TELKONET INC
Form 10-Q/A
December 11, 2009

U.S. SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q /A
(Amendment No.1)

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

For the quarterly period ended September 30, 2009

OR

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

For the transition period from __________ to __________.

Commission file number 001-31972

TELKONET, INC.

(Exact Name of Registrant as Specified in Its Charter)

Utah	87-0627421
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
20374 Seneca Meadows Parkway, Germantown, MD	20876
(Address of Principal Executive Offices)	(Zip Code)

(240) 912-1800
(Registrant’s Telephone Number, Including Area Code)

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 x No o

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 o No ¨

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

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: 96,563,771 shares of Common Stock ($.001 par value) as of November 14, 2009.

TELKONET, INC.
FORM 10-Q /A for the Quarter Ended September 30, 2009

Index

	Page
EXPLANATORY NOTE	2
PART I. FINANCIAL INFORMATION	3
Item 1. Financial Statements (Unaudited)	3
Condensed Consolidated Balance Sheets: September 30, 2009 and December 31, 2008	3
Condensed Consolidated Statements of Operations and Comprehensive Income (Loss): Three And Nine Months Ended September 30, 2009 and 2008	4
Condensed Consolidated Statement of Equity: January 1, 2009 through September 30, 2009	5
Condensed Consolidated Statements of Cash Flows: Nine Months Ended September 30, 2009 and 2008	6
Notes to Unaudited Condensed Consolidated Financial Statements: September 30, 2009	8
Item 2. Management's Discussion and Analysis	24
Item 3. Quantitative and Qualitative Disclosures About Market Risk.	35
Item 4. Controls and Procedures	35
PART II. OTHER INFORMATION	36
Item 1. Legal Proceedings	36
Item 1A. Risk Factors	36
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	37
Item 3. Defaults Upon Senior Securities	37
Item 4. Submission of Matters to a Vote of Security Holders	37
Item 5. Other Information	37

Item 6. Exhibits 38

EXPLANATORY NOTE

This Amendment No. 1 on Form 10-Q/A (the “Amendment”) amends our quarterly report on Form 10-Q for the fiscal quarter ended September 30, 2009 as filed with the Securities and Exchange Commission on November 16, 2009 (the “Original Report”). The Company is filing this Amendment in response to comments received from the SEC. This Amendment corrects errors and provides additional disclosure information in Item 1 of Part I, Note N Discontinued Operations in the notes to the unaudited financial statements for the period ended September 30, 2009, and Item 6 of Part II as permitted by the rules and regulations of the SEC. The amendment did not have any material impact on our financial results.

For convenience and ease of reference, we are filing the quarterly report in its entirety with the applicable changes. Except for the amendment named above and the updated certifications, this Amendment continues to speak as of the date of our Original Report, and we have not updated the disclosures contained herein to reflect any events that have occurred thereafter. For a discussion of events and developments thereafter, please see our reports filed with the Securities and Exchange Commission since November 16, 2009.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

TELKONET, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS

ASSETS	(Unaudited) September 30, 2009	December 31, 2008
Current assets:		
Cash and cash equivalents	$ 38,449	$ 168,492
Accounts receivable, net	687,056	836,336
Inventories	1,286,296	1,733,940
Other current assets	195,204	230,539
Current assets from discontinued operations	-	476,459
Total current assets	2,207,005	3,445,766
Property and equipment, net	290,924	403,593
Other assets:		
Marketable securities	-	397,403
Deferred financing costs, net	287,178	432,136
Goodwill and other intangible assets, net	14,956,212	15,137,469
Other assets	8,890	98,807
Other assets from discontinued operations	-	6,593,169
Total other assets	15,252,280	22,658,984
Total Assets	$ 17,750,209	$ 26,508,343

LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	$ 3,148,184	$ 2,561,213
Accrued liabilities and expenses	1,968,910	1,996,044
Line of credit	449,741	574,005
Other current liabilities	141,059	278,033
Current Liabilities from discontinued operations	-	13,450,362
Total current liabilities	5,707,894	18,859,657
Long-term liabilities:		
Convertible debentures, net of debt discounts of $538,305 and $825,585, respectively	1,067,718	1,311,065
Derivative liability	1,870,113	2,573,126
Note payable	300,000	-
Deferred lease liability and other	50,791	50,791
Total long-term liabilities	3,288,622	3,934,982
Commitments and contingencies	-	-

Equity		
Preferred stock, par value $.001 per share; 15,000,000 shares authorized; none issued and outstanding at September 30, 2009 and December 31, 2008	-	-
Common stock, par value $.001 per share; 155,000,000 shares authorized; 96,563,771 and 87,525,495 shares issued and outstanding at September 30, 2009 and December 31, 2008, respectively	96,564	87,526
Additional paid-in-capital	119,296,304	118,197,450
Accumulated deficit	(110,639,175)	(114,801,318)
Accumulated comprehensive loss	-	(32,750)
Total stockholders' equity	8,753,693	3,450,908
Non-controlling interest	-	262,795
Total equity	8,753,693	3,713,703
Total Liabilities and Equity	$ 17,750,209	$ 26,508,343

See accompanying notes to the unaudited condensed consolidated financial statements

3

TELKONET, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)
(UNAUDITED)

	For The Three Months Ended September 30,		For The Nine Months Ended September 30,	
	2009	2008	2009	2008
Revenues, net:				
Product	$ 1,445,888	$ 3,837,728	$ 5,462,955	$ 10,821,179
Recurring	991,130	897,482	2,982,384	2,559,728
Total Revenue	2,437,018	4,735,210	8,445,339	13,380,907
Cost of Sales:				
Product	833,926	2,076,776	2,942,748	6,800,627
Recurring	348,321	416,723	957,668	1,274,786
Total Cost of Sales	1,182,247	2,493,499	3,900,416	8,075,413
Gross Profit	1,254,771	2,241,711	4,544,923	5,305,494
Operating Expenses:				
Research and Development	263,672	509,418	761,950	1,667,229
Selling, General and Administrative	1,732,053	2,123,035	5,089,221	7,268,375
Impairment write-down in investment in affiliate	-	-	-	380,000
Stock Based Compensation	65,746	194,483	243,366	704,613
Depreciation and Amortization	86,223	103,056	266,740	318,210
Total Operating Expense	2,147,694	2,929,992	6,361,277	10,338,427
Loss from Operations	(892,923)	(688,281)	(1,816,354)	(5,032,933)
Other Income (Expenses):				
Financing Expense, net	(228,730)	(243,424)	(710,266)	(2,191,431)
Gain (Loss) on Derivative Liability	(650,338)	(576,156)	788,936	(1,594,609)
Impairment of Investment in Marketable Securities	(367,653)	-	(367,653)	-
(Loss) on Sale of Investment	-	-	(29,371)	-
Total Other Income (Expenses)	(1,246,721)	(819,580)	(318,354)	(3,786,040)
Income (Loss) Before Provision for Income Taxes	(2,139,644)	(1,507,861)	(2,134,708)	(8,818,973)
Provision for Income Taxes	-	-	-	-
Income (Loss) from Continuing Operations	$ (2,139,644)	$ (1,507,861)	$ (2,134,708)	$ (8,818,973)
Discontinued Operations				
Income (Loss) from Discontinued Operations	-	(1,370,896)	(635,735)	(3,412,656)
Gain on Deconsolidation	-	-	6,932,586	-
Net Income (Loss)	$ (2,139,644)	$ (2,878,757)	$ 4,162,143	$ (12,231,629)
Net income (loss) per share:				
Income (loss) per share from continuing operations - basic	$ (0.02)	$ (0.04)	$ (0.02)	$ (0.16)

Income (loss) per share from continuing operations - diluted	$	(0.02)	$	(0.04)	$	(0.02)	$	(0.16)
Income (loss) per share from discontinued operations – basic	$	0.00	$	(0.02)	$	0.07	$	(0.04)
Income (loss) per share from discontinued operations – diluted	$	0.00	$	(0.02)	$	0.07	$	(0.04)
Net income (loss) per share – basic	$	(0.02)	$	(0.04)	$	0.04	$	(0.16)
Net income (loss) per share - diluted	$	(0.02)	$	(0.04)	$	0.04	$	(0.16)
Weighted Average Common Shares Outstanding - basic		96,220,386		81,422,404		93,787,069		76,880,047
Weighted Average Common Shares Outstanding - diluted		96,220,386		81,422,404		93,787,069		76,880,047
Comprehensive Income (Loss):								
Net Income (Loss)	$	(2,139,644)	$	(2,878,757)	$	4,162,143	$	(12,231,629)
Unrecognized Gain (Loss) on Investment		-		(1,218,100)		32,750		(2,776,304)
Comprehensive Income (Loss)	$	(2,139,644)	$	(4,096,857)	$	4,194,893	$	(15,007,933)

See accompanying notes to the unaudited condensed consolidated financial statements

4

TELKONET, INC.
CONDENSED CONSOLIDATED STATEMENT OF EQUITY (UNAUDITED)
FOR THE PERIOD FROM JANUARY 1, 2009 THROUGH SEPTEMBER 30, 2009

	Preferred Shares	Preferred Stock Amount	Common Shares	Common Stock Amount	Additional Paid in Capital	Accumulated Deficit	Comprehensive Income (Loss)	Noncontrolling Interest	Total
Balance at January 1, 2009			87,525,495	$ 87,526	$ 118,197,450	$ (114,801,318)	$ (32,750)	$ 262,795	$ 3,713,703
Shares issued in exchange for services rendered at approximately $0.12 per share	-	-	83,333	83	9,917	-	-	-	10,000
Shares issued for warrants exercised at $0.09 per share	-	-	780,000	780	70,746	-	-	-	71,526
Shares issued in exchange for convertible debentures	-	-	8,174,943	8,175	714,339	-	-	-	722,514
Stock-based compensation expense related to employee stock options	-	-	-	-	233,366	-	-		233,366
Stock-based compensation expense related to the re-pricing of investor warrants	-	-	-	-	70,486	-	-	-	70,486
Unrealized Gain on available for sale securities	-	-	-	-	-	-	32,750	-	32,750
Reclass of non-controlling interest	-	-	-	-	-	-	-	(262,795)	(262,795)

Income from discontinued operations	-	-	-	-	-	6,296,851	-	-	6,296,851
Income from continuing operations	-	-	-	-	-	(2,134,708)	-	-	(2,134,708)
Balance at September 30, 2009	-	$ -	96,563,771	$ 96,564	$ 119,296,304	$ (110,639,175)	$ -	$ -	$ 8,753,693

See accompanying notes to the unaudited condensed consolidated financial statements

5

TELKONET, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	For the Nine Months Ended September 30, 2009	2008
Increase (Decrease) In Cash and Equivalents		
Cash Flows from Operating Activities:		
Net income (loss) attributable to common shareholders	$ 4,162,143	$ (12,231,639)
Net (income) loss from discontinued operations	(6,296,851)	3,082,656
Net income (loss) from continuing operations	(2,134,708)	(9,148,983)
Adjustments to reconcile net income (loss) from operations to cash (used in) operating activities:		
Amortization of debt discounts and financing costs	543,161	364,374
Loss on sale of investment	29,371	-
Impairment of investment in marketable securities	367,653	
(Gain) loss on derivative liability	(788,936)	1,594,609
Impairment write-down on fixed assets and goodwill	-	710,000
Stock based compensation	243,366	704,613
Fair value of issuance of warrants and re-pricing (financing expense)	70,486	1,798,662
Depreciation and amortization	266,740	350,163
Increase / decrease in:		
Accounts receivable, trade and other	766,598	455,162
Inventories	447,644	572,088
Prepaid expenses and deposits	117,019	345,520
Deferred revenue	(20,536)	(28,008)
Other Assets	(62,595)	157,654
Accounts payable, net	(90,088)	(803,822)
Accrued expenses, net	172,319	(305,398)
Cash used in continuing operations	(72,506)	(3,233,366)
Cash used in discontinued operations	(287,997)	(861,542)
Net Cash Used In Operating Activities	(360,503)	(4,094,908)
Cash Flows From Investing Activities:		
Purchase of property and equipment	(2,675)	(14,375)
Advances to unconsolidated subsidiary	(305,539)	-
Proceeds from sale of investment	33,129	-
Cash used in continuing operations	(275,085)	(14,375)
Cash used in discontinued operations	(5,979)	(994,344)
Net Cash Used In Investing Activities	(281,064)	(1,008,719)
Cash Flows From Financing Activities:		
Proceeds from issuance of convertible debentures	-	3,500,000
Proceeds from sale of common stock, net of costs and fees	-	1,500,000
Proceeds from issuance of notes payable	300,000	60,000
Proceeds (repayments) from line of credit	(124,264)	475,000

Financing fees	(25,000)	(462,566)
Repayment of notes payable	-	(1,500,000)
Proceeds from the exercise of warrants	71,526	-
Repayment of capital lease and other	(4,714)	(4,625)
Cash provided by continuing operations	217,548	3,567,809
Cash provided by discontinued operations	293,976	56,228
Net Cash Provided By Financing Activities	511,524	3,624,037
Net Decrease In Cash and Equivalents	(130,043)	(1,479,590)
Cash and cash equivalents at the beginning of the period	168,492	1,629,583
Cash and cash equivalents at the end of the period	$ 38,449	$ 149,993

TELKONET, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)
(UNAUDITED)

	For the Nine Months Ended September 30,	
	2009	2008
Supplemental Disclosures of Cash Flow Information:		
Cash transactions:		
Cash paid during the period for financing expenses	$ 355,340	$ 257,403
Income taxes paid	-	-
Non-cash transactions:		
Stock based compensation to employees and consultants in exchange for services	$ 243,366	$ 704,613
Fair value of issuance of warrants and re-pricing (financing expense)	70,486	1,798,662
(Gain) loss on derivative liability	(788,936)	1,594,609
Impairment write-down on goodwill and fixed assets	-	710,000
Amortization of debt discount on convertible debentures and financing costs	543,161	364,374
Accrued interest re classified as convertible debenture principal	191,887	-
Value of common stock issued in exchange for conversion of debenture principal	722,514	710,000

See accompanying notes to the unaudited condensed consolidated financial statements

TELKONET, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2009
(UNAUDITED)

NOTE A-SUMMARY OF ACCOUNTING POLICIES

A summary of the significant accounting policies applied in the preparation of the accompanying consolidated financial statements follows.

