Finance<br>Leases | Total        |
|--|----------------------------------|---------------------------------|--------------|-----------------------|--------------------------------------|--------------|
| Impaired loans without specific reserves:                    |                                  |                                 |              |                       |                                      |              |
| Principal balance of loans, net of charge-offs               | \$ 64,198                        | \$ 51,974                       | \$ 17,069    | \$ 1,016              | \$ 4,826                             | \$ 139,083   |
| Impaired loans with specific reserves:                       |                                  |                                 |              |                       |                                      |              |
| Principal balance of loans, net of charge-offs               | 379,841                          | 146,526                         | 161,105      | 46,691                | 39,608                               | 773,761      |
| Allowance for loan and lease losses                          | 9,667                            | 25,907                          | 28,668       | 3,004                 | 5,436                                | 72,682       |
| Allowance for loan and lease losses to principal balance     | 2.55%                            | 17.68%                          | 17.79%       | 6.43%                 | 13.72%                               |              |
| PCI loans:   |                                  |                                 |              |                       |                                      |              |
| Carrying value of PCI loans                                  | 165,014                          | 3,127                           | -            | -                     | -                                    | 168,141      |
| Allowance for PCI loans                                      | 6,638                            | 219                             | -            | -                     | -                                    | 6,857        |
| Allowance for PCI loans to carrying value                    | 4.02%                            | 7.00%                           | -            | -                     | -                                    |              |
| Loans with general allowance:                                |                                  |                                 |              |                       |                                      |              |
| Principal balance of loans                                   | 2,690,889                        | 1,343,387                       | 1,988,837    | 76,591                | 1,682,955                            | 7,782,649    |
| Allowance for loan and lease losses                          | 19,661                           | 30,126                          | 37,060       | 2,344                 | 45,340                               | 134,531      |
| Allowance for loan and lease losses to principal balance     | 0.73%                            | 2.24%                           | 1.86%        | 3.06%                 | 2.69%                                |              |
| Total loans held for investment:                             |                                  |                                 |              |                       |                                      |              |
| Principal balance of loans                                   | \$ 3,299,942                     | \$ 1,545,014                    | \$ 2,167,011 | \$ 124,298            | \$ 1,727,389                         | \$ 8,863,654 |
| Allowance for loan and lease losses                          | 35,966                           | 56,252                          | 65,728       | 5,348                 | 50,776                               | 214,070      |
| Allowance for loan and lease losses to principal balance (1) | 1.09%                            | 3.64%                           | 3.03%        | 4.30%                 | 2.94%                                |              |



| (Dollars in thousands)                                   | Residential Mortgage Loans | Commercial Mortgage Loans | C&I Loans | Construction Loans | Consumer and Finance Leases | Total      |
|--|----------------------------|---------------------------|-----------|--------------------|-----------------------------|------------|
| <b>As of December 31, 2015</b>                           |                            |                           |           |                    |                             |            |
| Impaired loans without specific reserves:                |                            |                           |           |                    |                             |            |
| Principal balance of loans, net of charge-offs           | \$ 65,495                  | \$ 54,048                 | \$ 27,492 | \$ 42,512          | \$ 2,618                    | \$ 192,165 |
| Impaired loans with specific reserves:                   |                            |                           |           |                    |                             |            |
| Principal balance of loans, net of charge-offs           | 395,173                    | 27,479                    | 143,214   | 11,004             | 37,474                      | 614,344    |
| Allowance for loan and lease losses                      | 21,787                     | 3,073                     | 18,096    | 1,202              | 8,423                       | 52,581     |
| Allowance for loan and lease losses to principal balance | 5.51%                      | 11.18%                    | 12.64%    | 10.92%             | 22.48%                      | 8.56%      |
| PCI loans:   |                            |                           |           |                    |                             |            |
| Carrying value of PCI loans                              | 170,766                    | 3,147                     | -         | -                  | -                           | 173,913    |
| Allowance for PCI loans                                  | 3,837                      | 125                       | -         | -                  | -                           | 3,962      |
| Allowance for PCI loans to carrying value                | 2.25%                      | 3.97%                     | -         | -                  | -                           | 2.28%      |
| Loans with general allowance:                            |                            |                           |           |                    |                             |            |
| Principal balance of loans                               | 2,713,285                  | 1,453,132                 | 2,075,807 | 102,679            | 1,787,057                   | 8,131,960  |
| Allowance for loan and lease losses                      | 13,946                     | 65,013                    | 50,672    | 2,317              | 52,219                      | 184,167    |
| Allowance for loan and lease losses to principal         |                            |                           |           |                    |                             |            |

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|  |              |              |              |            |              |              |
|--|--------------|--------------|--------------|------------|--------------|--------------|
| balance  | 0.51%        | 4.47%        | 2.44%        | 2.26%      | 2.92%        | 2.26%        |
| Total loans held for investment:                             |              |              |              |            |              |              |
| Principal balance of loans                                   | \$ 3,344,719 | \$ 1,537,806 | \$ 2,246,513 | \$ 156,195 | \$ 1,827,149 | \$ 9,112,382 |
| Allowance for loan and lease losses                          | 39,570       | 68,211       | 68,768       | 3,519      | 60,642       | 240,710      |
| Allowance for loan and lease losses to principal balance (1) | 1.18%        | 4.44%        | 3.06%        | 2.25%      | 3.32%        | 2.64%        |

- (1) Loans used in the denominator include PCI loans of \$168.1 million and \$173.9 million as of September 30, 2016 and December 31, 2015, respectively. However, the Corporation separately tracks and reports PCI loans and excludes these loans from the amounts of non-performing loans, impaired loans, Troubled Debt Restructurings ("TDRs") and non-performing assets.

The following tables show the activity for impaired loans held for investment and the related specific reserve during the quarter and nine-month period ended September 30, 2016 and 2015:

|   | Quarter Ended  |            | Nine-Month Period   |            |
|---|----------------|------------|---------------------|------------|
|   | September 30,  |            | Ended September 30, |            |
|   | 2016           | 2015       | 2016                | 2015       |
|   | (In thousands) |            | (In thousands)      |            |
| <b>Impaired Loans:</b>                                |                |            |                     |            |
| Balance at beginning of period                        | \$ 953,774     | \$ 824,816 | \$ 806,509          | \$ 945,407 |
| Loans determined impaired during the period           | 26,613         | 37,528     | 261,544             | 135,350    |
| Charge-offs (1)                                       | (30,426)       | (7,498)    | (50,027)            | (90,026)   |
| Loans sold, net of charge-offs                        | -              | -          | -                   | (67,836)   |
| Increase to impaired loans - additional disbursements | 1,091          | 408        | 2,852               | 2,524      |
| Reclassification from loans held for sale             | -              | 40,005     | -                   | 40,005     |
| Foreclosures  | (11,856)       | (12,858)   | (28,466)            | (33,044)   |
| Loans no longer considered impaired                   | (2,674)        | (25,877)   | (27,560)            | (39,062)   |
| Paid in full or partial payments                      | (23,668)       | (13,811)   | (51,998)            | (50,605)   |
| Balance at end of period                              | \$ 912,854     | \$ 842,713 | \$ 912,854          | \$ 842,713 |

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

|                          | Quarter Ended  |      | Nine-Month Period   |      |
|--------------------------|----------------|------|---------------------|------|
|                          | September 30,  |      | Ended September 30, |      |
|                          | 2016           | 2015 | 2016                | 2015 |
|                          | (In thousands) |      | (In thousands)      |      |
| <b>Specific Reserve:</b> |                |      |                     |      |



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|                                |           |           |           |           |
|--------------------------------|-----------|-----------|-----------|-----------|
| Balance at beginning of period | \$ 86,372 | \$ 49,918 | \$ 52,581 | \$ 55,205 |
| Provision for loan losses      | 16,619    | 9,439     | 70,011    | 81,796    |
| Net charge-offs                | (30,309)  | (7,498)   | (49,910)  | (85,142)  |
| Balance at end of period       | \$ 72,682 | \$ 51,859 | \$ 72,682 | \$ 51,859 |

As of September 30, 2016, the Corporation maintained a \$2.1 million reserve for unfunded loan commitments mainly related to an outstanding adversely classified floor plan relationship. The reserve for unfunded loan commitments is an estimate of the losses inherent in off-balance sheet loan commitments to borrowers that are experiencing financial difficulties at the balance sheet date. It is calculated by multiplying an estimated loss factor by an estimated probability of funding, and then by the period-end amounts for unfunded commitments. The reserve for unfunded loan commitments is included as part of accounts payable and other liabilities in the consolidated statement of financial condition.

### *Non-performing Loans and Non-performing Asset*

Total non-performing assets consist of non-performing loans (generally loans held for investment or loans held for sale on which the recognition of interest income has been discontinued when the loan became 90 days past due or earlier if the full and timely collection of interest or principal is uncertain), foreclosed real estate, other repossessed properties, and non-performing investment securities. When a loan is placed in non-performing status, any interest previously recognized and not collected is reversed and charged against interest income.