Business and Basis of Presentation

Telkonet, Inc., formed in 1999 and incorporated under the laws of the state of Utah, has evolved into a Clean Technology company that develops and manufactures proprietary energy efficiency and SmartGrid networking technology. Prior to January 1, 2007, the Company was primarily engaged in the business of developing, producing and marketing proprietary equipment enabling the transmission of voice and data communications over a building's existing internal electrical wiring.

In January 2006, of the Company acquired 90% of Microwave Satellite Technologies, Inc. (MST), and through this subsidiary, the Company began offering complete sales, installation, and service of VSAT and business television networks, and became a full-service national Internet Service Provider (ISP). In 2009, the Company completed the deconsolidation of MST by reducing its ownership percentage and board membership. Financial statements and accompanying notes included in this report include disclosure of the results of operations for MST, for all periods presented, as discontinued operations.

In March 2007, the Company acquired substantially all of the assets of Smart Systems International (SSI), a leading provider of energy management products and solutions to customers in the United States and Canada.

In March 2007, the Company acquired 100% of the outstanding membership units of EthoStream, LLC, a network solutions integration company that offers installation, sales and service to the hospitality industry. The EthoStream acquisition enables Telkonet to provide installation and support for PLC products and third party applications to customers across North America.

The unaudited condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, Telkonet Communications, Inc. and EthoStream, LLC. Significant intercompany transactions have been eliminated in consolidation.

Going Concern

The accompanying unaudited condensed consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which contemplate continuation of the Company as a going concern. The Company has reported a net income available to common shareholders of $4,162,143 for the nine months ended September 30, 2009. However, the Company has reported operating losses of $1,816,354, excluding gains on derivative liabilities, impairment of marketable securities and discontinued operations, for the nine months ended September 30, 2009. In addition, the Company has reported an accumulated deficit of $110,639,175 and a working capital deficit of $3,500,889 as of September 30, 2009.

The Company believes that anticipated revenues from operations will be insufficient to satisfy its ongoing capital requirements for at least the next 12 months. If the Company's financial resources from operations are insufficient, the Company will require additional financing in order to execute its operating plan and continue as a going concern. The Company cannot predict whether this additional financing will be in the form of equity or debt, or be in another form. The Company may not be able to obtain the necessary additional capital on a timely basis, on acceptable terms, or at all. In any of these events, the Company may be unable to implement its current plans for expansion, repay its debt obligations as they become due, or respond to competitive pressures, any of which circumstances would have a material adverse effect on its business, prospects, financial condition and results of operations.

Management intends to raise capital through asset-based financing and/or the sale of its stock in private placements. Management believes that with this financing, the Company will be able to generate additional revenues that will allow the Company to continue as a going concern. There can be no assurance that the Company will be successful in obtaining additional funding.

TELKONET, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2009
(UNAUDITED)

Goodwill and Other Intangibles

Goodwill represents the excess of the cost of businesses acquired over fair value or net identifiable assets at the date of acquisition. Goodwill is subject to a periodic impairment assessment by applying a fair value test based upon a two-step method. The first step of the process compares the fair value of the reporting unit with the carrying value of the reporting unit, including any goodwill. The Company utilizes a discounted cash flow valuation methodology to determine the fair value of the reporting unit. If the fair value of the reporting unit exceeds the carrying amount of the reporting unit, goodwill is deemed not to be impaired in which case the second step in the process is unnecessary. If the carrying amount exceeds fair value, the Company performs the second step to measure the amount of impairment loss. Any impairment loss is measured by comparing the implied fair value of goodwill, calculated per SFAS No. 142, with the carrying amount of goodwill at the reporting unit, with the excess of the carrying amount over the fair value recognized as an impairment loss.

Fair Value of Financial Instruments

In January 2008, the Company adopted the provisions under FASB for Fair Value Measurements, which define fair value for accounting purposes, establishes a framework for measuring fair value and expands disclosure requirements regarding fair value measurements. The Company's adoption of these provisions did not have a material impact on its consolidated financial statements. Fair value is defined as an exit price, which is the price that would be received upon sale of an asset or paid upon transfer of a liability in an orderly transaction between market participants at the measurement date. The degree of judgment utilized in measuring the fair value of assets and liabilities generally correlates to the level of pricing observability. Financial assets and liabilities with readily available, actively quoted prices or for which fair value can be measured from actively quoted prices in active markets generally have more pricing observability and require less judgment in measuring fair value. Conversely, financial assets and liabilities that are rarely traded or not quoted have less price observability and are generally measured at fair value using valuation models that require more judgment. These valuation techniques involve some level of management estimation and judgment, the degree of which is dependent on the price transparency of the asset, liability or market and the nature of the asset or liability. The Company has categorized its financial assets and liabilities measured at fair value into a three-level hierarchy in accordance with these provisions.

Investments

Telkonet maintained investments in two publicly-traded companies for the period ended September 30, 2009. The Company has classified these securities as available for sale. Such securities are carried at fair market value. Unrealized gains and losses on these securities, if any, are reported as accumulated other comprehensive income (loss), which is a separate component of stockholders' equity. Unrealized gains on the sale of one investment resulted in a gain of $32,750 recorded for the nine months ended September 30, 2009 and unrealized losses of $2,776,304 were recorded for the nine months ended September 30, 2008. Realized gains and losses and declines in value judged to be other than temporary on securities available for sale, if any, are included in operations. Realized losses of $397,024 were recognized for the nine months ended September 30, 2009, of which, a $29,371 loss was recorded in February 2009 for the sale of the Company's investment in Multiband, and a $367,653 loss was recorded in September 2009 for the write-off of the Company's remaining investment in Geeks on Call America, Inc. There were no realized gains or losses for the nine months ended September 30, 2008.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

TELKONET, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2009
(UNAUDITED)

Revenue Recognition

For revenue from product sales, the Company recognizes revenue in accordance with FASB’s Accounting Standards Codification (“ASC”) 605-10, and ASC Topic 13 guidelines that require that four basic criteria must be met before revenue can be recognized: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred; (3) the selling price is fixed and determinable; and (4) collectibility is reasonably assured. Determination of criteria (3) and (4) are based on management’s judgments regarding the fixed nature of the selling prices of the products delivered and the collectibility of those amounts. Provisions for discounts and rebates to customers, estimated returns and allowances, and other adjustments are provided for in the same period the related sales are recorded. The Company defers any revenue for which the product has not been delivered or is subject to refund until such time that the Company and the customer jointly determine that the product has been delivered or no refund will be required. The guidelines also address the accounting for arrangements that may involve the delivery or performance of multiple products, services and/or rights to use assets.

For equipment under lease, revenue is recognized over the lease term for operating lease and rental contracts. All of the Company’s leases are accounted for as operating leases. At the inception of the lease, no lease revenue is recognized and the leased equipment and installation costs are capitalized and appear on the balance sheet as “Equipment Under Operating Leases.” The capitalized cost of this equipment is depreciated from two to three years, on a straight-line basis down to the Company’s original estimate of the projected value of the equipment at the end of the scheduled lease term. Monthly lease payments are recognized as rental income.

Revenue from sales-type leases for EthoStream products is recognized at the time of lessee acceptance, which follows installation. The Company recognizes revenue from sales-type leases at the net present value of future lease payments. Revenue from operating leases is recognized ratably over the lease period

Reclassifications

Certain reclassifications have been made in prior year's financial statements to conform to classifications used in the current year.

Non-controlling Interest

As a result of adopting FASB ASC 810-10 Consolidations – Variable Interest Entities, on January 1, 2009, we present non-controlling interests (previously shown as minority interest) as a component of equity on our Consolidated Balance Sheets and Consolidated Statement of Equity (Deficit). The adoption of this guidance did not have any other material impact on our financial position, results of operations or cash flow.

New Accounting Pronouncements

Accounting Standards Codification and GAAP Hierarchy — Effective for interim and annual periods ending after September 15, 2009, the Accounting Standards Codification and related disclosure requirements issued by the FASB became the single official source of authoritative, nongovernmental GAAP. The ASC simplifies GAAP, without change, by consolidating the numerous, predecessor accounting standards and requirements into logically organized topics. All other literature not included in the ASC is non-authoritative. We adopted the ASC as of September 30, 2009, which did not have any impact on our results of operations, financial condition or cash flows as it does not

represent new accounting literature or requirements. All references to pre-codified U.S. GAAP have been removed from this Form 10-Q.

Financial Instruments — Effective for interim and annual periods ending after June 15, 2009, GAAP established new disclosure requirements for the fair value of financial instruments in both interim and annual financial statements. Previously, the disclosure was only required annually. We adopted the new requirements as of July 4, 2009, which resulted in no change to our accounting policies, and had no effect on our results of operations, cash flows or financial position, but did result in the addition of interim disclosure of the fair values of our financial instruments.

TELKONET, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2009
(UNAUDITED)

Consolidation— Effective for interim and annual periods beginning after November 15, 2009, with earlier application prohibited, GAAP amends the current accounting standards for determining which enterprise has a controlling financial interest in a VIE and amends guidance for determining whether an entity is a VIE. The new standards will also add reconsideration events for determining whether an entity is a VIE and will require ongoing reassessment of which entity is determined to be the VIE's primary beneficiary as well as enhanced disclosures about the enterprise's involvement with a VIE. We are currently assessing the future impact these new standards will have on our results of operations, financial position or cash flows.

Transfers and Servicing – Effective for interim and annual periods beginning after November 15, 2009, GAAP eliminates the concept of a qualifying special purpose entity, changes the requirements for derecognizing financial assets and requires additional disclosures. We are currently assessing the future impact these new standards will have on our results of operations, financial position or cash flows.

NOTE B- INTANGIBLE ASSETS AND GOODWILL

Total identifiable intangible assets acquired and their carrying values at December 31, 2008 are:

	Gross Carrying Amount	Accumulated Amortization	Net	Residual Value	Weighted Average Amortization Period (Years)
Amortized Identifiable Intangible Assets:					
Subscriber lists - EthoStream	$ 2,900,000	$ (432,986)	$ 2,467,014	$ -	12.0
Total Amortized Identifiable Intangible Assets	2,900,000	(432,986)	2,467,014	-	9.6
Goodwill - EthoStream	8,796,439	(2,000,000)	6,796,439	-	
Goodwill - SSI	5,874,016	-	5,874,016	-	
Total	$ 17,570,455	$ (2,432,985)	$ 15,137,469	$ -	

Total identifiable intangible assets acquired and their carrying values at September 30, 2009 are:

	Gross Carrying Amount	Accumulated Amortization	Net	Residual Value	Weighted Average Amortization Period (Years)
Amortized Identifiable Intangible Assets:					
Subscriber lists - EthoStream	$ 2,900,000	$ (614,243)	$ 2,285,757	$ -	12.0
Total Amortized Identifiable Intangible Assets	2,900,000	(614,243)	2,285,757	-	12.0
Goodwill - EthoStream	8,796,439	(2,000,000)	6,796,439	-	
Goodwill - SSI	5,874,016	-	5,874,016	-	
Total	$ 17,570,455	$ (2,614,243)	$ 14,956,212	$ -	

Total amortization expense charged to operations for the three and nine months ended September 30, 2009 and 2008 was $60,424 and $181,257, and $60,417 and $120,833, respectively.

TELKONET, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2009
(UNAUDITED)

NOTE C – ACCOUNTS RECEIVABLE

Components of accounts receivable as of September 30, 2009 and December 31, 2008 are as follows:

	September 30, 2009	December 31, 2008
Accounts receivable (factored)	$ 1,087,086	$ 1,961,535
Advances from factor	(342,876)	(1,075,879)
Due from factor	744,210	885,656
Accounts receivable (non-factored)	85,846	127,080
Allowance for doubtful accounts	(143,000)	(176,400)
Total	$ 687,056	$ 836,336

In February 2008, the Company entered into a factoring agreement to sell, without recourse, certain receivables to an unrelated third party financial institution in an effort to accelerate cash flow. Under the terms of the factoring agreement the maximum amount of outstanding receivables at any one time is $2.5 million. Proceeds on the transfer reflect the face value of the account less a discount. The discount is recorded as interest expense in the Consolidated Statement of Operations in the period of the sale. Net funds received reduced accounts receivable outstanding while increasing cash. Fees paid pursuant to this arrangement are included in "Operating expenses" in the Consolidated Statement of Operations and amounted to $156,582 for the period ended September 30, 2009. The amounts borrowed are collateralized by the outstanding accounts receivable, and are reflected as a reduction to accounts receivable in the accompanying consolidated balance sheets.

NOTE D - INVENTORIES

Components of inventories as of September 30, 2009 and December 31, 2008 are as follows:

	September 30, 2009	December 31, 2008
Raw Materials	$737,752	$843,978
Finished Goods	748,544	1,089,962
Reserve for Obsolescence	(200,000	(200,000)
Total	$1,286,296	$1,733,940

TELKONET, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2009
(UNAUDITED)

NOTE E - PROPERTY AND EQUIPMENT

The Company’s property and equipment at September 30, 2009 and December 31, 2008 consists of the following:

	September 30, 2009	December 31, 2008
Telecommunications and related equipment	$ 117,637	$ 117,493
Development Test Equipment	153,484	153,484
Computer Software	160,894	160,894
Leasehold Improvements	228,017	248,778
Office Equipment	371,251	377,851
Office Fixtures and Furniture	249,604	265,315
Total	1,280,887	1,328,818
Accumulated Depreciation	(989,966)	(925,225)
	$ 290,924	$ 403,593

Depreciation expense included as a charge to income was $25,803 and $90,364 and $54,120 and $168,911 for the three and nine months ended September 30, 2009 and 2008, respectively.