### *Non-performing Loans Policy*

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

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

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

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

*Purchased Credit Impaired Loans* — PCI loans were recorded at fair value at acquisition. Since the initial fair value of these loans included an estimate of credit losses expected to be realized over the remaining lives of the loans, the subsequent accounting for PCI loans differs from the accounting for non-PCI loans. The Corporation, therefore, separately tracks and reports PCI loans and excludes these from the amounts of non-performing loans, impaired loans, TDRs, and non-performing assets.

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

#### ***Other Real Estate Owned***

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

#### ***Other Repossessed Property***

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

#### ***Other Non-Performing Assets***

This category consists of bonds of the GDB and the Puerto Rico Public Buildings Authority placed in non-performing status in the third quarter of 2016 as these entities had recently defaulted on interest due on bonds held by the Corporation as part of its available-for-sale investment securities portfolio.

#### ***Past Due Loans 90 days and still accruing***

These are accruing loans that are contractually delinquent 90 days or more. These past due loans are either current as to interest but delinquent as to the payment of principal or are insured or guaranteed under applicable FHA and VA programs. Past Due Loans 90 days and still accruing also include PCI loans with individual delinquencies over 90 days, primarily related to mortgage loans acquired from Doral Bank in 2015 and from Doral Financial in 2014.

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

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

| (Dollars in thousands)  | <b>September 30,<br/>2016</b> | <b>December 31,<br/>2015</b> |
|---|-------------------------------|------------------------------|
| Non-performing loans held for investment:                                   |                               |                              |
| Residential mortgage  | \$ 162,201                    | \$ 169,001                   |
| Commercial mortgage   | 191,449                       | 51,333                       |
| Commercial and Industrial   | 137,016                       | 137,051                      |
| Construction  | 50,767                        | 54,636                       |
| Finance leases  | 1,969                         | 2,459                        |
| Consumer  | 23,310                        | 28,293                       |
| Total non-performing loans held for investment                              | \$ 566,712                    | \$ 442,773                   |
| OREO  | 139,446                       | 146,801                      |
| Other repossessed property  | 9,416                         | 12,223                       |
| Other assets (1)  | 20,393                        | -                            |
| Total non-performing assets, excluding loans held for sale                  | \$ 735,967                    | \$ 601,797                   |
| Non-performing loans held for sale  | 8,079                         | 8,135                        |
| Total non-performing assets, including loans held for sale (2) (3)          | \$ 744,046                    | \$ 609,932                   |
| Past due loans 90 days and still accruing (4) (5)                           | \$ 138,442                    | \$ 163,197                   |
| Non-performing assets to total assets                                       | 6.16%                         | 4.85%                        |
| Non-performing loans held for investment to total loans held for investment | 6.39%                         | 4.86%                        |
| Allowance for loan and lease losses   | \$ 214,070                    | \$ 240,710                   |
| Allowance to total non-performing loans held for investment                 | 37.77%                        | 54.36%                       |
| Allowance to total non-performing loans held for investment,                |                               |                              |

excluding residential real estate loans

52.92%

87.92%

- 
- (1) Bonds of the GDB and the Puerto Rico Public Buildings Authority held as part of the available-for-sale investment securities portfolio with an amortized cost of \$35.6 million (including accrued interest of \$0.9 million), recorded on the Corporation's books at their aggregate fair value of \$19.5 million.
  - (2) PCI loans accounted for under ASC 310-30 of \$168.1 million and \$173.9 million as of September 30, 2016 and December 31, 2015, respectively, are excluded and not considered non-performing due to the application of the accretion method, under which these loans will accrete interest income over the remaining life of the loans using estimated cash flow analysis.
  - (3) Non-performing assets exclude \$415.9 million and \$414.9 million of TDR loans that are in compliance with the modified terms and in accrual status as of September 30, 2016 and December 31, 2015, respectively.
  - (4) It is the Corporation's policy to report delinquent residential mortgage loans insured by the FHA or guaranteed by the VA as past-due loans 90 days and still accruing as opposed to non-performing loans since the principal repayment is insured. These balances include \$29.6 million of residential mortgage loans insured by the FHA or guaranteed by the VA that are over 15 months delinquent and are no longer accruing interest as of September 30, 2016.
  - (5) Amount includes PCI loans with individual delinquencies over 90 days and still accruing with a carrying value as of September 30, 2016 and December 31, 2015 of approximately \$27.9 million and \$23.2 million, respectively, primarily related to loans acquired from Doral Bank in the first quarter of 2015 and from Doral Financial in the second quarter of 2014.

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

| (Dollars in thousands)   | September 30,<br>2016 | December 31,<br>2015 |
|--|-----------------------|----------------------|
| <b>Puerto Rico:</b>  |                       |                      |
| Non-performing loans held for investment:                      |                       |                      |
| Residential mortgage   | \$ 138,147            | \$ 147,975           |
| Commercial mortgage  | 176,474               | 34,917               |
| Commercial and Industrial                                      | 132,180               | 131,450              |
| Construction   | 11,124                | 11,894               |
| Finance leases   | 1,969                 | 2,459                |
| Consumer   | 22,213                | 26,329               |
| Total non-performing loans held for investment                 | 482,107               | 355,024              |
| OREO   | 129,365               | 133,121              |
| Other repossessed property                                     | 9,369                 | 12,115               |
| Other assets (1)   | 20,393                | -                    |
| Total non-performing assets, excluding loans held for sale     | \$ 641,234            | \$ 500,260           |
| Non-performing loans held for sale                             | 8,079                 | 8,135                |
| Total non-performing assets, including loans held for sale (2) | \$ 649,313            | \$ 508,395           |
| Past due loans 90 days and still accruing (3)                  | \$ 134,611            | \$ 154,915           |
| <b>Virgin Islands:</b>   |                       |                      |
| Non-performing loans held for investment:                      |                       |                      |
| Residential mortgage   | \$ 18,250             | \$ 14,228            |
| Commercial mortgage  | 9,459                 | 10,073               |
| Commercial and Industrial                                      | 4,836                 | 5,601                |
| Construction   | 39,643                | 42,590               |
| Consumer   | 398                   | 471                  |
| Total non-performing loans held for investment                 | 72,586                | 72,963               |
| OREO   | 6,793                 | 5,458                |
| Other repossessed property                                     | -                     | 32                   |
| Total non-performing assets                                    | \$ 79,379             | \$ 78,453            |
| Past due loans 90 days and still accruing                      | \$ 1,910              | \$ 8,173             |
| <b>United States:</b>  |                       |                      |
| Non-performing loans held for investment:                      |                       |                      |
| Residential mortgage   | \$ 5,804              | \$ 6,798             |
| Commercial mortgage  | 5,516                 | 6,343                |
| Construction   | -                     | 152                  |
| Consumer   | 699                   | 1,493                |
| Total non-performing loans held for investment                 | 12,019                | 14,786               |
| OREO   | 3,288                 | 8,222                |
| Other repossessed property                                     | 47                    | 76                   |

|   |    |        |    |        |
|---|----|--------|----|--------|
| Total non-performing assets               | \$ | 15,354 | \$ | 23,084 |
| Past due loans 90 days and still accruing | \$ | 1,921  | \$ | 109    |

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- (1) Bonds of the GDB and the Puerto Rico Public Buildings Authority held as part of the available-for-sale investment securities portfolio with an amortized cost of \$35.6 million (including accrued interest of \$0.9 million), recorded on the Corporation's books at their aggregate fair value of \$19.5 million.
- (2) PCI loans accounted for under ASC 310-30 of \$168.1 million and \$173.9 million as of September 30, 2016 and December 31, 2015, respectively, are excluded and not considered non-performing due to the application of the accretion method, under which these loans will accrete interest income over the remaining life of the loans using estimated cash flow analysis.
- (3) Amount includes PCI loans with individual delinquencies over 90 days and still accruing with a carrying value as of September 30, 2016 and December 31, 2015 of approximately \$27.9 million and \$23.2 million, respectively, primarily related to loans acquired from Doral Bank in the first quarter of 2015 and from Doral Financial in the second quarter of 2014.

Total non-performing loans, including non-performing loans held for sale, were \$574.8 million as of September 30, 2016. This represents an increase of \$123.9 million from \$450.9 million as of December 31, 2015. The increase was primarily attributable to the inflow in the first quarter of 2016 of the \$112.8 million exposure to commercial mortgage loans guaranteed by the TDF and the inflow in the second quarter of 2016 of a \$35.0 million commercial relationship in Puerto Rico. The increase resulting from the inflow of large commercial loans was partially offset by reductions in non-performing residential and consumer loan balances.

Non-performing commercial mortgage loans increased by \$140.1 million to \$191.4 million as of September 30, 2016 from \$51.3 million as of December 31, 2015. The increase was primarily driven by the aforementioned inflow of the \$112.8 million exposure to loans guaranteed by the TDF in the first quarter of 2016 and the inflow of a \$20.7 million loan that is part of the aforementioned \$35.0 million commercial relationship in Puerto Rico placed in non-performing status in the second quarter of 2016. Total inflows of non-performing commercial mortgage loans of \$166.0 million during the first nine months of 2016 increased by \$151.8 million compared to inflows of \$14.2 million for the same period in 2015.

Non-performing C&I loans remained relatively flat at \$137.0 million as of September 30, 2016 compared to \$137.1 million as of December 31, 2015. The slight decrease was driven by charge-offs and collections that were almost entirely offset by new inflows, including a \$14.3 million loan which is also part of the aforementioned \$35.0 million commercial relationship in Puerto Rico placed in non-performing status in the second quarter of 2016. Total inflows of non-performing C&I loans were \$35.2 million during the first nine months of 2016, a decrease of \$52.6 million compared to inflows of \$87.8 million for the same period in 2015.

Non-performing construction loans, including non-performing construction loans held for sale, decreased by \$3.9 million to \$58.8 million from \$62.8 million as of December 31, 2015, primarily from a combination of cash collections, charge-offs and foreclosures. The inflows of non-performing construction loans during the first nine months of 2016 amounted to \$1.0 million compared to inflows of \$0.5 million for the same period in 2015.

The following tables present the activity of commercial and construction non-performing loans held for investment:

|   | <b>Commercial<br/>Mortgage</b> | <b>Commercial &amp;<br/>Industrial</b> | <b>Construction</b> | <b>Total</b> |
|---|--------------------------------|--|---------------------|--------------|
| (In thousands)                          |                                |  |                     |              |
| <b>Quarter ended September 30, 2016</b> |                                |  |                     |              |
| Beginning balance                       | \$ 200,376                     | \$ 154,405                             | \$ 52,549           | \$ 407,330   |
| Plus:                                   |                                |  |                     |              |
| Additions to non-performing             | 9,040                          | 3,603                                  | 353                 | 12,996       |
| Less:                                   |                                |  |                     |              |
| Loans returned to accrual<br>status     | (646)                          | (828)                                  | (255)               | (1,729)      |



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|  |            |            |           |            |
|--|------------|------------|-----------|------------|
| Non-performing loans transferred to OREO | (1,064)    | (514)      | (25)      | (1,603)    |
| Non-performing loans charge-offs         | (13,840)   | (10,587)   | (19)      | (24,446)   |
| Loan collections                         | (3,797)    | (7,683)    | (1,836)   | (13,316)   |
| Reclassification                         | 1,380      | (1,380)    | -         | -          |
| Ending balance                           | \$ 191,449 | \$ 137,016 | \$ 50,767 | \$ 379,232 |

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|   | <b>Commercial<br/>Mortgage</b> | <b>Commercial &amp;<br/>Industrial</b> | <b>Construction</b> | <b>Total</b> |
|---|--------------------------------|--|---------------------|--------------|
| (In thousands)                                    |                                |  |                     |              |
| <b>Nine-Month Period Ended September 30, 2016</b> |                                |  |                     |              |
| Beginning balance                                 | \$ 51,333                      | \$ 137,051                             | \$ 54,636           | 243,020      |
| Plus:   |                                |  |                     |              |
| Additions to non-performing                       | 165,999                        | 35,211                                 | 959                 | 202,169      |
| Less:   |                                |  |                     |              |
| Loans returned to accrual status                  | (1,265)                        | (1,570)                                | (255)               | (3,090)      |
| Non-performing loans transferred to OREO          | (2,808)                        | (2,051)                                | (821)               | (5,680)      |
| Non-performing loans charge-offs                  | (15,468)                       | (16,180)                               | (599)               | (32,247)     |
| Loan collections                                  | (7,316)                        | (14,549)                               | (3,075)             | (24,940)     |
| Reclassification                                  | 974                            | (896)                                  | (78)                | -            |
| Ending balance                                    | \$ 191,449                     | \$ 137,016                             | \$ 50,767           | \$ 379,232   |

|   | <b>Commercial<br/>Mortgage</b> | <b>Commercial &amp;<br/>Industrial</b> | <b>Construction</b> | <b>Total</b> |
|---|--------------------------------|--|---------------------|--------------|
| (In thousands)                            |                                |  |                     |              |
| <b>Quarter ended September 30, 2015</b>   |                                |  |                     |              |
| Beginning balance                         | \$ 95,088                      | \$ 143,935                             | \$ 16,118           | \$ 255,141   |
| Plus:                                     |                                |  |                     |              |
| Additions to non-performing               | 4,530                          | 5,756                                  | 57                  | 10,343       |
| Less:                                     |                                |  |                     |              |
| Loans returned to accrual status          | (24,998)                       | (251)                                  | (30)                | (25,279)     |
| Non-performing loans transferred to OREO  | (866)                          | (2,531)                                | (102)               | (3,499)      |
| Non-performing loans charge-offs          | (3,522)                        | (805)                                  | (70)                | (4,397)      |
| Loan collections                          | (1,253)                        | (4,249)                                | (7)                 | (5,509)      |
| Reclassification from loans held for sale | -                              | -                                      | 40,005              | 40,005       |
| Ending balance                            | \$ 68,979                      | \$ 141,855                             | \$ 55,971           | \$ 266,805   |

|   | <b>Commercial<br/>Mortgage</b> | <b>Commercial &amp;<br/>Industrial</b> | <b>Construction</b> | <b>Total</b> |
|---|--------------------------------|--|---------------------|--------------|
| (In thousands)                                    |                                |  |                     |              |
| <b>Nine-Month Period Ended September 30, 2015</b> |                                |  |                     |              |
| Beginning balance                                 | \$ 148,473                     | \$ 122,547                             | \$ 29,354           | \$ 300,374   |
| Plus:   |                                |  |                     |              |
| Additions to non-performing                       | 14,234                         | 87,835                                 | 465                 | 102,534      |
| Less:   |                                |  |                     |              |
| Loans returned to accrual status                  | (31,625)                       | (1,126)                                | (52)                | (32,803)     |

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|   |           |            |           |            |
|---|-----------|------------|-----------|------------|
| Non-performing loans transferred to OREO      | (7,692)   | (7,910)    | (487)     | (16,089)   |
| Non-performing loans charge-offs              | (26,850)  | (25,220)   | (4,754)   | (56,824)   |
| Loan collections                              | (9,799)   | (11,584)   | (1,336)   | (22,719)   |
| Reclassification from loans held for sale     | -         | -          | 40,005    | 40,005     |
| Other Reclassification                        | -         | -          | (249)     | (249)      |
| Non-performing loans sold, net of charge-offs | (17,762)  | (22,687)   | (6,975)   | (47,424)   |
| Ending balance                                | \$ 68,979 | \$ 141,855 | \$ 55,971 | \$ 266,805 |
|   | 121       |            |           |            |

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Total non-performing commercial and construction loans, including non-performing loans held for sale, with a book value of \$387.3 million as of September 30, 2016, are being carried at 58.2% of unpaid principal balance, net of reserves and accumulated charge-offs.

Non-performing residential mortgage loans decreased by \$6.8 million to \$162.2 million as of September 30, 2016 from \$169.0 million as of December 31, 2015. The decrease was mainly driven by loans brought current, modifications through TDRs after a sustained performance period, foreclosures, and charge-offs during the first nine months of 2016, partially offset by inflows of \$71.0 million. The inflows of non-performing residential mortgage loans during the first nine months of 2016 amounted to \$71.0 million compared to inflows of \$71.7 million for the same period in 2015. Approximately \$53.1 million, or 33% of total non-performing residential mortgage loans, have been written down to their net realizable value and no specific reserve was allocated.

The following table presents the activity of residential non-performing loans held for investment:

|  | <b>Quarter Ended</b> |          | <b>Nine-Month Period Ended</b> |
|--|----------------------|----------|--------------------------------|
|  |                      |          | <b>September 30, 2016</b>      |
|  |                      |          | (In thousands)                 |
| Beginning balance                        | \$                   | 164,399  | \$ 169,001                     |
| Plus:                                    |                      |          |                                |
| Additions to non-performing              |                      | 26,142   | 71,005                         |
| Less:                                    |                      |          |                                |
| Loans returned to accrual status         |                      | (10,028) | (28,283)                       |
| Non-performing loans transferred to OREO |                      | (11,574) | (26,120)                       |
| Non-performing loans charge-offs         |                      | (6,259)  | (18,914)                       |
| Loan collections                         |                      | (479)    | (4,488)                        |
| Ending balance                           | \$                   | 162,201  | \$ 162,201                     |

|  | <b>Quarter Ended</b> |          | <b>Nine-Month Period Ended</b> |
|--|----------------------|----------|--------------------------------|
|  |                      |          | <b>September 30, 2015</b>      |
|  |                      |          | (In thousands)                 |
| Beginning balance                        | \$                   | 175,035  | \$ 180,707                     |
| Plus:                                    |                      |          |                                |
| Additions to non-performing              |                      | 27,392   | 71,663                         |
| Less:                                    |                      |          |                                |
| Loans returned to accrual status         |                      | (12,452) | (40,360)                       |
| Non-performing loans transferred to OREO |                      | (10,833) | (21,511)                       |
| Non-performing loans charge-offs         |                      | (2,790)  | (10,251)                       |
| Loan collections                         |                      | (1,797)  | (5,942)                        |
| Reclassification                         |                      | -        | 249                            |
| Ending balance                           | \$                   | 174,555  | \$ 174,555                     |



The amount of non-performing consumer loans, including finance leases, showed a \$5.5 million decrease during the first nine months of 2016 to \$25.3 million compared to \$30.8 million as of December 31, 2015. The decrease was mainly related to charge-offs and cash collections, primarily auto loans. The inflows of non-performing consumer loans of \$32.6 million for the first nine months of 2016 decreased by \$7.6 million compared to inflows of \$40.2 million for the same period in 2015.