NOTE F – MARKETABLE SECURITIES

Multiband Corporation

In connection with a payment of $75,000 of accounts receivable, the Company received 30,000 shares of common stock of Multiband Corporation, a Minnesota-based communication services provider to multiple dwelling units. The Company classifies this security as available for sale, and it is carried at fair market value. The Company sold its remaining investment in Multiband and recorded a loss of $29,371 in January 2009.

Geeks on Call America, Inc

As of September 30, 2009, the Company maintained an investment in a publicly traded company which was approximately 18% of the outstanding shares of common stock of Geeks on Call Holdings, Inc. (“GOCA”), a provider of on-site computer services to residential and commercial customers. As of December 31, 2008, the Company determined that a significant portion of this investment was permanently impaired and wrote-off $4,098,514. Management has determined that the entire investment in GOCA is impaired and the remaining value of $367,653 has been written off during the period ended September 30, 2009.

TELKONET, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2009
(UNAUDITED)

NOTE G – LINE OF CREDIT

In September 2008, the Company entered into a two-year line of credit facility with a third party financial institution. The line of credit has an aggregate principal amount of $1,000,000 and is secured by the Company's inventory. The outstanding principal balance bears interest at the greater of (i) the Wall Street Journal Prime Rate plus nine (9%) percent per annum, adjusted on the date of any change in such prime or base rate, or (ii) sixteen percent (16%). Interest, computed on a 365/360 simple interest basis, and fees on the credit facility are payable monthly in arrears on the last day of each month and continuing on the last day of each month until the maturity date. The Company may prepay amounts outstanding under the credit facility in whole or in part at any time. In the event of such prepayment, the lender will be entitled to receive a prepayment fee of four percent (4.0%) of the highest aggregate loan commitment amount if prepayment occurs before the end of the first year and three percent (3.0%) if prepayment occurs thereafter. The outstanding borrowing under the agreement at September 30, 2009 was $449,741. The Company has incurred interest expense of $103,881 related to the line of credit for the nine months ended September 30, 2009. The Prime Rate was 3.25% at September 30, 2009.

On November 11, 2009, the Company received a notice of waiver of the "minimum cash flow to debt service ratio" and the "tangible net worth" requirements under the line of credit facility, as such terms are defined in items D(10)a and D(10)b, respectively, of the line of credit agreement. The waiver is in effect as of September 30, 2009 and continues for the 90 day period thereafter.

NOTE H - SENIOR CONVERTIBLE DEBENTURES

Senior Convertible Debenture

A summary of convertible debentures payable at September 30, 2009 and December 31, 2008 is as follows:

	September 30, 2009	December 31, 2008
Senior Convertible Debentures, accrue interest at 13% per annum and mature on May 29, 2011	$ 1,606,023	$ 2,136,650
Debt Discount - beneficial conversion feature, net of accumulated amortization of $514,381 and $295,508 at September 30, 2009 and December 31, 2008, respectively.	(292,508)	(425,458)
Debt Discount - value attributable to warrants attached to notes, net of accumulated amortization of $432,243 and $277,913 at September 30, 2009 and December 31, 2008, respectively.	(245,797)	(400,127)
Total	$ 1,067,718	$ 1,311,065
Less: current portion	-	-
	$ 1,067,718	$ 1,311,065

The evaluation of the Corporation s compliance with its risk management process relating to the Corporation s assets and liabilities.

Credit Committee

The Credit Committee of the Board of Directors is appointed by the Board of Directors to assist them in its oversight of the Corporation s policies and procedures related to all matters of the Corporation s lending function. In

doing so, the Committee s primary general functions involve:

- The establishment of a process to enable the identification, assessment, and management of risks that could affect the Corporation s credit management;

- The identification of the Corporation s risk tolerance levels related to its credit management;

- The evaluation of the adequacy and effectiveness of the Corporation s risk management process related to the Corporation s credit management, including management s role in that process;

- The evaluation of the Corporation s compliance with its risk management process related to the Corporation s credit management; and

- The approval of loans as required by the lending authorities approved by the Board of Directors.

Audit Committee

The Audit Committee of First BanCorp is appointed by the Board of Directors to assist the Board of Directors in fulfilling its responsibility to oversee management regarding:

- The conduct and integrity of the Corporation s financial reporting to any governmental or regulatory body, shareholders, other users of the Corporation s financial reports and the public;

- The Corporation s systems of internal control over financial reporting and disclosure controls and procedures;

105

- The qualifications, engagement, compensation, independence and performance of the Corporation s independent auditors, their conduct of the annual audit of the Corporation s financial statements, and their engagement to provide any other services;
- The Corporation s legal and regulatory compliance;
- The application for the Corporation s related person transaction policy as established by the Board of Directors;
- The application of the Corporation s code of business conduct and ethics as established by management and the Board of Directors; and
- The preparation of the Audit Committee report required to be included in the Corporation s annual proxy statement by the rules of the Securities and Exchange Commission.

In performing this function, the Audit Committee is assisted by the Chief Risk Officer (CRO), the General Auditor and the Risk Management Council (RMC), and other members of senior management.

Strategic Planning Committee

The Strategic Planning Committee of the Corporation is appointed by the Board of Directors of the Corporation to assist and advise management with respect to, and monitor and oversee on behalf of the Board, corporate development activities not in the ordinary course of the Corporation s business and strategic alternatives under consideration from time to time by the Corporation, including, but not limited to, acquisitions, mergers, alliances, joint ventures, divestitures, capitalization of the Corporation and other similar corporate transactions.

Risk Management Council

The Risk Management Council is appointed by the Chief Executive Officer to assist the Corporation in overseeing, and receiving information regarding the Corporation s policies, procedures and practices related to the Corporation s risks. In doing so, the Council s primary general functions involve:

- The appointment of persons responsible for the Corporation s significant risks;
- The development of the risk management infrastructure needed to enable it to monitor risk policies and limits established by the Board of Directors;
- The evaluation of the risk management process to identify any gap and the implementation of any necessary control to close such gap;
- The establishment of a process to enable the recognition, assessment, and management of risks that could affect the Corporation; and
- The provision to the Board of Directors of appropriate information about the Corporation s risks.

Refer to Interest Rate Risk, Credit Risk, Liquidity, Operational, Legal and Regulatory Risk Management -Operational Risk discussion below for further details of matters discussed in the Risk Management Council.

Other Management Committees

As part of its governance framework, the Corporation has various additional risk management related-committees. These committees are jointly responsible for ensuring adequate risk measurement and management in their respective areas of authority. At the management level, these committees include:

(1) Management s Investment and Asset Liability Committee (MIALCO) oversees interest rate and market risk, liquidity management and other related matters. Refer to Liquidity Risk and Capital Adequacy and Interest Rate Risk Management discussions below for further details.

(2) Information Technology Steering Committee is responsible for the oversight of and counsel on matters related to information technology including the development of information management policies and procedures throughout the Corporation.

(3) Bank Secrecy Act Committee is responsible for oversight, monitoring and reporting of the Corporation s compliance with the Bank Secrecy Act.

(4) Credit Committees (Delinquency and Credit Management Committee) oversees and establishes standards for credit risk management processes within the Corporation. The Credit Management Committee is responsible for the approval of loans above an established size threshold. The Delinquency Committee is responsible for the periodic review of (1) past due loans, (2) overdrafts, (3) non-accrual loans, (4) other real estate owned (OREO) assets, and (5) the bank s watch list and non-performing loans.

(5) Florida Executive Steering Committee oversees implementation and compliance of policies approved by the Board of Directors and the performance of the Florida region s operations. The Florida Executive Steering Committee evaluates and monitors interrelated risks related to FirstBank s operations in Florida.

Officers

As part of its governance framework, the following officers play a key role in the Corporation s risk management process:

(1) Chief Executive Officer is responsible for the overall risk governance structure of the Corporation.

(2) Chief Risk Officer is responsible for the oversight of the risk management organization as well as risk governance processes. In addition, the CRO with the collaboration of the Risk Assessment Manager manages the operational risk program.

(3) Chief Credit Risk Officer and the Chief Lending Officer are responsible of managing the Corporation s credit risk program.

(4) Chief Financial Officer in combination with the Corporation s Treasurer, manages the Corporation s interest rate and market and liquidity risks programs and, together with the Corporation s Chief Accounting Officer, is responsible for the implementation of accounting policies and practices in accordance with GAAP and applicable regulatory requirements. The Chief Financial Officer is assisted by the Risk Assessment Manager in the review of the Corporation s internal control over financial reporting.

(5) Chief Accounting Officer is responsible for the development and implementation of the Corporation s accounting policies and practices and the review and monitoring of critical accounts and transactions to ensure that they are managed in accordance with GAAP and applicable regulatory requirements.

Other Officers

In addition to a centralized Enterprise Risk Management function, certain lines of business and corporate functions have their own Risk Managers and support staff. The Risk Managers, while reporting directly within their respective line of business or function, facilitate communications with the Corporation s risk functions and work in partnership with the CRO and CFO to ensure alignment with sound risk management practices and expedite the implementation of the enterprise risk management framework and policies.

107

Liquidity and Capital Adequacy, Interest Rate Risk, Credit Risk, Operational, Legal and Regulatory Risk Management

The following discussion highlights First BanCorp s adopted policies and procedures for liquidity risk, interest rate risk, credit risk, operational risk, legal and regulatory risk.

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 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. 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 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 Wholesale Banking Executive, the Retail Financial Services & Strategic Planning Director, the Risk Manager of the Treasury and Investments Division, the Asset/Liability Manager and the Treasurer. The Treasury and Investments Division is responsible for planning and executing the Corporation s funding activities and strategy; monitors liquidity availability on a daily basis and reviews 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.

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

The Corporation manages its liquidity in a proactive manner, and maintains an adequate position. Multiple measures are utilized to monitor the Corporation s liquidity position, including basic surplus and volatile liabilities measures. Among the actions taken in recent months to bolster the liquidity position and to safeguard the Corporation s access to credit was the posting of additional collateral to the FHLB, thereby increasing borrowing capacity. The Corporation has also maintained the basic surplus (cash, short-term assets minus short-term liabilities, and secured lines of credit) well in excess of the self-imposed minimum limit of 5% of total assets. As of December 31, 2009, the estimated basic surplus ratio of approximately 8.6% included unpledged investment securities, FHLB lines of credit,

and cash. As of December 31, 2009, the Corporation had $378 million available for additional credit on FHLB lines of credit. Unpledged liquid securities as of December 31, 2009 mainly consisted of fixed-rate MBS

108

and U.S. agency debentures totaling approximately $646.9 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 surplus computation.

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 and the FED. The Asset Liability Committee of the Board of Directors reviews credit availability on a regular basis. The Corporation has also securitized and sold mortgage loans as a supplementary source of funding. Commercial paper has also in the past provided additional funding. Long-term funding has also been obtained through the issuance of notes and, to a lesser extent, long-term brokered CDs. The cost of these different alternatives and interest rate risk management strategies, among other things, is taken into consideration.

The Corporation s principal sources of funding are:

Deposits

The following table presents the composition of total deposits:

	Weighted-Average Rate as of December 31, 2009	As of December 31,		
		2009	2008	2007
		(Dollars in thousands)		
Savings accounts	1.68%	$ 1,774,273	$ 1,288,179	$ 1,036,662
Interest-bearing checking accounts	1.75%	985,470	726,731	518,570
Certificates of deposit	2.17%	9,212,282	10,416,592	8,857,405
Interest-bearing deposits	2.06%	11,972,025	12,431,502	10,412,637
Non-interest-bearing deposits		697,022	625,928	621,884
Total		$ 12,669,047	$ 13,057,430	$ 11,034,521
Interest-bearing deposits:				
Average balance outstanding		$ 11,387,958	$ 11,282,353	$ 10,755,719
Non-interest-bearing deposits:				
Average balance outstanding		$ 715,982	$ 682,496	$ 563,990
Weighted average rate during the period on interest-bearing deposits[1]		2.79%	3.75%	4.88%

(1) Excludes changes in fair value of callable brokered CDs measured at fair value and changes in the fair value of

derivatives that
economically
hedge brokered
CDs .

Brokered CDs A large portion of the Corporation s funding is retail brokered CDs issued by the Bank subsidiary, FirstBank Puerto Rico. Total brokered CDs decreased from $8.4 billion at year end 2008 to $7.6 billion as of December 31, 2009. The Corporation has been partly refinancing brokered CDs that matured or were called during 2009 with alternate sources of funding at a lower cost. Also, the Corporation shifted the funding emphasis to retail deposits to reduce reliance on brokered CDs.

In the event that the Corporation s Bank subsidiary falls below the ratios of a well-capitalized institution, it faces the risk of not being able to replace funding through this source. Only a well capitalized insured depository institution is allowed to solicit and accept, renew or roll over any brokered deposit without restriction. The Bank currently complies and exceeds the minimum requirements of ratios for a well-capitalized institution. As of December 31, 2009, the Bank s total and Tier I capital exceed by $410 million and $814 million, respectively, the minimum well-capitalized levels. The average term to maturity of the retail brokered CDs outstanding as of

109

December 31, 2009 is approximately 1 year. Approximately 2% of the principal value of these certificates is callable at the Corporation s option.