As of September 30, 2016, approximately \$218.3 million of the loans placed in non-accrual status, mainly commercial loans, were current, or had delinquencies of less than 90 days in their interest payments, including \$121.3 million of TDRs maintained in nonaccrual status until the restructured loans meet the criteria of sustained payment performance under the revised terms for reinstatement to accrual status and there is no doubt about full collectability. Collections on these loans are being recorded on a cash basis through earnings, or on a cost-recovery basis, as conditions warrant.

During the nine-month period ended September 30, 2016, interest income of approximately \$10.1 million related to non-performing loans with a carrying value of \$379.8 million as of September 30, 2016, mainly non-performing construction and commercial loans, was applied against the related principal balances under the cost-recovery method.

As of September 30, 2016, approximately \$101.7 million, or 18%, of total non-performing loans held for investment have been charged-off to their net realizable value and no specific reserve was allocated, as shown in the following table:

| (Dollars in thousands)  | <b>Residential<br/>Mortgage<br/>Loans</b> | <b>Commercial<br/>Mortgage<br/>Loans</b> | <b>C&amp;I<br/>Loans</b> | <b>Construction<br/>Loans</b> | <b>Consumer<br/>and<br/>Finance<br/>Leases</b> | <b>Total</b> |
|---|---|--|--------------------------|-------------------------------|--|--------------|
| <b>As of September 30, 2016</b>   |   |  |                          |                               |  |              |
| Non-performing loans held for investment charged-off to realizable value  | \$ 53,139                                 | \$ 31,402                                | \$ 14,872                | \$ 1,016                      | \$ 1,304                                       | \$ 101,733   |
| Other non-performing loans held for investment  | 109,062                                   | 160,047                                  | 122,144                  | 49,751                        | 23,975   | 464,979      |
| Total non-performing loans held for investment  | \$ 162,201                                | \$ 191,449                               | \$ 137,016               | \$ 50,767                     | \$ 25,279                                      | \$ 566,712   |
| Allowance to non-performing loans held for investment   | 22.17%                                    | 29.38%                                   | 47.97%                   | 10.53%                        | 200.86%  | 37.77%       |
| Allowance to non-performing loans held for investment, excluding non-performing loans charged-off to realizable value | 32.98%                                    | 35.15%                                   | 53.81%                   | 10.75%                        | 211.79%  | 46.04%       |
| <b>As of December 31, 2015</b>  |   |  |                          |                               |  |              |
| Non-performing loans held for investment charged-off to realizable value  | \$ 53,612                                 | \$ 15,190                                | \$ 27,492                | \$ 39,466                     | \$ 1,282                                       | \$ 137,042   |
| Other non-performing loans held for investment  | 115,389                                   | 36,143                                   | 109,559                  | 15,170                        | 29,470   | 305,731      |

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|   |            |           |            |           |           |            |
|---|------------|-----------|------------|-----------|-----------|------------|
| Total non-performing loans held<br>for investment   | \$ 169,001 | \$ 51,333 | \$ 137,051 | \$ 54,636 | \$ 30,752 | \$ 442,773 |
| Allowance to non-performing loans held for<br>investment  | 23.41%     | 132.88%   | 50.18%     | 6.44%     | 197.20%   | 54.36%     |
| Allowance to non-performing loans held for<br>investment, excluding non-performing loans<br>charged-off to realizable value | 34.29%     | 188.73%   | 62.77%     | 23.20%    | 205.78%   | 78.73%     |

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The Corporation provides homeownership preservation assistance to its customers through a loss mitigation program in Puerto Rico that is similar to the U.S. government's Home Affordable Modification Program guidelines. Depending upon the nature of borrowers' financial condition, restructurings or loan modifications through this program as well as other restructurings of individual commercial, commercial mortgage, construction, and residential mortgage loans fit the definition of a TDR. A restructuring of a debt constitutes a TDR if the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider. Modifications involve changes in one or more of the loan terms that bring a defaulted loan current and provide sustainable affordability. Changes may include the refinancing of any past-due amounts, including interest and escrow, the extension of the maturity of the loan and modifications of the loan rate. As of September 30, 2016, the Corporation's total TDR loans held for investment of \$656.3 million consisted of \$378.7 million of residential mortgage loans, \$150.9 million of commercial and industrial loans, \$44.0 million of commercial mortgage loans, \$40.2 million of construction loans, and \$42.5 million of consumer loans.

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

Prior to permanently modifying a loan, the Corporation may enter into trial modifications with certain borrowers. Trial modifications generally represent a six-month period during which the borrower makes monthly payments under the anticipated modified payment terms prior to a formal modification. Upon successful completion of a trial modification, the Corporation and the borrower enter into a permanent modification. TDR loans that are participating in, or that have been offered a binding trial modification are classified as TDRs when the trial offer is made and continue to be classified as TDRs regardless of whether the borrower enters into a permanent modification. As of September 30, 2016, the Corporation classified an additional \$5.6 million of residential mortgage loans as TDRs that were participating in or had been offered a trial modification.

For the commercial real estate, commercial and industrial, and construction portfolios, at the time of a restructuring, the Corporation determines, on a loan-by-loan basis, whether a concession was granted for economic or legal reasons related to the borrower's financial difficulty. Concessions granted for commercial loans could include: reductions in interest rates to rates that are considered below market; extension of repayment schedules and maturity dates beyond original contractual terms; waivers of borrower covenants; forgiveness of principal or interest; or other contractual changes that would be considered a concession. The Corporation mitigates loan defaults for its commercial loan portfolios through its collection function. The function's objective is to minimize both early stage delinquencies and losses upon default of commercial loans. In the case of the commercial and industrial, commercial mortgage, and construction loan portfolios, the SAG focuses on strategies for the accelerated reduction of non-performing assets through note sales, short sales, loss mitigation programs, and sales of OREO. In addition to the management of the resolution process for problem loans, the SAG oversees collection efforts for all loans to prevent migration to the



non-performing and/or adversely classified status. The SAG utilizes relationship officers, collection specialists, and attorneys. In the case of residential construction projects, the workout function monitors project specifics, such as project management and marketing, as deemed necessary. The SAG utilizes its collections infrastructure of workout collection officers, credit work-out specialists, in-house legal counsel, and third-party consultants. In the case of residential construction projects and large commercial loans, the SAG function also utilizes third-party specialized consultants to monitor the residential and commercial construction projects in terms of construction, marketing and sales, and to assist with the restructuring of large commercial loans.

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

TDR loans are classified as either accrual or nonaccrual loans. Loans in accrual status may remain in accrual status when their contractual terms have been modified in a TDR if the loan had demonstrated performance prior to the restructuring and payment in full under the restructured terms is expected. Otherwise, loans on non-accrual and restructured as a TDR will remain on nonaccrual status until the borrower has proven the ability to perform under the modified structure, generally for a minimum of six months, and there is evidence that such payments can and are likely to continue as agreed. Performance prior to the restructuring, or significant events that coincide with the restructuring, are included in assessing whether the borrower can meet the new terms and may result in the loan being returned to accrual status at the time of the restructuring or after a shorter performance period. If the borrower's ability to meet the revised payment schedule is uncertain, the loan remains classified as a nonaccrual loan. Loan modifications increase the

Corporation's interest income by returning a non-performing loan to performing status, if applicable, increase cash flows by providing for payments to be made by the borrower, and limit increases in foreclosure and OREO costs. The Corporation continues to consider a modified loan as an impaired loan for purposes of estimating the allowance for loan and lease losses.

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

| (In thousands)                        | <b>September 30, 2016</b> |                       |                   |
|---------------------------------------|---------------------------|-----------------------|-------------------|
|                                       | <b>Accrual</b>            | <b>Nonaccrual (1)</b> | <b>Total TDRs</b> |
| Non-FHA/VA Residential Mortgage loans | \$ 296,840                | \$ 81,881             | \$ 378,721        |
| Commercial Mortgage Loans             | 28,699                    | 15,273                | 43,972            |
| Commercial and Industrial Loans       | 58,004                    | 92,886                | 150,890           |
| Construction Loans                    | 1,205                     | 38,985                | 40,190            |
| Consumer Loans - Auto                 | 16,561                    | 8,462                 | 25,023            |
| Finance Leases                        | 2,437                     | 139                   | 2,576             |
| Consumer Loans - Other                | 12,173                    | 2,773                 | 14,946            |
| Total Troubled Debt Restructurings    | \$ 415,919                | \$ 240,399            | \$ 656,318        |

- (1) Included in non-accrual loans are \$121.3 million in loans that are performing under the terms of the restructuring agreements but are reported in non-accrual status until the restructured loans meet the criteria of sustained payment performance under the revised terms for reinstatement to accrual status and are deemed fully collectible.

The OREO portfolio, which is part of non-performing assets, decreased by \$7.4 million. The following tables show the composition of the OREO portfolio as of September 30, 2016 and December 31, 2015 as well as the activity during the nine-month period ended September 30, 2016 of the OREO portfolio by geographic region:

### **OREO Composition by Region**

| (In thousands) | <b>As of September 30, 2016</b> |                       |                |                     |
|----------------|---------------------------------|-----------------------|----------------|---------------------|
|                | <b>Puerto Rico</b>              | <b>Virgin Islands</b> | <b>Florida</b> | <b>Consolidated</b> |
| Residential    | \$ 42,457\$                     | 509\$                 | 2,921\$        | 45,887              |
| Commercial     | 75,450                          | 5,221                 | 367            | 81,038              |
| Construction   | 11,475                          | 1,046                 | -              | 12,521              |
|                | \$ 129,382\$                    | 6,776\$               | 3,288\$        | 139,446             |

| (In thousands) | <b>As of December 31, 2015</b> |                       |                |                     |
|----------------|--------------------------------|-----------------------|----------------|---------------------|
|                | <b>Puerto Rico</b>             | <b>Virgin Islands</b> | <b>Florida</b> | <b>Consolidated</b> |

|              |    |           |         |         |         |
|--------------|----|-----------|---------|---------|---------|
| Residential  | \$ | 37,501\$  | 838\$   | 5,224\$ | 43,563  |
| Commercial   |    | 86,423    | 111     | 1,315   | 87,849  |
| Construction |    | 9,197     | 4,509   | 1,683   | 15,389  |
|              | \$ | 133,121\$ | 5,458\$ | 8,222\$ | 146,801 |

**OREO Activity by Region**

(In thousands)

**As of September 30, 2016**

|                        |    | <b>Virgin</b>      |                |                |                     |
|------------------------|----|--------------------|----------------|----------------|---------------------|
|                        |    | <b>Puerto Rico</b> | <b>Islands</b> | <b>Florida</b> | <b>Consolidated</b> |
| Beginning Balance      | \$ | 133,121\$          | 5,458\$        | 8,222\$        | 146,801             |
| Additions              |    | 34,127             | 2,248          | 1,237          | 37,612              |
| Sales                  |    | (24,389)           | (889)          | (6,109)        | (31,387)            |
| Fair value adjustments |    | (13,477)           | (41)           | (62)           | (13,580)            |
| Ending Balance         | \$ | 129,382\$          | 6,776\$        | 3,288\$        | 139,446             |

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In the third quarter of 2016, the Corporation discontinued the income recognition related to, and placed in non-performing status, the bonds of GDB and the Puerto Rico Public Buildings Authority as these entities had recently defaulted on interest due on bonds held by the Corporation as part of its available-for-sale investment securities portfolio. As of September 30, 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 credit impairment charges). These bonds are recorded on the Corporation's books at their aggregate fair value of \$19.5 million.

#### *Net Charge-offs and Total Credit Losses*

Total net charge-offs for the first nine months of 2016 were \$90.2 million, or 1.35% of average loans on an annualized basis, compared to \$131.8 million, or an annualized 1.91%, for the same period in 2015. The bulk sale of assets in the second quarter of 2015 added \$61.4 million in net charge-offs for the first nine months of 2015. Excluding the impact of net charge-offs related to the bulk sale of assets in 2015, the \$90.2 million of net charge-offs for the first nine months of 2016 increased by \$19.8 million compared to adjusted net charge-offs of \$70.4 million for the first nine months of 2015, driven by higher losses on residential mortgage loans as well as the impact of four large commercial loan charge-offs recorded in the third quarter of 2016, including charge-offs of \$13.7 million recorded on loans guaranteed by the TDF.

C&I loans net charge-offs in the first nine months of 2016 totaled \$14.4 million, or an annualized 0.89% of related average loans, compared to \$26.7 million, or an annualized 1.59%, for the first nine months of 2015. C&I loans net charge-offs in the first nine months of 2015 included \$20.6 million associated with the bulk sale of assets. Excluding the impact of net charge-offs related to the bulk sale of assets in 2015, the \$14.4 million of C&I loans net charge-offs for the first nine months of 2016 increased by \$8.3 million compared to adjusted C&I loans net charge-offs of \$6.1 million for the first nine months of 2015. Substantially all of the charge-offs recorded in the first nine months of 2016 are related to loans in Puerto Rico, including charge-offs totaling \$11.9 million on three commercial relationships.

Commercial mortgage loans net charge-offs in the first nine months of 2016 were \$15.3 million, or an annualized 1.34% of related average loans, compared to \$47.6 million, or an annualized 3.96%, for the first nine months of 2015. Commercial mortgage loans net charge-offs in the first nine months of 2015 included \$37.6 million associated with the bulk sale of assets. Excluding the impact of net charge-offs related to the bulk sale of assets in 2015, the \$15.3 million of commercial mortgage loans net charge-offs for the first nine months of 2016 increased by \$5.3 million compared to adjusted commercial mortgage loans net charge-offs of \$10.0 million for the first nine months of 2015. Most of the charge-offs recorded in the first nine months of 2016 are related to loans in Puerto Rico, including the \$13.7 million charge-offs recorded on loans guaranteed by the TDF in the third quarter. As noted above, these charge-offs are associated with two of the three credit facilities guaranteed by the TDF as the payments received on these facilities are insufficient to cover the contractual payments and the Corporation is not receiving collections from the TDF guarantee. As such, these two facilities are collateral dependent loans; thus, the portion of the recorded investment in excess of the fair value of the collateral identified as uncollectible was charged off against the allowance for loan losses. Approximately \$12.8 million of the \$13.7 million charge-offs recorded in the third quarter of 2016 on loans guaranteed by the TDF was charged against specific reserves established in prior periods.

Construction loans net charge-offs in the first nine months of 2016 were \$0.3 million, or an annualized 0.29% of related average loans, compared to \$2.4 million, or an annualized 1.88%, for the first nine months of 2015. Construction loans net-charge offs in the first nine months of 2015 included \$3.3 million of net charge-offs related to the bulk sale of assets. Excluding the impact of net charge-offs related to the bulk sale of assets in 2015, the \$0.3

million of construction loans net charge-offs for the first nine months of 2016 increased by \$1.2 million compared to adjusted construction loans net recoveries of \$0.9 million for the first nine months of 2015. More than half of the net construction loans net charge-offs in 2016 was related to an individual land loan in Puerto Rico fully charged-off in the second quarter.

Residential mortgage loans net charge-offs in the first nine months of 2016 were \$25.2 million, or an annualized 1.02% of related average loans, compared to \$13.2 million, or an annualized 0.54%, for the first nine months of 2015. The increase in the residential mortgage loans net charge-offs is mainly due to updated appraisals. Approximately \$18.3 million in charge-offs for the first nine months of 2016 resulted from valuations for impairment purposes of residential mortgage loans considered homogeneous given high delinquency and loan-to-value levels compared to \$8.2 million for the first nine months of 2015. Net charge-offs for residential mortgage loans also included \$5.6 million related to foreclosures in the first nine months of 2016, compared to \$4.7 million for the first nine months of 2015.

Consumer and finance leases net charge-offs in the first nine months of 2016 were \$35.0 million, or an annualized 2.63% of related average loans, compared to \$41.9 million, or an annualized 2.91% of average loans, in the first nine months of 2015. The decrease is mainly attributable to the auto loan portfolio.

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

|                               | Quarter Ended         |                       | Nine-Month Period Ended |                       |
|-------------------------------|-----------------------|-----------------------|-------------------------|-----------------------|
|                               | September 30,<br>2016 | September 30,<br>2015 | September<br>30, 2016   | September<br>30, 2015 |
| Residential mortgage loans    | 0.91%                 | 0.59%                 | 1.02%                   | 0.54%                 |
| Commercial mortgage (1)       | 3.49%                 | 0.95%                 | 1.34%                   | 3.96%                 |
| Commercial and industrial (2) | 1.81%                 | 0.17%                 | 0.89%                   | 1.59%                 |
| Construction loans (3)        | (0.36)%               | (0.17)%               | 0.29%                   | 1.88%                 |
| Consumer loans (4)            | 2.63%                 | 3.05%                 | 2.63%                   | 2.91%                 |
| Total loans (5)               | 1.90%                 | 1.04%                 | 1.35%                   | 1.91%                 |

- (1) For the nine-month period ended September 30, 2015, includes net charge-offs totaling \$37.6 million associated with the bulk sale of assets. The ratio of commercial mortgage net charge-offs to average loans, excluding net charge-offs associated with the bulk sale of assets, was 0.86%.
- (2) For the nine-month period ended September 30, 2015, includes net charge-offs totaling \$20.6 million associated with the bulk sale of assets. The ratio of commercial and industrial net charge-offs to average loans, excluding net charge-offs associated with the bulk sale of assets, was 0.36%.
- (3) For the nine-month period ended September 30, 2015, includes net charge-offs totaling \$3.3 million associated with the bulk sale of assets. The ratio of construction net charge-offs to average loans, excluding net charge-offs associated with the bulk sale of assets, was (0.70)%.
- (4) Includes lease financing.
- (5) For the nine-month period ended September 30, 2015, includes net charge-offs totaling \$61.4 million associated with the bulk sale of assets. The ratio of total net charge-offs to average loans, excluding charge-offs associated with the bulk sale of assets, was 1.03%.