The use of brokered CDs has been particularly important for the growth of the Corporation. The Corporation encounters intense competition in attracting and retaining regular retail deposits in Puerto Rico. The brokered CDs market is very competitive and liquid, and the Corporation has been able to obtain substantial amounts of funding in short periods of time. This strategy enhances the Corporation s liquidity position, since the brokered CDs are insured by the FDIC up to regulatory limits and can be obtained faster and cheaper compared to regular retail deposits. The brokered CDs market continues to be a reliable source to fulfill the Corporation s needs for the issuance of new and replacement transactions. For the year ended December 31, 2009, the Corporation issued $8.3 billion in brokered CDs (including rollovers of short-term broker CDs and replacement of brokered CDs called) at an average rate of 0.97% compared to $9.8 billion at an average rate of 3.64% issued in 2008.

The following table presents a maturity summary of brokered and retail CDs with denominations of $100,000 or higher as of December 31, 2009.

	(In thousands)
Three months or less	$ 1,958,454
Over three months to six months	1,366,163
Over six months to one year	2,258,717
Over one year	2,969,471
Total	$ 8,552,805

Certificates of deposit in denominations of $100,000 or higher include brokered CDs of $7.6 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. Certificates of deposit also include $25.6 million of deposits through the Certificate of Deposit Account Registry Service (CDARS). In an effort to meet customer needs and provide its customers with the best products and services available, the Corporation s bank subsidiary, FirstBank Puerto Rico, has joined a program that gives depositors the opportunity to insure their money beyond the standard FDIC coverage. CDARS can offer customers access to FDIC insurance coverage of up to $50 million, when they enter into the CDARS Deposit Placement Agreement, while earning attractive returns on their deposits.

Retail deposits The Corporation s deposit products also include regular savings accounts, demand deposit accounts, money market accounts and retail CDs. Total deposits, excluding brokered CDs, increased by $480 million from the balance as of December 31, 2008, reflecting increases in core-deposit products such as savings and interest-bearing checking accounts. A significant portion of the increase was related to deposits in Puerto Rico, the Corporation s primary market, reflecting successful marketing campaigns and cross-selling initiatives. The increase was also related to increases in money market accounts in Florida, as management shifted the funding emphasis to retail deposits to reduce reliance on brokered CDs. Successful marketing campaigns and attractive rates were the main reasons for the increase in Florida. Even thought rates offered in Florida were higher for this product, rates were lower than those offered in Puerto Rico. Refer to Note 13 in the Corporation s financial statements for the year ended December 31, 2009 included in Item 8 of this Form 10-K for further details.

Table of Contents

Borrowings

As of December 31, 2009, total borrowings amounted to $5.2 billion as compared to $4.7 billion and $4.5 billion as of December 31, 2008 and 2007, respectively.

The following table presents the composition of total borrowings as of the dates indicated:

	Weighted Average Rate as of December 31, 2009	As of December 31,		
		2009	2008	2007
		(Dollars in thousands)		
Federal funds purchased and securities sold under agreements to repurchase	3.34%	$ 3,076,631	$ 3,421,042	$ 3,094,646
Loans payable (1)	1.00%	900,000		
Advances from FHLB	3.21%	978,440	1,060,440	1,103,000
Notes payable	4.63%	27,117	23,274	30,543
Other borrowings	2.86%	231,959	231,914	231,817
Total (2)		$ 5,214,147	$ 4,736,670	$ 4,460,006
Weighted-average rate during the period		2.79%	3.78%	5.06%

(1) Advances from the FED under the FED Discount Window Program.

(2) Includes $3.0 billion as of December 31, 2009 that are tied to variable rates or matured within a year.

Securities sold under agreements to repurchase The Corporation s investment portfolio is substantially funded with repurchase agreements. Securities sold under repurchase agreements were $3.1 billion at December 31, 2009, compared with $3.4 billion at December 31, 2008. One of the Corporation s strategies is the use of structured repurchase agreements and long-term repurchase agreements to reduce exposure to interest rate risk by lengthening the final maturities of its liabilities while keeping funding cost at reasonable levels. Of the total of $3.1 billion repurchase agreements outstanding as of December 31, 2009, approximately $2.4 billion consist of structured repo s and $500 million of long-term repos. The access to this type of funding was affected by the liquidity turmoil in the financial markets witnessed in the second half of 2008 and in 2009. Certain counterparties have not been willing to enter into additional repurchase agreements and the capacity to extend the term of maturing repurchase agreements has also been reduced, however, the Corporation has been able to keep access to credit by using cost effective sources such as FED and FHLB advances. Refer to Note 15 in the Corporation s financial statements for the year ended

December 31, 2009 included in Item 8 of this Form 10-K for further details about repurchase agreements outstanding by counterparty and maturities.

Under the Corporation s repurchase agreements, as is the case with derivative contracts, the Corporation is required to pledge cash or qualifying securities to meet margin requirements. To the extent that the value of securities previously pledged as collateral declines due to changes in interest rates, a liquidity crisis or any other factor, the Corporation will be required to deposit additional cash or securities to meet its margin requirements, thereby adversely affecting its liquidity. Given the quality of the collateral pledged, recently the Corporation has not experienced significant margin calls from counterparties arising from credit-quality-related write-downs in valuations with only $0.95 million of cash equivalent instruments deposited in connection with collateralized interest rate swap agreements.

Advances from the FHLB The Corporation s Bank subsidiary is a member of the FHLB system and obtains advances to fund its operations under a collateral agreement with the FHLB that requires the Bank to maintain minimum qualifying mortgages as collateral for advances taken. As of December 31, 2009 and December 31, 2008, the outstanding balance of FHLB advances was $978.4 million and $1.1 billion, respectively. Approximately $653.4 million of outstanding advances from the FHLB has maturities over one year. As part of its precautionary initiatives to safeguard access to credit and the low level of interest rates, the Corporation has been increasing its pledging of assets to the FHLB, while at the same time the FHLB has been revising their credit guidelines and haircuts in the computation of availability of credit lines.

111

Table of Contents

FED Discount window FED initiatives to ease the credit crisis have included cuts to the discount rate, which was lowered from 4.75% to 0.50% through eight separate actions since December 2007, and adjustments to previous practices to facilitate financing for longer periods. That made the FED Discount Window a viable source of funding given market conditions in 2009. As of December 31, 2009, the Corporation had $900 million outstanding in short-term borrowings from the FED Discount Window and had collateral pledged related to this credit facility amounted to $1.2 billion, mainly commercial, consumer and mortgage loan.

Credit Lines The Corporation maintains unsecured and un-committed lines of credit with other banks. As of December 31, 2009, the Corporation s total unused lines of credit with other banks amounted to $165 million. The Corporation has not used these lines of credit to fund its operations.

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

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

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

The trust preferred debentures are presented in the Corporation s Consolidated Statement of Financial Condition as Other Borrowings, net of related issuance costs. The variable rate trust preferred securities are fully and unconditionally guaranteed by the Corporation. The $100 million Junior Subordinated Deferrable Debentures issued by the Corporation in April 2004 and the $125 million issued in September 2004 mature on September 17, 2034 and September 20, 2034, respectively; however, under certain circumstances, the maturity of Junior Subordinated Debentures may be shortened (such shortening would result in a mandatory redemption of the variable rate trust preferred securities). The trust preferred securities, subject to certain limitations, qualify as Tier I regulatory capital under current Federal Reserve rules and regulations.

The Corporation s principal uses of funds are the origination of loans and the repayment of maturing deposits and borrowings. Over the last five years, the Corporation has committed substantial resources to its mortgage banking subsidiary, FirstMortgage, Inc. As a result, residential real estate loans as a percentage of total loans receivable have increased over time from 14% at December 31, 2004 to 26% at December 31, 2009. Commensurate with the increase in its mortgage banking activities, the Corporation has also invested in technology and personnel to enhance the Corporation s secondary mortgage market capabilities. The enhanced capabilities improve the Corporation s liquidity profile as they allow the Corporation to derive liquidity, if needed, from the sale of mortgage loans in the secondary market. The U.S. (including Puerto Rico) secondary mortgage market is still highly liquid in large part because of the sale or guarantee programs of the FHA, VA, HUD, FNMA and FHLMC. In December 2008, the Corporation obtained from GNMA Commitment Authority to issue GNMA mortgage-backed securities. Under this program, during 2009, the Corporation completed the securitization of approximately $305.4 million of FHA/VA mortgage loans into GNMA MBS. Any regulatory actions affecting GNMA, FNMA or FHLMC could adversely affect the secondary mortgage market.

Table of Contents

Credit Ratings

The Corporation s credit as a long-term issuer is currently rated B by Standard & Poor s (S&P) and B- by Fitch Ratings Limited (Fitch); both with negative outlook.

At the FirstBank subsidiary level, long-term senior debt is currently rated B1 by Moody s Investor Service (Moodys), four notches below their definition of investment grade; B by S&P, and B by Fitch, both five notches below their definition of investment grade. The outlook on the Bank s credit ratings from the three rating agencies is negative.

The Corporation does not have any outstanding debt or derivative agreements that would be affected by the recent credit downgrades. The Corporation s liquidity is contingent upon its ability to obtain external sources of funding to finance its operations. Any further downgrades in credit ratings can hinder the Corporation s access to external funding and/or cause external funding to be more expensive, which could in turn adversely affect the results of operations. Also, any change in credit ratings may affect the fair value of certain liabilities and unsecured derivatives that consider the Corporation s own credit risk as part of the valuation.

Cash Flows

Cash and cash equivalents were $704.1 million and $405.7 million as of December 31, 2009 and 2008, respectively. These balances increased by $298.4 million and $26.8 million from December 31, 2008 and 2007, respectively. The following discussion highlights the major activities and transactions that affected the Corporation s cash flows during 2009 and 2008.

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 year ended December 31, 2009, net cash provided by operating activities was $243.2 million. Net cash generated from operating activities was higher than net loss reported largely as a result of adjustments for operating items such as the provision for loan and lease losses and non-cash charges recorded to increase the Corporation s valuation allowance for deferred tax assets.

For the year ended December 31, 2008, net cash provided by operating activities was $175.9 million, which was higher than net income, largely as a result of adjustments for operating items such as the provision for loan and lease losses and depreciation and amortization.

Cash Flows from Investing Activities

The Corporation s investing activities primarily include originating loans to be held to maturity and its available-for-sale and held-to-maturity investment portfolios. For the year ended December 31, 2009, net cash of $381.8 million was used in investing activities, primarily for loan origination disbursements and purchases of available-for-sale investment securities to mitigate in part the impact of investments securities mainly U.S. Agency debentures, called by counterparties prior to maturity and MBS prepayments. Partially offsetting these uses of cash were proceeds from sales and maturities of available-for-sale securities as well as proceeds from held-to-maturity securities called during 2009, and proceeds from loans and from MBS repayments.

For the year ended December 31, 2008, net cash used by investing activities was $2.3 billion, primarily for purchases of available-for-sale investment securities as market conditions presented an opportunity for the Corporation to obtain attractive yields, improve its net interest margin and mitigate the impact of investment securities, mainly U.S. Agency debentures, called by counterparties prior to maturity, for loan originations disbursements and for the purchase of a $218 million auto loan portfolio. Partially offsetting these uses of cash were proceeds from sales and maturities of available-for-sale securities as well as proceeds from held-to-maturity securities called during 2008; proceeds from sales of loans and the gain on the mandatory redemption of part of the Corporation s investment in VISA, Inc., which completed its initial public offering (IPO) in March 2008.

Cash Flows from Financing Activities

The Corporation s financing activities primarily include the receipt of deposits and issuance of brokered CDs, the issuance and payments of long-term debt, the issuance of equity instruments and activities related to its short-term funding. In addition, the Corporation paid monthly dividends on its preferred stock and quarterly dividends on its common stock until it announced the suspension of dividends beginning in August 2009. For the year ended December 31, 2009, net cash provided by financing activities was $436.9 million due to the investment of $400 million by the U.S. Treasury in preferred stock of the Corporation through the U.S. Treasury TARP Capital Purchase Program and the use of the FED Discount Window Program as a low-cost funding source to finance the Corporation s investing activities. Partially offsetting these cash proceeds was the payment of cash dividends and pay down of maturing borrowings, in particular brokered CDs and repurchase agreements.

For the year ended December 31, 2008, net cash used in financing activities was $2.1 billion due to increases in its deposit base, including brokered CDs to finance lending activities and increase liquidity levels and increases in securities sold under repurchase agreements to finance the Corporation s securities inventory. Partially offsetting these cash proceeds was the payment of cash dividends.

Capital

The Corporation s stockholders equity amounted to $1.6 billion as of December 31, 2009, an increase of $50.9 million compared to the balance as of December 31, 2008, driven by the $400 million investment by the United States Department of the Treasury (the U.S. Treasury) in preferred stock of the Corporation through the U.S. Treasury Troubled Asset Relief Program (TARP) Capital Purchase Program. This was partially offset by the net loss of $275.2 million recorded for 2009, dividends paid amounting to $43.1 million in 2009 ($13.0 million in common stock, or $0.14 per share, and $30.1 million in preferred stock) and a $30.9 million decrease in other comprehensive income mainly due to a noncredit-related impairment of $31.7 million on private label MBS.

For the year ended December 31, 2009, the Corporation declared in aggregate cash dividends of $0.14 per common share, $0.28 for 2008, and $0.28 for 2007. Total cash dividends paid on common shares amounted to $13.0 million for 2009, $25.9 million for 2008, and $24.6 million for 2007. Dividends declared on preferred stock amounted to $30.1 million in 2009 and $40.3 million in 2008 and 2007.

On July 30, 2009, the Corporation announced the suspension of dividends on common and all its outstanding series of preferred stock, including the TARP preferred dividends. This suspension was effective with the dividends for the month of August 2009 on the Corporation s five outstanding series of non-cumulative preferred stock and the dividends for the Corporation s outstanding Series F Cumulative Preferred Stock and the Corporation s common stock. The Corporation took this prudent action to preserve capital, as the duration and depth of recessionary economic conditions is uncertain, and consistent with federal regulatory guidance.