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

|                                 | Quarter Ended         |                       | Nine-Month Period Ended |                       |
|---------------------------------|-----------------------|-----------------------|-------------------------|-----------------------|
|                                 | September 30,<br>2016 | September 30,<br>2015 | September 30,<br>2016   | September 30,<br>2015 |
| <b>PUERTO RICO:</b>             |                       |                       |                         |                       |
| Residential mortgage            | 1.16%                 | 0.73%                 | 1.30%                   | 0.68%                 |
| Commercial mortgage             |                       |                       |                         |                       |
| (1)                             | 4.59%                 | 1.20%                 | 1.73%                   | 4.94%                 |
| Commercial and Industrial (2)   | 2.43%                 | 0.21%                 | 1.17%                   | 1.94%                 |
| Construction (3)                | 0.01%                 | 0.28%                 | 1.08%                   | 6.80%                 |
| Consumer and finance leases (4) | 2.71%                 | 3.16%                 | 2.74%                   | 3.02%                 |
| Total loans (5)                 | 2.39%                 | 1.27%                 | 1.68%                   | 2.33%                 |
| <b>VIRGIN ISLANDS:</b>          |                       |                       |                         |                       |
| Residential mortgage            | 0.31%                 | 0.02%                 | 0.17%                   | 0.06%                 |
| Commercial mortgage             |                       |                       |                         |                       |
| (6)                             | (0.44)%               | 0.00%                 | (0.16)%                 | 0.00%                 |
| Commercial and Industrial (7)   | 0.01%                 | 0.03%                 | (0.01)%                 | 0.34%                 |
| Construction                    | 0.13%                 | 0.12%                 | 0.31%                   | 0.20%                 |
| Consumer and finance leases     | 0.95%                 | 0.75%                 | 0.89%                   | 0.26%                 |
| Total loans                     | 0.20%                 | 0.08%                 | 0.17%                   | 0.14%                 |
| <b>FLORIDA:</b>                 |                       |                       |                         |                       |
| Residential mortgage            | 0.02%                 | 0.11%                 | 0.04%                   | 0.03%                 |
| Commercial mortgage             |                       |                       |                         |                       |
| (8)                             | (0.20)%               | 0.04%                 | (0.05)%                 | 0.35%                 |
| Commercial and Industrial (9)   | 0.00%                 | 0.00%                 | (0.01)%                 | 0.00%                 |
| Construction (10)               | (1.58)%               | (1.90)%               | (1.41)%                 | (6.98)%               |
| Consumer and finance leases     | 1.40%                 | 0.81%                 | 0.65%                   | 0.90%                 |
| Total loans (11)                | (0.03)%               | 0.03%                 | (0.01)%                 | (0.05)%               |

- (1) For the nine-month period ended September 30, 2015, includes net charge-offs totaling \$37.6 million associated with the bulk sale of assets. The ratio of commercial mortgage net charge-offs to average loans in Puerto Rico, excluding net charge-offs associated with the bulk sale of assets, was 1.02%.
- (2) For the nine-month period ended September 30, 2015, includes net charge-offs totaling \$20.6 million associated with the bulk sale of assets. The ratio of commercial and industrial net charge-offs to average loans in Puerto Rico, excluding net charge-offs associated with the bulk sale of assets, was 0.42%.
- (3) For the nine-month period ended September 30, 2015, includes net charge-offs totaling \$3.3 million associated with the bulk sale of assets. The ratio of construction net charge-offs to average loans in Puerto Rico, excluding net charge-offs associated with the bulk sale of assets, was 0.93%.
- (4) Includes lease financing.
- (5)

For the nine-month period ended September 30, 2015, includes net charge-offs totaling \$61.4 million associated with the bulk sale of assets. The ratio of total net charge-offs to average loans in Puerto Rico, excluding net charge-offs associated with the bulk sale of assets, was 1.26%.

- (6) For the third quarter and nine-month period ended September 30, 2016, recoveries in commercial mortgage loans in the Virgin Islands exceeded charge-offs.
- (7) For the nine-month period ended September 30, 2016, recoveries in commercial and industrial loans in the Virgin Islands exceeded charge-offs.
- (8) For the third quarter and nine-month period ended September 30, 2016, recoveries in commercial mortgage loans in Florida exceeded charge-offs.
- (9) For the nine-month period ended September 30, 2016, recoveries in commercial and industrial loans in Florida exceeded charge-offs.
- (10) For the third quarter and nine-month period ended September 30, 2015, and the nine-month period ended September 30, 2016, recoveries in construction loans in Florida exceeded charge-offs.
- (11) For the third quarter and nine-month period ended September 30, 2016, and the nine-month period ended September 30, 2015, recoveries in total loans in Florida exceeded charge-offs.

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

Total credit losses (equal to net charge-offs plus losses on OREO operations) for the first nine months of 2016 amounted to \$99.3 million, or 1.59% on an annualized basis to average loans and repossessed assets, in contrast to credit losses of \$143.7 million, or 2.06% on an annual basis to average loans and repossessed assets, for the same period in 2015.



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

|   | Quarter Ended<br>September 30, |                    | Nine-Month Period Ended<br>September 30, |                     |
|---|--------------------------------|--------------------|--|---------------------|
|   | 2016                           | 2015               | 2016                                     | 2015                |
| (Dollars in thousands)                        |                                |                    |  |                     |
| <b>OREO</b>                                   |                                |                    |  |                     |
| OREO balances, carrying value:                |                                |                    |  |                     |
| Residential                                   | \$ 45,887                      | \$ 37,996          | \$ 45,887                                | \$ 37,996           |
| Commercial                                    | 81,038                         | 71,124             | 81,038                                   | 71,124              |
| Construction                                  | 12,521                         | 15,322             | 12,521                                   | 15,322              |
| Total   | \$ 139,446                     | \$ 124,442         | \$ 139,446                               | \$ 124,442          |
| OREO activity (number of properties):         |                                |                    |  |                     |
| Beginning property inventory                  | 566                            | 472                | 549                                      | 458                 |
| Properties acquired                           | 123                            | 108                | 309                                      | 252                 |
| Properties disposed                           | (94)                           | (63)               | (263)                                    | (193)               |
| Ending property inventory                     | 595                            | 517                | 595                                      | 517                 |
| Average holding period (in days)              |                                |                    |  |                     |
| Residential                                   | 309                            | 370                | 309                                      | 370                 |
| Commercial                                    | 730                            | 523                | 730                                      | 523                 |
| Construction                                  | 920                            | 1,173              | 920                                      | 1,173               |
|   | 609                            | 559                | 609                                      | 559                 |
| OREO operations (loss) gain:                  |                                |                    |  |                     |
| Market adjustments and (losses) gain on sale: |                                |                    |  |                     |
| Residential                                   | \$ (473)                       | \$ (475)           | \$ (1,608)                               | \$ (2,347)          |
| Commercial                                    | (1,772)                        | (3,466)            | (7,190)                                  | (6,630)             |
| Construction                                  | 374                            | (192)              | 245                                      | (902)               |
|   | (1,871)                        | (4,133)            | (8,553)                                  | (9,879)             |
| Other OREO operations expenses                | (732)                          | (212)              | (581)                                    | (1,968)             |
| <b>Net Loss on OREO operations</b>            | <b>\$ (2,603)</b>              | <b>\$ (4,345)</b>  | <b>\$ (9,134)</b>                        | <b>\$ (11,847)</b>  |
| <b>CHARGE-OFFS</b>                            |                                |                    |  |                     |
| Residential charge-offs, net                  | (7,542)                        | (4,880)            | (25,193)                                 | (13,231)            |
| Commercial charge-offs, net                   | (23,053)                       | (4,597)            | (29,703)                                 | (74,304)            |
| Construction recoveries (charge-offs), net    | 121                            | 73                 | (322)                                    | (2,408)             |
| Consumer and finance leases charge-offs, net  | (11,413)                       | (14,324)           | (34,964)                                 | (41,898)            |
| Total charge-offs, net                        | (41,887)                       | (23,728)           | (90,182)                                 | (131,841)           |
| <b>TOTAL CREDIT LOSSES (1)</b>                | <b>\$ (44,490)</b>             | <b>\$ (28,073)</b> | <b>\$ (99,316)</b>                       | <b>\$ (143,688)</b> |
| <b>LOSS RATIO PER CATEGORY (2)</b>            |                                |                    |  |                     |
| Residential                                   | 0.96%                          | 0.64%              | 1.07%                                    | 0.63%               |
| Commercial                                    | 2.65%                          | 0.85%              | 1.30%                                    | 2.77%               |
| Construction                                  | (1.35)%                        | 0.26%              | 0.06%                                    | 2.35%               |
| Consumer                                      | 2.61%                          | 3.03%              | 2.62%                                    | 2.89%               |
| <b>TOTAL CREDIT LOSS RATIO (3)</b>            | <b>2.06%</b>                   | <b>1.22%</b>       | <b>1.59%</b>                             | <b>2.06%</b>        |

(1) Equal to OREO operations (losses) gains plus charge-offs, net.