As of December 31, 2009, First BanCorp and FirstBank Puerto Rico were in compliance with regulatory capital requirements that were applicable to them as a financial holding company and a state non-member bank, respectively (i.e., total capital and Tier 1 capital to risk-weighted assets of at least 8% and 4%, respectively, and Tier 1 capital to average assets of at least 4%). Set forth below are First BanCorp s, and FirstBank Puerto Rico s regulatory capital ratios as of December 31, 2009 and December 31, 2008, based on existing Federal Reserve and Federal Deposit Insurance Corporation guidelines. Effective July 1, the operations conducted by FirstBank Florida as a separate subsidiary were merged with and into FirstBank Puerto Rico, the Corporation s main banking

subsidiary. As part of the Corporation s strategic planning it was determined that business synergies would be achieved by merging FirstBank Florida with and into FirstBank Puerto Rico. This reorganization included the consolidation of FirstBank Puerto Rico s loan production office with the former thrift banking operations of FirstBank Florida. For the last three years prior to July 1, the Corporation conducted dual banking operations in the Florida market. The consolidation of the former thrift banking operations with the loan production office resulted in FirstBank Puerto Rico having a more diversified and efficient banking operation in the form of a branch network in the Florida market. The merger allows the Florida operations to benefit by leveraging the capital position of FirstBank Puerto Rico and thereby provide them with the support necessary to grow in the Florida market.

		Banking Subsidiary	
	First BanCorp	FirstBank	To be well capitalized
As of December 31, 2009			
Total capital (Total capital to risk-weighted assets)	13.44%	12.87%	10.00%
Tier 1 capital ratio (Tier 1 capital to risk-weighted assets)	12.16%	11.70%	6.00%
Leverage ratio	8.91%	8.53%	5.00%
As of December 31, 2008			
Total capital (Total capital to risk-weighted assets)	12.80%	12.23%	10.00%
Tier 1 capital ratio (Tier 1 capital to risk-weighted assets)	11.55%	10.98%	6.00%
Leverage ratio	8.30%	7.90%	5.00%

The increase in regulatory capital ratios is mainly related to the $400 million investment by the U.S. Treasury in preferred stock of the Corporation through the U.S. Treasury TARP Capital Purchase Program. Refer to Note 23 in the Corporation s financial statements for the year ended December 31, 2009 included in Item 8 of this Form 10-K for additional information regarding this issuance. The funds were used in part to strengthen the Corporation s lending programs and ability to support growth strategies that are centered on customers needs, including programs to preserve home ownership. Together with private and public sector initiatives, the Corporation looks to support the local economy and the communities it serves during the current economic environment.

The Corporation is well-capitalized, having sound margins over minimum well-capitalized regulatory requirements. As of December 31, 2009, the total regulatory capital ratio is 13.4% and the Tier 1 capital ratio is 12.2%. This translates to approximately $492 million and $881 million of total capital and Tier 1 capital, respectively, in excess of the total capital and Tier 1 capital well capitalized requirements of 10% and 6%, respectively. A key priority for the Corporation is to maintain a sound capital position to absorb any potential future credit losses due to the distressed economic environment and to provide business expansion opportunities.

The Corporation s tangible common equity ratio was 3.20% as of December 31, 2009, compared to 4.87% as of December 31, 2008, and the Tier 1 common equity to risk-weighted assets ratio as of December 31, 2009 was 4.10% compared to 5.92% as of December 31, 2008.

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

equity and tangible assets for the years ended December 31, 2009 and December 31, 2008, respectively.

(In thousands)	December 31, 2009	December 31, 2008
Total equity GAAP	$ 1,599,063	$ 1,548,117
Preferred equity	(928,508)	(550,100)
Goodwill	(28,098)	(28,098)
Core deposit intangible	(16,600)	(23,985)
Tangible common equity	**$ 625,857**	**$ 945,934**
Total assets GAAP	$ 19,628,448	$ 19,491,268
Goodwill	(28,098)	(28,098)
Core deposit intangible	(16,600)	(23,985)
Tangible assets	**$ 19,583,750**	**$ 19,439,185**
Common shares outstanding	**92,542**	**92,546**
Tangible common equity ratio	**3.20%**	**4.87%**
Tangible book value per common share	**$ 6.76**	**$ 10.22**

The Tier 1 common equity to risk-weighted assets ratio is calculated by dividing (a) tier 1 capital less non-common elements including qualifying perpetual preferred stock and qualifying trust preferred securities, by (b) risk-weighted assets, which assets are calculated in accordance with applicable bank regulatory requirements. The Tier 1 common equity ratio is not required by GAAP or on a recurring basis by applicable bank regulatory requirements. However, this ratio was used by the Federal Reserve in connection with its stress test administered to the 19 largest U.S. bank holding companies under the Supervisory Capital Assessment Program (SCAP), the results of which were announced on May 7, 2009. Management is currently monitoring this ratio, along with the other ratios set forth in the table above, in evaluating the Corporation s capital levels.

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

(In thousands)	December 31, 2009	December 31, 2008
Total equity GAAP	$ 1,599,063	$ 1,548,117
Qualifying preferred stock	(928,508)	(550,100)
Unrealized gain on available-for-sale securities (1)	(26,617)	(57,389)
Disallowed deferred tax asset (2)	(11,827)	(69,810)
Goodwill	(28,098)	(28,098)
Core deposit intangible	(16,600)	(23,985)
Cumulative change gain in fair value of liabilities acounted for under a fair value option	(1,535)	(3,473)
Other disallowed assets	(24)	(508)
Tier 1 common equity	**$ 585,854**	**$ 814,754**

Total risk-weighted assets	**$ 14,303,496**	**$ 13,762,378**
Tier 1 common equity to risk-weighted assets ratio	**4.10%**	**5.92%**

1- Tier 1 capital excludes net unrealized gains (losses) on available-for-sale debt securities and net unrealized gains on available-for-sale equity securities with readily determinable fair values, in accordance with regulatory risk-based capital guidelines. In arriving at Tier 1 capital, institutions are required to deduct net unrealized losses on available-for-sale equity securities with readily determinable fair values, net of tax.

2- Approximately $111 million of the Corporation s deferred tax assets at December 31, 2009 (December 31, 2008 $58 million) were included without limitation in regulatory capital pursuant to the risk-based capital guidelines, while approximately

$12 million of such assets at December 31, 2009 (December 31, 2008 $70 million) exceeded the limitation imposed by these guidelines and, as disallowed deferred tax assets, were deducted in arriving at Tier 1 capital. According to regulatory capital guidelines, the deferred tax assets that are dependent upon future taxable income are limited for inclusion in Tier 1 capital to the lesser of: (i) the amount of such deferred tax asset that the entity expects to realize within one year of the calendar quarter end-date, based on its projected future taxable income for that year or (ii) 10% of the amount of the entity s Tier 1 capital. Approximately $4 million of the Corporation s other net deferred tax liability at December 31, 2009 (December 31, 2008 $0)

represented primarily the deferred tax effects of unrealized gains and losses on available-for-sale debt securities, which are permitted to be excluded prior to deriving the amount of net deferred tax assets subject to limitation under the guidelines.

On February 1, 2010, the Corporation reported that it is planning to conduct an exchange offer under which it will be offering to exchange newly issued shares of common stock for the issued and outstanding shares of publicly held Series A through E Noncumulative Perpetual Monthly Income Preferred Stock, subject to any necessary proration. The exchange offer will be conducted to improve its capital structure given the current economic conditions in the markets in which it operates and the evolving regulatory environment. Through the exchange offer, First BanCorp seeks to improve its tangible and Tier 1 common equity ratios. The Corporation expects to file a registration statement for the exchange offer shortly after the filing of this Form 10-K for fiscal year 2009. Completion of the exchange offer will be subject to certain conditions, including the consent by common stockholders of the issuance of shares of the common stock pursuant to the exchange.

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 than 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 December 31, 2009, commitments to extend credit and commercial and financial standby letters of credit amounted to approximately $1.5 billion and $103.9 million, respectively. Commitments to extend credit are agreements to lend to customers as long as the conditions established in the contract are met. Generally, the Corporation s mortgage banking activities do not enter into interest rate lock agreements with its prospective borrowers.

Table of Contents

Contractual Obligations and Commitments

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

	Contractual Obligations and Commitments As of December 31, 2009				
	Total	Less than 1 year	1-3 years	3-5 years	After 5 years
			(In thousands)		
Contractual obligations:					
Certificates of deposit (1)	$ 9,212,283	$ 6,041,065	$ 2,835,562	$ 321,850	$ 13,806
Loans payable	900,000	900,000			
Securities sold under agreements to repurchase	3,076,631	676,631	1,600,000	800,000	
Advances from FHLB	978,440	325,000	445,000	208,440	
Notes payable	27,117		13,756		13,361
Other borrowings	231,959				231,959
Operating leases	63,795	10,342	14,362	8,878	30,213
Other contractual obligations	10,387	7,157	3,130	100	
Total contractual obligations	$ 14,500,612	$ 7,960,195	$ 4,911,810	$ 1,339,268	$ 289,339
Commitments to sell mortgage loans	$ 13,158	$ 13,158			
Standby letters of credit	$ 103,904	$ 103,904			
Commitments to extend credit:					
Lines of credit	$ 1,220,317	$ 1,220,317			
Letters of credit	48,944	48,944			
Commitments to originate loans	255,598	255,598			
Total commercial commitments	$ 1,524,859	$ 1,524,859			

(1) Includes $7.6 billion of brokered CDs sold by third-party intermediaries in denominations of $100,000 or less, within FDIC insurance limits and

$25.6 million in
CDARS.

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. The funding needs of customers have not significantly changed as a result of the latest market disruptions. In the case of credit cards and personal lines of credit, the Corporation can at any time and without cause cancel the unused credit facility.

Lehman Brothers Special Financing, Inc. (Lehman) was the counterparty to the Corporation on certain interest rate swap agreements. During the third quarter of 2008, Lehman failed to pay the scheduled net cash settlement due to the Corporation, which constitutes an event of default under those interest rate swap agreements. The Corporation terminated all interest rate swaps with Lehman and replaced them with other counterparties under similar terms and conditions. In connection with the unpaid net cash settlement due as of December 31, 2009 under the swap agreements, the Corporation has an unsecured counterparty exposure with Lehman, which filed for bankruptcy on October 3, 2008, of approximately $1.4 million. This exposure was reversed in the third quarter of 2008. The Corporation had pledged collateral of $63.6 million with Lehman to guarantee its performance under the swap agreements in the event payment thereunder was required. The book value of pledged securities with Lehman as of December 31, 2009 amounted to approximately $64.5 million.

The Corporation believes that the securities pledged as collateral should not be part of the Lehman bankruptcy estate given the fact that the posted collateral constituted a performance guarantee under the swap agreements, was not part of a financing agreement, and ownership of the securities was never transferred to Lehman. Upon termination of the interest rate swap agreements, Lehman s obligation was to return the collateral to the Corporation. During the fourth quarter of 2009, the Corporation discovered that Lehman Brothers, Inc., acting as agent of Lehman, had deposited the securities in a custodial account at JP Morgan/Chase, and that, shortly before the filing of

118

the Lehman bankruptcy proceedings, it had provided instructions to have most of the securities transferred to Barclay s Capital in New York. After Barclay s refusal to turn over the securities, the Corporation, during the month of December 2009, filed a lawsuit against Barclay s Capital in federal court in New York demanding the return of the securities. While the Corporation believes it has valid reasons to support its claim for the return of the securities, there are no assurances that it will ultimately succeed in its litigation against Barclay s Capital to recover all or a substantial portion of the securities.

Additionally, the Corporation continues to pursue its claim filed in January 2009 in the proceedings under the Securities Protection Act with regard to Lehman Brothers Incorporated in Bankruptcy Court, Southern District of New York. The Corporation can provide no assurances that it will be successful in recovering all or substantial portion of the securities through these proceedings. An estimated loss was not accrued as the Corporation is unable to determine the timing of the claim resolution or whether it will succeed in recovering all or a substantial portion of the collateral or its equivalent value. If additional negative relevant facts become available in future periods, a need to recognize a partial or full reserve of this claim may arise. Considering that the investment securities have not yet been recovered by the Corporation, despite its efforts in this regard, the Corporation decided to classify such investments as non-performing during the second quarter of 2009.

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 in the profitability under varying interest rate environments. The MIALCO oversees interest rate risk and focuses on, among other things, current and expected conditions in world financial markets, competition and prevailing rates in the local deposit market, liquidity, securities market values, recent or proposed changes to the investment portfolio, alternative funding sources and related costs, hedging and the possible purchase of derivatives such as swaps and caps, and any tax or regulatory issues which may be pertinent to these areas. The MIALCO approves funding decisions in light of the Corporation s overall growth strategies and objectives.

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

(1) using a static balance sheet as the Corporation had it on the simulation date, and

(2) using a dynamic balance sheet based on recent patterns and current strategies.

The balance sheet is divided into groups of assets and liabilities detailed by maturity or re-pricing structure and their corresponding interest yields and costs. As interest rates rise or fall, these simulations incorporate expected future lending rates, current and expected future funding sources and costs, the possible exercise of options, changes in prepayment rates, deposits decay and other factors which may be important in projecting the future growth of 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 use many simplifying assumptions that are intended to reflect the general behavior of the Corporation over the period in question. It is highly unlikely that actual events will match these assumptions in all cases. For this reason, the results of these simulations are only approximations of the true sensitivity of net interest income to changes in market interest rates.

Table of Contents

The following table presents the results of the simulations as of December 31, 2009 and 2008. Consistent with prior years, these exclude non-cash changes in the fair value of derivatives and liabilities measured at fair value:

	December 31, 2009 Net Interest Income Risk (Projected for the next 12 months)				December 31, 2008 Net Interest Income Risk (Projected for the next 12 months)			
	Static Simulation		Growing Balance Sheet		Static Simulation		Growing Balance Sheet	
(Dollars in millions)	**$ Change**	**% Change**	**$ Change**	**% Change**	**$ Change**	**% Change**	**$ Change**	**% Change**
+200 bps ramp	$ 10.6	2.16%	$ 16.0	3.39%	$ 6.5	1.39%	$ 6.4	1.29%
-200 bps ramp	$ (31.9)	(6.53)%	$ (33.0)	(6.98)%	$ (12.8)	(2.77)%	$ (15.5)	(3.15)%

During the past year, the Corporation continued managing its balance sheet structure to control the overall interest rate risk. As part of the strategy, the Corporation reduced long-term fixed-rate and callable investment securities and increased shorter-duration investment securities. During 2009, MBS prepayments accelerated significantly as a result of the low interest rate environment. Approximately $1.7 billion of Agency MBS were sold during 2009, and $945 million of US Agency debentures were called during 2009. Partial proceeds from these sales and calls, in conjunction with prepayments on mortgage backed securities were re-invested in instruments with shorter durations such as 15-Years US Agency MBS, US Agency callable debentures with contractual maturities ranging from two to three years, and US Agency floating rate collateral mortgage obligations. In addition, during 2009, the Corporation continued adjusting the mix of its funding sources to better match the expected average life of the assets.

Taking into consideration the above-mentioned facts for modeling purposes, the net interest income for the next twelve months under a growing balance sheet scenario is estimated to increase by $16.0 million in a gradual parallel upward move of 200 basis points.

Following the Corporation s risk management policies, modeling of the downward parallel rates moves by anchoring the short end of the curve, (falling rates with a flattening curve) was performed, even though, given the current level of rates as of December 31, 2009, some market interest rates were projected to be zero. Under this scenario, where a considerable spread compression is projected, net interest income for the next twelve months in a growing balance sheet scenario is estimated to decrease by $33.0 million.

The Corporation used the gap analysis tool to evaluate the potential effect of rate shocks on net interest income over the selected time-periods. The gap report as of December 31, 2009 showed a positive cumulative gap for 3 month of $2.3 billion and a positive cumulative gap of $254.8 million for 1 year, compared to positive cumulative gaps of $2.1 billion and $1.4 billion for 3 months and 1 year, respectively, as of December 31, 2008. Gap management is a dynamic process, through which the Corporation makes constant adjustments to maintain sound and prudent interest rate risk exposures.

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 against rising interest rates. Specifically, the interest rate on certain private label mortgage pass-through securities and certain of the Corporation s commercial loans to other financial institutions is generally a variable rate limited to the weighted-average coupon of the pass-through certificate or referenced residential mortgage collateral, less a contractual servicing fee.

Interest rate swaps Interest rate swap agreements generally involve the exchange of fixed and floating-rate interest payment obligations without the exchange of the underlying notional principal amount. As of December 31, 2009, most of the interest rate swaps outstanding are used for protection against rising interest rates. In the past, interest rate swaps volume was much higher since they were used to convert fixed-rate brokered CDs

120

(liabilities), mainly those with long-term maturities, to a variable rate and mitigate the interest rate risk inherent in variable rate loans. All outstanding interest rate swaps related to brokered CDs were called during 2009, in the face of lower interest rate levels, and as a consequence the Corporation exercised its call option on the swapped-to-floating brokered CDs.

Structured repurchase agreements The Corporation uses structured repurchase agreements, with embedded call options, to reduce the Corporation s exposure to interest rate risk by lengthening the contractual maturities of its liabilities, while keeping funding costs low. Another type of structured repurchase agreement includes repurchased agreements with embedded cap corridors; these instruments also provide protection for a rising rate scenario.

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 (Loss) Income, refer to Note 32 in the Corporation s financial statements for the year ended December 31, 2009 included in Item 8 of this Form 10-K.

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

Fair Value Change

(In thousands)	**Year ended December 31, 2009**
Fair value of contracts outstanding at the beginning of year	$ (495)
Fair value of new contracts at inception	(35)
Contracts terminated or called during the year	(5,198)
Changes in fair value during the year	5,197
Fair value of contracts outstanding as of December 31, 2009	$ (531)

Source of Fair Value

	Payments Due by Period				
(In thousands)	Maturity Less Than One Year	Maturity 1-3 Years	Maturity 3-5 Years	Maturity In Excess of 5 Years	Total Fair Value
As of December 31, 2009					
Pricing from observable market inputs	$ (461)	$ 18	$ (636)	$ (3,651)	$ (4,730)
Pricing that consider unobservable market inputs				4,199	4,199
	$ (461)	$ 18	$ (636)	$ 548	$ (531)

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

As of December 31, 2009 and 2008, all of the derivative instruments held by the Corporation were considered economic undesignated hedges.

During 2009, all of the $1.1 billion of interest rate swaps that economically hedge brokered CDs that were outstanding as of December 31, 2008 were called by the counterparties, mainly due to lower levels of 3-month

LIBOR. Following the cancellation of the interest rate swaps, the Corporation exercised its call option on the approximately $1.1 billion swapped-to- floating brokered CDs. The Corporation recorded a net loss of $3.5 million as a result of these transactions resulting from the reversal of the cumulative mark-to-market valuation of the swaps and the brokered CDs called.

Refer to Note 29 of the Corporation s financial statements for the year ended December 31, 2009 included in Item 8 of this Form 10-K for additional information regarding the fair value determination of derivative instruments.

Table of Contents

The use of derivatives involves market and credit risk. The market risk of derivatives stems principally from the potential for changes in the value of derivative contracts based on changes in interest rates. The credit risk of derivatives arises from the potential of default from the counterparty. To manage this credit risk, the Corporation deals with counterparties of good credit standing, enters into master netting agreements 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. Currently the Corporation is mostly engaged in derivative instruments with counterparties with a credit rating of single A or better. All of the Corporation s interest rate swaps are supported by securities collateral agreements, which allow the delivery of securities to and from the counterparties depending on the fair value of the instruments, to minimize credit risk.

Set forth below is a detailed analysis of the Corporation s credit exposure by counterparty with respect to derivative instruments outstanding as of December 31, 2009 and December 31, 2008.

(In thousands)			As of December 31, 2009			
Counterparty	**Rating(1)**	**Notional**	**Total Exposure at Fair Value(2)**	**Negative Fair Values**	**Total Fair Value**	**Accrued interest receivable (payable)**
Interest rate swaps with rated counterparties:						
JP Morgan	A+	$ 67,345	$ 621	$ (4,304)	$ (3,683)	$
Credit Suisse First Boston	A+	49,311	2	(764)	(762)	
Goldman Sachs	A	6,515	557		557	
Morgan Stanley	A	109,712	238		238	
		232,883	1,418	(5,068)	(3,650)	
Other derivatives (3)		284,619	4,518	(1,399)	3,119	(269)
Total		$ 517,502	$ 5,936	$ (6,467)	$ (531)	$ (269)

(In thousands)			As of December 31, 2008			
Counterparty	**Rating(1)**	**Notional**	**Total Exposure at Fair Value(2)**	**Negative Fair Values**	**Total Fair Value**	**Accrued interest receivable (payable)**
Interest rate swaps with rated counterparties:						
Wachovia	AA-	$ 16,570	$ 41	$	$ 41	$ 108
Merrill Lynch	A	230,190	1,366		1,366	(106)
UBS Financial Services, Inc.	A+	14,384	88		88	179
JP Morgan	A+	531,886	2,319	(5,726)	(3,407)	1,094
Credit Suisse First Boston	A+	151,884	178	(1,461)	(1,283)	512
Citigroup	A+	295,130	1,516	(1)	1,515	2,299
Goldman Sachs	A	16,165	597		597	158
Morgan Stanley	A	107,450	735		735	59
		1,363,659	6,840	(7,188)	(348)	4,303

Other derivatives (3)	332,634	1,170	(1,317)	(147)	(203)
Total	$ 1,696,293	$ 8,010	$ (8,505)	$ (495)	$ 4,100

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

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

(3) Credit exposure with several Puerto Rico counterparties for which a credit rating is not readily available. Approximately $4.2 million and $0.8 million of the credit exposure with local companies relates to caps referenced to mortgages bought from R&G Premier Bank as of December 31, 2009 and 2008, respectively.

A Hull-White Interest Rate Tree approach is used to value the option components of derivative instruments. The discounting of the cash flows is performed using US dollar LIBOR-based discount rates or yield curves that account for the industry sector and the credit rating of the counterparty and/or the Corporation. Although most of the derivative instruments are fully collateralized, a credit spread is considered for those that are not secured in full. The cumulative mark-to-market effect of credit risk in the valuation of derivative instruments resulted in an unrealized gain of approximately $0.5 million as of December 31, 2009, of which an unrealized loss of $1.9 million was recorded in 2009, an unrealized gain of $1.5 million was recorded in 2008 and an unrealized gain of $0.9 million was recorded in 2007. The Corporation compares the valuations obtained with valuations received from counterparties, as an internal control procedure.

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 condition, for specific amounts and maturities. These commitments may expose the Corporation to credit risk and are subject to the same review and approval process as for loans. Refer to Contractual Obligations and Commitments above for further details. The credit risk of derivatives arises from the potential of the counterparty s default on its contractual obligations. To manage this credit risk, the Corporation deals with counterparties of good credit standing, enters into master netting agreements whenever possible and, when appropriate, obtains collateral. For further details and information on the Corporation s derivative credit risk exposure, refer to Interest Rate Risk Management section above. The Corporation manages its credit risk through fundamental portfolio risk management principles including credit policy, underwriting, independent loan review and quality control procedures, comprehensive financial analysis, and established management committees. The Corporation also employs proactive collection and loss mitigation efforts. Furthermore, there are structured loan workout functions responsible for avoiding defaults and minimizing losses upon default for each region and for each business segment. The group 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 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 backed by the full faith and credit of the U.S. government and is deemed to be of the highest credit quality.

Management, comprised of the Corporation s Chief 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. Those 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 judgments regarding the quality of each individual loan portfolio. All known relevant internal and external factors that affected loan collectibility 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 Puerto Rico, Florida (USA), US Virgin Islands or British Virgin Islands economies may contribute to delinquencies and defaults above the Corporation s historical loan and lease losses. Such factors are subject to regular review and may change to reflect updated performance trends and expectations, particularly in times of severe stress such as was experienced throughout 2009. We believe the process for determining the allowance considers all of the potential factors that could result in credit losses. However, the process includes judgmental and quantitative elements that may be subject to significant change. There is no certainty that the allowance will be adequate over time to cover credit

losses in the portfolio because of continued adverse changes in the economy, market conditions, or events adversely affecting specific customers, industries or markets. To the extent actual outcomes differ from our estimates, the credit quality of our customer base materially decreases and the risk profile of a market, industry, or group of customers changes materially, or if the allowance is determined to not be adequate, additional provision for credit losses could be required, which could adversely affect our business, financial condition, liquidity, capital, and results of operations in future periods. Refer to Critical Accounting Policies Allowance for Loan and Lease Losses section above for additional information about the methodology used by the Corporation to determine specific reserves and the general valuation allowance.

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. British Virgin Islands or the U.S. mainland (mainly in the state of Florida), the performance of the Corporation s loan portfolio and the value of the collateral supporting the transactions are dependent upon the performance of and conditions within each specific area real estate market. Recent economic reports related to the real estate market in Puerto Rico indicate that the real estate market is experiencing readjustments in value driven by the deteriorated purchasing power of consumers and general economic conditions. The Corporation sets adequate loan-to-value ratios upon original approval following the regulatory and credit policy standards. The real estate market for the U.S. Virgin islands remains fairly stable. In the Florida market, residential real estate has experienced a very slow turnaround.

As shown in the following table below, the allowance for loan and lease losses increased to $528.1 million at December 31, 2009, compared with $281.5 million at December 31, 2008. Expressed as a percent of period-end total loans receivable, the ratio increased to 3.79% at December 31, 2009, compared with 2.15% at December 31, 2008. The $246.6 million increase in the allowance primarily reflected an increase in specific reserves associated with impaired loans, an increase associated with risk-grade migration and an increase in non-performing loans, predominantly in the commercial and construction portfolio. The increase is also a result of updating the loss rates factors used to determine the general reserve to account for the increase in net charge-offs, non-performing loans and the stressed economic environment. Refer to the Provision for Loan and Lease Losses discussion above for additional information.

Table of Contents

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

Year Ended December 31,	**2009**	**2008**	**2007**	**2006**	**2005**
			(Dollars in thousands)		
Allowance for loan and lease losses, beginning of year	$ 281,526	$ 190,168	$ 158,296	$ 147,999	$ 141,036
Provision (recovery) for loan and lease losses:					
Residential mortgage	45,010	13,032	2,736	4,059	2,759
Commercial mortgage	71,401	7,740	1,326	3,898	1,133
Commercial and Industrial	146,157	35,561	18,369	(1,662)	(5,774)
Construction	264,246	53,109	23,502	5,815	7,546
Consumer and finance leases	53,044	81,506	74,677	62,881	44,980
Total provision for loan and lease losses	579,858	190,948	120,610	74,991	50,644
Charged-off:					
Residential mortgage	(28,934)	(6,256)	(985)	(997)	(945)
Commercial mortgage	(25,871)	(3,664)	(1,333)	(19)	(268)
Commercial and Industrial	(35,696)	(25,911)	(9,927)	(6,017)	(8,290)
Construction	(183,800)	(7,933)	(3,910)		
Consumer and finance leases	(70,121)	(73,308)	(78,675)	(70,176)	(42,417)
	(344,422)	(117,072)	(94,830)	(77,209)	(51,920)
Recoveries:					
Residential mortgage	73		1	17	
Commercial mortgage	667				4
Commercial and Industrial	1,188	1,678	659	3,491	1,275
Construction	200	198	78		
Consumer and finance leases	9,030	6,875	5,354	9,007	5,597
	11,158	8,751	6,092	12,515	6,876
Net charge-offs	(333,264)	(108,321)	(88,738)	(64,694)	(45,044)
Other adjustments[(1)]		8,731			1,363
Allowance for loan and lease losses, end of year	$ 528,120	$ 281,526	$ 190,168	$ 158,296	$ 147,999
Allowance for loan and lease losses to year end total loans receivable	3.79%	2.15%	1.61%	1.41%	1.17%
Net charge-offs to average loans outstanding during the period	2.48%	0.87%	0.79%	0.55%	0.39%
	1.74x	1.76x	1.36x	1.16x	1.12x

Provision for loan and lease losses to net charge-offs during the period

(1) For 2008, carryover of the allowance for loan losses related to the $218 million auto loan portfolio acquired from Chrysler.