(2) Calculated as net charge-offs plus market adjustments and gains (losses) on sale of OREO divided by average loans and repossessed assets.

(3) Calculated as net charge-offs plus net losses on OREO operations divided by average loans and repossessed assets.



## **Operational Risk**

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

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

## **Legal and Compliance Risk**

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

## **Concentration Risk**

The Corporation conducts its operations in a geographically concentrated area, as its main market is Puerto Rico. However, the Corporation has diversified its geographical risk as evidenced by its operations in the Virgin Islands and in Florida. Of the total gross loans held for investment of \$8.9 billion as of September 30, 2016, approximately 78% have credit risk concentration in Puerto Rico, 15% in the United States, and 7% in the Virgin Islands.

## **Exposure to Puerto Rico Government**

As of September 30, 2016, the Corporation had \$325.9 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. 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 \$83.7 million consisted of loans to public corporations, including a direct exposure to PREPA with a book value of \$66.9 million as of September 30, 2016. The PREPA credit facility was placed in non-accrual status in the first quarter of 2015, and interest payments are recorded on a cost-recovery basis. The Corporation's total direct exposure also includes obligations of the Puerto Rico Government with an amortized cost of \$43.5 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 September 30, 2016.

The following table details the Corporation's total direct exposure to the Puerto Rico Government according to their maturities:

| <b>As of September 30, 2016</b>                                 |  |  |                   |                           |
|---|--|--|-------------------|---------------------------|
|   | <b>Investment<br/>Portfolio<br/>(Amortized<br/>cost)</b> |  | <b>Loans</b>      | <b>Total<br/>Exposure</b> |
| <b>(Dollars in thousands)</b>                                   |  |  |                   |                           |
| <b>Central Government:</b>                                      |  |  |                   |                           |
| After 1 to 5 years  | \$ -   |  | \$ 6,886          | \$ 6,886                  |
| <b>Total Central Government</b>                                 | <b>-</b>   |  | <b>6,886</b>      | <b>6,886</b>              |
| <b>Government Development Bank:</b>                             |  |  |                   |                           |
| After 1 to 5 years  | 21,423   |  | -                 | 21,423                    |
| <b>Total Government Development Bank</b>                        | <b>21,423</b>  |  | <b>-</b>          | <b>21,423</b>             |
| <b>Puerto Rico Housing Finance Authority:</b>                   |  |  |                   |                           |
| After 5 to 10 years   | 845  |  | -                 | 845                       |
| After 10 years  | 7,890  |  | -                 | 7,890                     |
| <b>Total Puerto Rico Housing Finance<br/>Authority</b>          | <b>8,735</b>   |  | <b>-</b>          | <b>8,735</b>              |
| <b>Puerto Rico Public Buildings Authority:</b>                  |  |  |                   |                           |
| After 10 years  | 13,315   |  | -                 | 13,315                    |
| <b>Total Puerto Rico Public Buildings<br/>Authority</b>         | <b>13,315</b>  |  | <b>-</b>          | <b>13,315</b>             |
| <b>Public Corporations:</b>                                     |  |  |                   |                           |
| <b>Puerto Rico Electric Power Authority<br/>and affiliates:</b> |  |  |                   |                           |
| Due within one year   | -  |  | 66,853            | 66,853                    |
| After 5 to 10 years   | -  |  | 16,851            | 16,851                    |
| <b>Total Public Corporations</b>                                | <b>-</b>   |  | <b>83,704</b>     | <b>83,704</b>             |
| <b>Municipalities:</b>  |  |  |                   |                           |
| Matured (30 days past due)                                      | -  |  | 6,160             | 6,160                     |
| After 1 to 5 years  | 1,136  |  | 29,495            | 30,631                    |
| After 5 to 10 years   | 10,741   |  | -                 | 10,741                    |
| After 10 years  | 144,313  |  | -                 | 144,313                   |
| <b>Total Municipalities</b>                                     | <b>156,190</b>   |  | <b>35,655</b>     | <b>191,845</b>            |
| <b>Total Direct Government Exposure</b>                         | <b>\$ 199,663</b>  |  | <b>\$ 126,245</b> | <b>\$ 325,908</b>         |

Furthermore, as of September 30, 2016, the Corporation had \$128.0 million outstanding (book value of \$112.8 million) in financings 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. 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 \$1.6 million of interest payments received on loans guaranteed by the TDF since late March 2016 have been applied against principal. As of the date of filing of this Form 10-Q, the largest of these three facilities is current on contractual payments as its operations are generating the cash flows to cover payments. The Corporation has been receiving partial payments from the other two facilities since their operations are insufficient to cover the entire contractual payments 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 \$13.7 million were recorded in the third quarter of 2016, of which \$12.8 million was charged against specific reserves established in prior periods. These loans have been adversely classified since the third quarter of 2015. The Corporation's collections of principal and interest from the TDF in the first half of 2016 amounted to \$0.6 million compared to \$5.3 million in the entire 2015 year.

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"), which gives Puerto Rico's governor emergency powers to deal with Puerto Rico's challenging fiscal situation, including the ability to declare a moratorium on all bonds and other payments. On June 30, 2016, pursuant to Act 21, the Puerto Rico governor ordered a moratorium on the payment of \$780 million of the Puerto Rico Government's general obligations and the debt of certain other instrumentalities due on July 1, 2016. This followed a default on the principal payment of \$367 million of GDB notes due on May 1, 2016. Puerto Rico's governor also issued an executive order intended to protect the GDB's liquidity by allowing withdrawals only to fund necessary costs for essential services such as health, public safety and education services. Recently, the GDB defaulted on a \$28 million payment of interest due to its creditors on August 1, 2016, including interest due on GDB bonds held by the Corporation.

As of September 30, 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 16% and the loans are being carried at 76% of unpaid principal balance, net of reserves and accumulated charge-offs.

In addition, the Corporation had \$121.4 million in indirect exposure to residential mortgage loans that are guaranteed by the Puerto Rico Housing Finance Authority. Residential mortgage loans guaranteed by the Puerto Rico Housing Finance Authority are secured by the underlying properties and the guarantees serve to cover shortfalls in collateral in the event of a borrower default. The Puerto Rico Government guarantees up to \$75 million of the principal guaranteed under the mortgage loans insurance program. According to the most recently released audited financial statements of the Puerto Rico Housing Finance Authority, as of June 30, 2015, the Puerto Rico Housing Finance Authority's mortgage loans insurance program covered loans aggregating to 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 of 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 September 30, 2016, the Corporation had \$463.5 million of public sector deposits in Puerto Rico. Approximately 32% is from municipalities and municipal agencies in Puerto Rico and 68% is from public corporations and the central government and agencies in Puerto Rico.

### **Impact of Inflation and Changing Prices**

The financial statements and related data presented herein have been prepared in conformity with GAAP, which requires the measurement of financial position and operating results in terms of historical dollars without considering changes in the relative purchasing power of money over time due to inflation.

Unlike most industrial companies, substantially all of the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates have a greater impact on a financial institution's performance than the effects of general levels of inflation. Interest rate movements are not necessarily correlated with changes in the prices of goods and services.

### **Basis of Presentation**

The Corporation has included in this Form 10-Q the following financial measures that are not recognized under U.S. generally accepted accounting principles, which are referred to as non-GAAP financial measures: (i) the calculation of net interest income, interest rate spread and net interest margin rate on a tax-equivalent basis and excluding changes in the fair value of derivative instruments; (ii) the calculation of the tangible common equity ratio and the tangible book value per common share; and (iii) certain other financial measures, including net income, provision for loan and lease losses, non-interest income, non-interest expenses and net charge-offs adjusted to exclude the effect of gain on sales of U.S. agency MBS recorded in the third quarter of 2016, severance payments on job discontinuance recorded in the third quarter of 2016, other-than-temporary impairment charges on debt securities recorded during the third quarter of 2015 and nine-month periods ended September 30, 2016 and 2015, the effect of the gain on the repurchase and cancellation of \$10 million in trust-preferred securities recorded in the first nine months of 2016, the effect of the bulk sale of assets in the first nine months of 2015, and the bargain purchase gain and acquisition and conversion costs related to the acquisition of assets and assumption of deposits from Doral Bank recorded in the first nine months of 2015. Investors should be aware that non-GAAP financial measures have inherent limitations and should be read only in conjunction with the Corporation's consolidated financial data prepared in accordance with GAAP.

Net interest income, interest rate spread and net interest margin are reported excluding changes in the fair value of derivative instruments and on a tax-equivalent basis in order to provide to investors additional information about the Corporation's net interest income that management uses and believes should facilitate comparability and analysis. The changes in the fair value of derivative instruments have no effect on interest due or interest earned on interest-bearing liabilities or interest-earning assets, respectively. The tax-equivalent adjustment to net interest income recognizes the income tax savings when comparing taxable and tax-exempt assets and assumes a marginal income tax rate. Income from tax-exempt earning assets is increased by an amount equivalent to the taxes that would have been paid if this income had been taxable at statutory rates. 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. This adjustment puts all earning assets, most notably tax-exempt securities and certain loans, on a common basis that facilitates comparison of results to results of peers. Refer to "*Net Interest Income*" above for the table that reconciles the non-GAAP financial measure "net interest income excluding fair value changes and on a tax-equivalent basis" with net interest income calculated and presented in accordance with GAAP. The table also reconciles the non-GAAP financial measures "net interest spread and margin excluding fair value changes and on a tax-equivalent basis" with net interest spread and margin calculated and presented in accordance with GAAP.