For 2005, allowance for loan losses from the acquisition of FirstBank Florida.

The following table sets forth information concerning the allocation of the Corporation s 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:

	2009		**2008**		**2007**		**2006**		**2005**	
(In thousands)	**Amount**	**Percent**	**Amount**	**Percent**	**Amount**	**Percent**	**Amount**	**Percent**	**Amount**	**Percent**
					(Dollars in thousands)					
Residential mortgage	$ 31,165	26%	$ 15,016	27%	$ 8,240	27%	$ 6,488	25%	$ 3,409	18%
Commercial mortgage loans	63,972	11%	17,775	12%	13,699	11%	13,706	11%	9,827	9%
Construction loans	164,128	11%	83,482	12%	38,108	12%	18,438	13%	12,623	9%
Commercial and Industrial loans (including loans to local financial institutions)	186,007	38%	74,358	33%	63,030	33%	53,929	32%	58,117	48%
Consumer loans and finance leases	82,848	14%	90,895	16%	67,091	17%	65,735	19%	64,023	16%
	$ 528,120	100%	$ 281,526	100%	$ 190,168	100%	$ 158,296	100%	$ 147,999	100%

The following table sets forth information concerning the composition of the Corporation s allowance for loan and lease losses as of December 31, 2009 and 2008 by loan category and by whether the allowance and related provisions were calculated individually or through a general valuation allowance:

Table of Contents

(Dollars in thousands)	**Residential Mortgage Loans**	**Commercial Mortgage Loans**	**C&I Loans**	**Construction Loans**	**Consumer and Finance Leases**	**Total**
As of December 31, 2009						
Impaired loans without specific reserves:						
Principal balance of loans, net of charge-offs	$ 384,285	$ 62,920	$ 48,943	$ 100,028	$	$ 596,176
Impaired loans with specific reserves:						
Principal balance of loans, net of charge-offs	60,040	159,284	243,123	597,641		1,060,088
Allowance for loan and lease losses	2,616	30,945	62,491	86,093		182,145
Allowance for loan and lease losses to principal balance	4.36%	19.43%	25.70%	14.41%	0.00%	17.18%
Loans with general allowance:						
Principal balance of loans	3,151,183	1,368,617	5,059,363	794,920	1,898,104	12,272,187
Allowance for loan and lease losses	28,549	33,027	123,516	78,035	82,848	345,975
Allowance for loan and lease losses to principal balance	0.91%	2.41%	2.44%	9.82%	4.36%	2.82%
Total portfolio, excluding loans held for sale:						
Principal balance of loans	$3,595,508	$1,590,821	$5,351,429	$1,492,589	$1,898,104	$13,928,451
Allowance for loan and lease losses	31,165	63,972	186,007	164,128	82,848	528,120
Allowance for loan and lease losses to principal balance	0.87%	4.02%	3.48%	11.00%	4.36%	3.79%
As of December 31, 2008						
Impaired loans without specific reserves:						

Principal balance of loans, net of charge-offs	$ 19,909	$ 18,359	$ 55,238	$ 22,809	$	$ 116,315
Impaired loans with specific reserves:						
Principal balance of loans, net of charge-offs		47,323	79,760	257,831		384,914
Allowance for loan and lease losses		8,680	18,343	56,330		83,353
Allowance for loan and lease losses to principal balance	0.00%	18.34%	23.00%	21.85%	0.00%	21.65%
Loans with general allowance:						
Principal balance of loans	3,461,416	1,470,076	4,290,450	1,246,355	2,108,363	12,576,660
Allowance for loan and lease losses	15,016	9,095	56,015	27,152	90,895	198,173
Allowance for loan and lease losses to principal balance	0.43%	0.62%	1.31%	2.18%	4.31%	1.58%
Total portfolio, excluding loans held for sale:						
Principal balance of loans	$3,481,325	$1,535,758	$4,425,448	$1,526,995	$2,108,363	$13,077,889
Allowance for loan and lease losses	15,016	17,775	74,358	83,482	90,895	281,526
Allowance for loan and lease losses to principal balance	0.43%	1.16%	1.68%	5.47%	4.31%	2.15%

The following tables show the activity for impaired loans and related specific reserve during 2009:

Impaired Loans:	**(In thousands)**
Balance at beginning of year	$ 501,229
Loans determined impaired during the year	1,466,805
Net charge-offs (1)	(244,154)
Loans sold, net of charge-offs of $49.6 million (2)	(39,374)
Loans foreclosed, paid in full and partial payments	(28,242)
Balance at end of year	$ 1,656,264

(1) Approximately $114.2 million, or 47%, is related to

construction loans in Florida and $44.6 million, or 18%, is related to construction loans in Puerto Rico.

(2) Related to five construction projects sold in Florida.

	Year ended December 31, 2009				
(In thousands)	Construction Loans	Commercial Loans	Commercial Mortgage Loans	Residential Mortgage Loans	Total
Allowance for impaired loans, beginning of period	$ 56,330	$ 18,343	$ 8,680	$	$ 83,353
Provision for impaired loans	211,658	69,401	43,583	18,304	342,946
Charge-offs	(181,895)	(25,253)	(21,318)	(15,688)	(244,154)
Allowance for impaired loans, end of period	$ 86,093	$ 62,491	$ 30,945	$ 2,616	$ 182,145

126

Credit Quality

We believe the most meaningful way to assess overall credit quality performance for 2009 is through an analysis of credit quality performance ratios. This approach forms the basis of most of the discussion in the two sections immediately following: Non-accruing and Non-performing assets and Net Charge-Offs and Total Credit Losses.

Credit quality performance in 2009 was negatively impacted by the sustained economic weakness in Puerto Rico and the United States and the significant deterioration of the real estate market in Florida, although there were positive signs late in the year. In addition, we initiated certain actions in 2009 to reduce non-performing credits, including note sales and restructuring of loans into two separate agreement (loan splitting). We anticipate a challenging year in 2010 with regards to credit quality.

Non-accruing and Non-performing Assets

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

Non-accruing Loans Policy

Residential Real Estate Loans The Corporation classifies real estate loans in non-accruing 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-accruing status when interest and principal have not been received for a period of 90 days or more or when there are doubts about the potential to collect all of the principal based on collateral deficiencies or, in other situations, when collection of all of principal or interest is not expected due to deterioration in the financial condition of the borrower. Cash payments received on certain loans that are impaired and collateral dependent are recognized when collected in accordance with the contractual terms of the loans. The principal portion of the payment is used to reduce the principal balance of the loan, whereas the interest portion is recognized on a cash basis (when collected). However, when management believes that the ultimate collectability of principal is in doubt, the interest portion is applied to principal. The risk exposure of this portfolio is diversified as to individual borrowers and industries among other factors. In addition, a large portion is secured with real estate collateral.

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

Other Real Estate Owned (OREO)

OREO acquired in settlement of loans is carried at the lower of cost (carrying value of the loan) or fair value less estimated costs to sell off the real estate at the date of acquisition (estimated realizable value).

Table of Contents

Other Repossessed Property

The other repossessed property category 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.

Investment Securities

This category presents investment securities reclassified to non-accruing status, at their book value.

Past Due Loans

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

During the third quarter of 2007, the Corporation started a loan loss mitigation program providing homeownership preservation assistance. Loans modified through this program are reported as non-performing loans and interest is recognized on a cash basis. When there is reasonable assurance of repayment and the borrower has made payments over a sustained period, the loan is returned to accruing status.

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

	2009	2008	2007	2006	2005
			(Dollars in thousands)		
Non-accruing loans:					
Residential mortgage	$ 441,642	$ 274,923	$ 209,077	$ 114,828	$ 54,777
Commercial mortgage	196,535	85,943	46,672	38,078	15,273
Commercial and Industrial	241,316	58,358	26,773	24,900	18,582
Construction	634,329	116,290	75,494	19,735	1,959
Finance leases	5,207	6,026	6,250	8,045	3,272
Consumer	44,834	45,635	48,784	46,501	40,459
	1,563,863	587,175	413,050	252,087	134,322
REO	69,304	37,246	16,116	2,870	5,019
Other repossessed property	12,898	12,794	10,154	12,103	9,631
Investment securities (1)	64,543				
Total non-performing assets	$ 1,710,608	$ 637,215	$ 439,320	$ 267,060	$ 148,972
Past due loans 90 days and still accruing	$ 165,936	$ 471,364	$ 75,456	$ 31,645	$ 27,501
Non-performing assets to total assets	8.71%	3.27%	2.56%	1.54%	0.75%
Non-accruing loans to total loans receivable	11.23%	4.49%	3.50%	2.24%	1.06%
Allowance for loan and lease losses	$ 528,120	$ 281,526	$ 190,168	$ 158,296	$ 147,999
Allowance to total non-accruing loans	33.77%	47.95%	46.04%	62.79%	110.18%

Allowance to total non-accruing loans, excluding residential real estate loans	47.06%	90.16%	93.23%	115.33%	186.06%

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

Total non-performing assets as of December 31, 2009 was $1.71 billion compared to $637.2 million as of December 31, 2008. Even though deterioration in credit quality was observed in all of the Corporation s portfolios, it was more significant in the construction and commercial loan portfolios, which were affected by both the stagnant housing market and further weakening in the economies of the markets served during most of 2009. The increase in non-performing assets was led by an increase of $518.0 million in non-performing construction loans, of which $314.1 million is related to the construction loan portfolio in Puerto Rico portfolio and $205.2 million is related to construction projects in Florida. Other portfolios that experienced a significant growth in credit risk, mainly in Puerto Rico, include: (i) a $183.0 million increase in non-performing commercial and industrial (C&I) loans, (ii) a $166.7 million increase in non-performing residential mortgage loans, and (ii) a $110.6 million increase in non-performing commercial mortgage loans. Also, during 2009, the Corporation classified as non-performing investment securities with a book value of $64.5 million that were pledged to Lehman Brothers Special Financing, Inc., in connection with several interest rate swap agreements entered into with that institution. Considering that the investment securities have not yet been recovered by the Corporation, despite its efforts in this regard, the

128

Corporation decided to classify such investments as non-performing. It is important to note that although there was a significant increase in non-performing assets from December 31, 2008, to December 31,2009, there was a slower growth rate in the 2009 fourth quarter as compared to all previous quarters in 2009 as a result of actions taken by the Corporation including note sales, restructuring of loans into two separate agreements (loan splitting) and restructured loans restored to accrual status after a sustained period of repayment and that have been deemed collectible.

Total non-performing construction loans increased by $518.0 million from December 31, 2008. The non-performing construction loans in Puerto Rico increased by $314.1 million in 2009 primarily related to residential housing projects. There were 10 relationships greater than $10 million in non-accrual status as of December 31, 2009, compared to two as of December 31, 2008, including $123.8 million on two high-rise residential projects.

Non-performing construction loans in Florida increased by $205.2 million from December 31, 2008. There were five relationships in the state of Florida greater than $10 million totaling $186.8 million as of December 31, 2009 compared to one relationship of $11.1 million as of December 31, 2008. Most of the non-performing loans in Florida are related to condo-conversion and residential housing projects affected by low absorption rates. Even though a significant increase was observed from 2008 to 2009, there was a decrease experienced in the last quarter of 2009 mainly due to note sales and loans restructured into two notes. During the fourth quarter of 2009, the Corporation completed the sales of non-performing construction loans in Florida totaling approximately $40.4 million and also completed the restructuring of condo-conversion loans with an aggregate book value of $38.1 million.

Non-performing construction loans in the Virgin Islands decreased by $1.3 million.

The C&I non-performing loans portfolio increased by $183.0 million from December 31, 2008. Non-performing C&I loans in Puerto Rico increased by $174.5 million, reflecting the sustained economic weakness that affected several industries such as food and beverage, accommodation, financial and printing. There were four relationships greater than $10 million as of December 31, 2009 totaling $101.8 million that entered into non-accrual status during 2009 and accounted for 55% of the increase. C&I non-performing loans in Florida and Virgin Islands were more stable with increases of $2.2 million and $6.2 million, respectively, from December 31, 2008.

Total non-performing commercial mortgage loans increased by $110.6 million from December 31, 2008. Non-performing commercial mortgage loans in Puerto Rico increased by $66.5 million spread across several industries. In Florida, non-performing commercial mortgage loans increased by $33.8 million from December 31, 2008, including a single rental-property relationship of $11.4 million. Non-performing commercial mortgage loans in the Virgin Islands increased by $10.3 million.

In many cases, commercial and construction loans were placed on non-accrual status even though the loan was less than 90 days past due in their interest payments. At the close of 2009, approximately $229.4 million of loans placed in non-accrual status, mainly construction and commercial loans, were current or had delinquencies less than 90 days in their interest payments. Further, collections are being recorded on a cash basis through earnings, or on a cost-recovery basis, as conditions warrant. In Florida, as sales of units within condo-conversion projects continue to lag, some borrowers reverted to rental projects. For several of these loans, cash collections cover interest, property taxes, insurance and other operating costs associated with the projects.