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

To supplement the Corporation's financial statements presented in accordance with GAAP, the Corporation uses, and believes that investors benefit from disclosure of adjustments to the provision for loan and lease losses, non-interest income, non-interest expenses, and net income to exclude items that management believes are not reflective of core operating performance, are not expected to reoccur with any regularity, or may reoccur at uncertain times and amounts. During the third quarter and first nine months of 2016 and 2015, the following adjustments were made for one of those reasons:

- Adjusted provision for loan and lease losses excludes a \$46.9 million charge related to the bulk sale of assets completed in the first nine months of 2015.
- Adjusted non-interest income excludes: (i) gain on sales of U.S. agency MBS of \$6.1 million for the quarter and nine month period ended September 30, 2016, (ii) OTTI charges on debt securities of \$6.7 million for the nine-month period ended September 30, 2016, \$0.2 million for the third quarter of 2015 and \$13.3 million for the nine-month period ended September 30, 2015, (iii) a \$4.2 million gain on the repurchase and cancellation of trust-preferred securities recorded for the nine-month period ended September 30, 2016, (iv) a \$13.4 million bargain purchase gain on assets acquired and deposits assumed from Doral Bank recorded in the nine-month period ended September 30, 2015, and (v) a \$0.6 million loss related to a commercial mortgage loan held for sale sold as part of the bulk sale of assets recorded for the nine-month period ended September 30, 2015.
- Adjusted non-interest expenses excludes: (i) severance payments on job discontinuance of \$0.3 million for the quarter and nine-month period ended September 30, 2016, (ii) acquisition and conversion costs of \$4.6 million for the nine-month period ended September 30, 2015 associated with the assets acquired and liabilities assumed from Doral Bank in 2015, and (iii) expenses and losses of \$1.2 million directly attributable to the bulk sale of assets recorded for the nine-month period ended September 30, 2015.

- Adjusted net income excludes the effect of all the items mentioned in the above captions and their related tax effects. A \$0.2 million tax expense related to the taxable portion of the gain on sale of U.S. agency MBS (calculated based on the applicable capital gain tax rate of 20%) was recorded for the quarter and nine-month period ended September 30, 2016. An income tax benefit of \$0.1 million related to the severance payments on job discontinuance (calculated based on the statutory tax rate of 30%) was recorded for the quarter and nine-month period ended September 30, 2016. A \$19.0 million tax benefit related to the bulk sale of assets and transaction costs (calculated based on the statutory tax rate of 39%) was recorded for the nine-month period ended September 30, 2015. A \$5.2 million tax expense related to the bargain purchase gain on assets acquired and liabilities assumed from Doral Bank (calculated based on the statutory tax rate of 39%) was recorded in the nine-month period ended September 30, 2016. A tax benefit of \$1.8 million (calculated based on the statutory tax rate of 39%) was recorded for the nine-month period ended September 30, 2015, related to acquisition and conversion costs associated with assets acquired and liabilities assumed from Doral Bank. No tax benefit or expense was recognized for OTTI charges on debt securities and the gain on the repurchase and cancellation of trust-preferred securities.

Adjusted net charge-offs exclude net charge-offs of \$61.4 million recorded for the nine-month period ended September 30, 2015 related to the bulk sale of assets.

Management believes that disclosure of the adjusted provision for loan and lease losses, adjusted non-interest income, adjusted non-interest expenses, adjusted net income, and adjusted net charge-offs enhances the ability of analysts and investors to analyze trends in the Corporation's business and understand the performance of the Corporation. In addition, the Corporation may utilize these non-GAAP financial measures as a guide in its budgeting and long-term planning process.

|                                       | As<br>reported<br>(GAAP) | OTTI on<br>Debt<br>Securities | Gain on<br>Sale of<br>Investment<br>Securities | Severance<br>payments |
|---------------------------------------|--------------------------|-------------------------------|--|-----------------------|
| <b>2016 Third Quarter</b>             |                          |                               |  |                       |
| (In thousands)                        |                          |                               |  |                       |
| <b>Non-interest income</b>            | \$ 26,146                | \$ -                          | \$ (6,096)                                     | \$ -                  |
| Gain on sale of investment securities | \$ 6,096                 | \$ -                          | \$ (6,096)                                     | \$ -                  |
| <b>Non-interest expenses</b>          | \$ 88,303                | \$ -                          | \$ -   | \$ (281)              |
| Employees' compensation and benefits  | \$ 38,005                | \$ -                          | \$ -   | \$ (281)              |
| <b>Net income</b>                     | \$ 24,074                | \$ -                          | \$ (6,096)                                     | \$ 281                |

|   | As<br>reported<br>(GAAP) | OTTI on<br>Debt<br>Securities | Gain on<br>Sale of<br>Investment<br>Securities | Severance<br>payments |
|---|--------------------------|-------------------------------|--|-----------------------|
| <b>2015 Third Quarter</b>                                   |                          |                               |  |                       |
| (In thousands)  |                          |                               |  |                       |
| <b>Non-interest income</b>                                  | \$ 18,758                | \$ 231                        | \$ -   | \$ -                  |
| Net impairment losses on available-for-sale debt securities | \$ (231)                 | \$ 231                        | \$ -   | \$ -                  |
| <b>Net income</b>   | \$ 14,758                | \$ 231                        | \$ -   | \$ -                  |

| 2016 First Nine-Months                                      | As<br>reported<br>(GAAP) | OTTI on<br>Debt<br>Securities | Gain on<br>Sale of<br>Investment<br>Securities | Gain on<br>Repurchase<br>and<br>Cancellation<br>of Trust<br>Preferred<br>Securities |
|---|--------------------------|-------------------------------|--|---|
| (In thousands)  |                          |                               |  |   |
| <b>Non-interest income</b>                                  | \$ 64,393                | \$ 6,687                      | \$ (6,096)                                     | \$ (4,217)  |
| Gain on Sale of Investment Securities                       | \$ 6,096                 | \$ -                          | \$ (6,096)                                     |   |
| Net impairment losses on available-for-sale debt securities | \$ (6,687)               | \$ 6,687                      | \$ -   |   |
| Gain on early extinguishment of debt                        | \$ 4,217                 | \$ -                          | \$ -   | \$ (4,217)  |
| <b>Non-interest expenses</b>                                | \$ 270,844               | \$ -                          | \$ -   |   |
| Employees' compensation and benefits                        | \$ 113,841               | \$ -                          | \$ -   |   |
| <b>Net income</b>   | \$ 69,371                | \$ 6,687                      | \$ (6,096)                                     | \$ (4,217)  |

| 2015 First-Nine<br>Months   | As<br>Reported<br>(GAAP) | Bargain<br>Purchase<br>Gain | OTTI on<br>Debt<br>Securities | Bulk Sale<br>Transaction<br>Impact | Acquisition<br>and<br>conversion<br>costs | Tax<br>effect | Adjusted<br>(Non-GAAP) |
|---|--------------------------|-----------------------------|-------------------------------|------------------------------------|---|---------------|------------------------|
| (In thousands)  |                          |                             |                               |                                    |   |               |                        |
| <b>Total net charge-offs<br/>(1)</b>                                      | \$ 131,841               | \$ -                        | \$ -                          | \$ (61,435)                        | \$ -                                      | \$ -          | \$ 70,406              |
| Total net<br>charge-offs to average<br>loans                              | 1.91%                    |                             |                               |                                    | -   | -             | 1.03%                  |
| Commercial<br>mortgage  | \$ 47,600                | \$ -                        | \$ -                          | \$ (37,590)                        | \$ -                                      | \$ -          | 10,010                 |
| Commercial<br>mortgage loans net<br>charge-offs to average<br>loans       | 3.96%                    |                             |                               |                                    | -   | -             | 0.86%                  |
| Commercial and<br>Industrial  | \$ 26,704                | \$ -                        | \$ -                          | \$ (20,570)                        | \$ -                                      | \$ -          | 6,134                  |
| Commercial and<br>Industrial loans net<br>charge-offs to average<br>loans | 1.59%                    |                             |                               |                                    | -   | -             | 0.36%                  |
| Construction  | \$ 2,408                 | \$ -                        | \$ -                          | \$ (3,275)                         | \$ -                                      | \$ -          | (867)                  |
| Construction<br>loans net charge-offs<br>to average loans                 | 1.88%                    |                             |                               |                                    | -   | -             | -0.70%                 |
| <b>Provision for loan<br/>and lease losses</b>                            | \$ 138,412               | \$ -                        | \$ -                          | \$ (46,947)                        | \$ -                                      | \$ -          | \$ 91,465              |