During the year ended December 31, 2009, interest income of approximately $4.7 million related to $761.5 million of non-performing loans, mainly non-performing construction and commercial loans, was applied against the related principal balances under the cost-recovery method. The Corporation will continue to evaluate restructuring alternatives to mitigate losses and enable borrowers to repay their loans under revised terms in an effort to preserve the value of the Corporation s interests over the long-term.

Non-performing residential mortgage loans increased by $166.7 million during 2009, mainly attributable to the Puerto Rico portfolio, which has been adversely affected by the continued trend of higher unemployment rates affecting consumers and includes $36.9 million related to loans acquired in the previously explained transaction with R&G. The non-performing residential mortgage loan portfolio in Puerto Rico increased by $131.2 million during 2009. The Corporation continues to address loss mitigation and loan modifications by offering alternatives to

avoid foreclosures through internal programs and programs sponsored by the Federal Government. In Florida, non-performing residential mortgage loans increased by $35.0 million from December 31, 2008, however, a decrease was observed in the last quarter due to modified loans that have been restored to accrual status after a sustained repayment performance (generally six months) and are deemed collectible. During 2009, the non-performing residential mortgage loan portfolio in the Virgin Islands increased by $0.6 million.

The consumer and finance leases non-performing loan portfolio remained relatively flat at $50.0 million as of December 31, 2009 when compared to $51.7 million as of December 31, 2008. This portfolio showed signs of stability and benefited from changes in underwriting standards implemented in late 2005. The consumer loan portfolio, with an average life of approximately four years, has been replenished by new originations under the revised standards.

The allowance to non-performing loans ratio as of December 31, 2009 was 33.77%, compared to 47.95% as of December 31, 2008. The decrease in the ratio is attributable in part to non-performing collateral dependent loans that are evaluated individually for impairment that, after charge-offs, reflected limited impairment or no impairment at all, and other impaired loans that did not require specific reserves based on collateral values or cash flows projections analyses performed. Also 17% of the increase in non-performing loans since December 31, 2008 is related to residential mortgage loans, mainly in Puerto Rico, where the Corporation s loan loss experience has been comparatively low due to, among other things, the Corporation s conservative underwriting practices and loan-to-value ratios, thus requiring a lower general reserve as compared to other portfolios.

As of December 31, 2009, approximately $517.7 million, or 33%, of total non-performing loans have been charged-off to their net realizable value as set forth below:

(Dollars in thousands)	**Residential Mortgage Loans**	**Commercial Mortgage Loans**	**C&I Loans**	**Construction Loans**	**Consumer and Finance Leases**	**Total**
As of December 31, 2009						
Non-performing loans charged-off to realizable value	$ 320,224	$ 38,421	$ 19,244	$ 139,787	$	$ 517,676
Other non-performing loans	121,418	158,114	222,072	494,542	50,041	1,046,187
Total non-performing loans	$ 441,642	$ 196,535	$ 241,316	$ 634,329	$ 50,041	$ 1,563,863
Allowance to non-performing loans	7.06%	32.55%	77.08%	25.87%	165.56%	33.77%
Allowance to non-performing loans, excluding non-performing loans charged-off to realizable value	25.67%	40.46%	83.76%	33.19%	165.56%	50.48%
As of December 31, 2008						

Non-performing loans charged-off to realizable value	$ 19,909	$ 8,852	$ 9,890	$ 1,810	$	$ 40,461
Other non-performing loans	255,014	77,091	48,468	114,480	51,661	546,714
Total non-performing loans	$ 274,923	$ 85,943	$ 58,358	$ 116,290	$ 51,661	$ 587,175
Allowance to non-performing loans	5.46%	20.68%	127.42%	71.79%	175.95%	47.95%
Allowance to non-performing loans, excluding non-performing loans charged-off to realizable value	5.89%	23.06%	153.42%	72.92%	175.95%	51.49%

The Corporation provides homeownership preservation assistance to its customers through a loss mitigation program in Puerto Rico and through programs sponsored by the Federal Government. Due to the nature of the borrower s financial condition, the restructure or loan modification through these program as well as other restructurings of individual commercial, commercial mortgage loans, construction loans and residential mortgages in the U.S. mainland fit the definition of Troubled Debt Restructuring (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 loans and modifications of the loan rate. As of December 31, 2009, the Corporation s TDR loans consisted of $124.1 million of residential mortgage loans, $42.1 million commercial and industrial loans, $68.1 million commercial mortgage loans and $101.7 million of construction loans. From the $336.0 million total TDR loans, approximately $130.4 million are in compliance with modified terms, $23.8 million are 30-89 days delinquent, and $181.8 million are classified as non-accrual as of December 31, 2009.

130

Table of Contents

Included in the $101.7 million of construction TDR loans are certain impaired condo-conversion loans restructured into two separate agreements (loan splitting) in the fourth quarter of 2009. Each of these loans were restructured into two notes: one that represents the portion of the loan that is expected to be fully collected along with contractual interest and the second note that represents the portion of the original loan that was charged-off. The renegotiations of these loans have been made after analyzing the borrowers and guarantors capacity to serve the debt and ability to perform under the modified terms. As part of the renegotiation of the loans, the first note of each loan have been placed on a monthly payment that amortize the debt over 25 years at a market rate of interest. An interest rate reduction was granted for the second note. The following tables provide additional information about the volume of this type of loan restructurings and the effect on the allowance for loan and lease losses in 2009.

		(In thousands)
Principal balance deemed collectible	$	22,374
Amount charged-off	$	(29,713)

Specific Reserve:		(In thousands)
Balance at beginning of year	$	14,375
Provision for loan losses		17,213
Charge-offs		(29,713)
Balance at end of year	$	1,875

The loans comprising the $22.4 million that have been deemed collectible continue to be individually evaluated for impairment purposes. These transactions contributed to a $29.9 million decrease in non-performing loans during the last quarter of 2009.

Past due and still accruing loans, which are contractually delinquent 90 days or more, amounted to $165.9 million as of December 31, 2009 (2008 $471.4 million) of which $71.1 million are government guaranteed loans.

Net Charge-Offs and Total Credit Losses

The Corporation s net charge-offs for 2009 were $333.3 million, or 2.48%, of average loans compared to $108.3 million or 0.87% of average loans for 2008. The significant increase is mainly due to the continued deterioration in the collateral values of construction loans, primarily in the Florida region. Florida s economy has been hampered by a deteriorating housing market since the second half of 2007. The overbuilding in the face of waning demand, among other things, caused a decline in the housing prices. The Corporation had been obtaining appraisals and increasing its reserve, as necessary, with expectations for a gradual housing market recovery. Nonetheless, the passage of time increased the possibility that the recovery of the market will not be in the near term. For these reasons, the Corporation decided to charge-off during 2009 collateral deficiencies for a significant amount of impaired collateral dependent loans based on current appraisals obtained. The deficiencies in the collateral raised doubts about the potential to collect the principal. The Corporation is engaged in continuous efforts to identify alternatives that enable borrowers to repay their loans and protect the Corporation s investment.

Total construction net charge-offs in 2009 were $183.6 million, or 11.54% of average loans, up from $7.7 million, or 0.52% of average loans in 2008. Condo-conversion and residential development projects in Florida represent a significant portion of the losses. There were $137.4 million in net-charge offs in 2009 related to construction projects in Florida. Approximately $79.2 million of the charge-offs for 2009 was recorded in connection with loans sold and loan split type of restructuring. Net charge-offs of $46.2 million were recorded in connection with the construction loan portfolio in Puerto Rico, mainly residential housing projects. We continued our ongoing portfolio management efforts, including obtaining updated appraisals on properties and assessing a project status within the context of

market environment expectations.

Total commercial mortgage net charge-offs in 2009 were $25.2 million, or 1.64% of average loans, up from $3.7 million, or 0.27% of average loans in 2008. The charge-offs in 2009 were spread through several loans, distributed across our geographic markets. Commercial mortgage net charge-offs for 2009 in Puerto Rico were $7.9 million, in the United States $15.2 million and $2.1 million in the Virgin Islands.

131

Table of Contents

Total C&I net charge-offs in 2009 were $34.5 million, or 0.72% of average loans, up from $24.2 million, or 0.59% of average loans in 2008. C&I loans net charge-offs were distributed across several industries, principally in Puerto Rico. C&I net charge-offs for 2009 in Puerto Rico were $32.8 million, in the United States $0.6 million and $1.1 million in the Virgin Islands. In assessing C&I net charge-offs trends, it is helpful to understand the process of how these loans are treated as they deteriorate over time. Reserves for loans are established at origination consistent with the level of risk associated with the original underwriting. If the quality of a commercial loan deteriorates, it migrates to a lower quality risk rating as a result of our normal portfolio management process, and a higher reserve amount is assigned. As a part of our normal portfolio management process, the loan is reviewed and reserves are increased as warranted. Charge-offs, if necessary, are generally recognized in a period after the reserves were established. If the previously established reserves exceed that needed to satisfactorily resolve the problem credit, a reduction in the overall level of the reserve could be recognized. In summary, if loan quality deteriorates, the typical credit sequence for commercial loans are periods of reserve building, followed by periods of higher net charge-offs as previously established reserves are utilized. Additionally, it is helpful to understand that increases in reserves either precede or are in conjunction with increases in impaired commercial loans. When a credit is classified as impaired, it is evaluated for specific reserves or charged-off.

Residential mortgage net charge-offs were $28.9 million, or 0.82% of related average loans in 2009. This was up from $6.3 million, or 0.19% of related average balances in 2008. The higher loss level for 2009 was a result of negative trends in delinquency levels. Approximately $15.7 million in charge-offs for 2009 ($7.1 million in Puerto Rico and $8.5 million in Florida) resulted from valuations, for impairment purposes, of residential mortgage loan portfolios with high delinquency and loan-to-value levels, compared to $1.8 million recorded in 2008. Total residential mortgage loan portfolios evaluated for impairment purposes and charged-off to their net realizable value amounted to $320.2 million as of December 31, 2009. This amount represents approximately 73% of the total non-performing residential mortgage loan portfolio outstanding as of December 31, 2009. Net charge-offs for residential mortgage loans also includes $11.2 million related to loans foreclosed during 2009, up from $3.9 million recorded for loans foreclosed in 2008. Consistent with the Corporation s assessment of the value of properties, current and future market conditions, management is executing strategies to accelerate the sale of the real estate acquired in satisfaction of debt (REO). The ratio of net charge-offs to average loans on the Corporation s residential mortgage loan portfolio of 0.82% for 2009 is lower than the approximately 2.4% average charge-off rate for commercial banks in the U.S. mainland for the third quarter of 2009 as per statistical releases published by the Federal Reserve on its website.

Net charge-offs of consumer loans and finance leases in 2009 were $61.1 million, or 3.05% of related average loans, compared to net charge-offs of $66.4 million, or 3.19% of related average loans for 2008. Performance of this portfolio on both an absolute and relative basis continued to be consistent with our views regarding the underlying quality of the portfolio. The 2009 level of delinquencies has improved compared with 2008 levels, further supporting our view of stable performance going forward.

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

			Year Ended		
	December 31, 2009	**December 31, 2008**	**December 31, 2007**	**December 31, 2006**	**December 31, 2005**
Residential mortgage	0.82%	0.19%	0.03%	0.04%	0.05%
Commercial mortgage	1.64%	0.27%	0.10%	0.00%	0.03%
Commercial and Industrial	0.72%	0.59%	0.26%	0.06%	0.11%
Construction	11.54%	0.52%	0.26%	0.00%	0.00%
Consumer and finance leases	3.05%	3.19%	3.48%	2.90%	2.06%
Total loans	2.48%	0.87%	0.79%	0.55%	0.39%

Table of Contents

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

	December 31, 2009	December 31, 2008
PUERTO RICO:		
Residential mortgage	0.64%	0.20%
Commercial mortgage	0.82%	0.37%
Commercial and Industrial	0.72%	0.32%
Construction	4.88%	0.19%
Consumer and finance leases	2.93%	3.10%
Total loans	1.44%	0.82%
VIRGIN ISLANDS:		
Residential mortgage	0.08%	0.02%
Commercial mortgage	2.79%	0.00%
Commercial and Industrial	0.59%	6.73%
Construction	0.00%	0.00%
Consumer and finance leases	3.50%	3.54%
Total loans	0.73%	1.48%
FLORIDA:		
Residential mortgage	2.84%	0.30%
Commercial mortgage	3.02%	0.09%
Commercial and Industrial	1.87%	6.58%
Construction	29.93%	1.08%
Consumer and finance leases	7.33%	5.88%
Total loans	11.70%	0.86%

Total credit losses (equal to net charge-offs

plus losses on REO operations) for 2009 amounted to $355.1 million, or 2.62% to average loans and repossessed assets, respectively, in contrast to credit losses of $129.7 million, or a loss rate of 1.04%, for 2008. In addition, there was a $1.8 million increase in the reserve for probable losses on outstanding unfunded loan commitments.

133

Table of Contents

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

	Year Ended December 31,	
	2009	2008
	(Dollars in thousands)	
REO		
REO balances, carrying value:		
Residential	$ 35,778	$ 20,265
Commercial	19,149	2,306
Condo-conversion projects	8,000	9,500
Construction	6,377	5,175
Total	$ 69,304	$ 37,246
REO activity (number of properties):		
Beginning property inventory,	155	87
Properties acquired	295	169
Properties disposed	(165)	(101)
Ending property inventory	285	155
Average holding period (in days)		
Residential	221	160
Commercial	170	237
Condo-conversion projects	643	306
Construction	330	145
	266	200
REO operations (loss) gain:		
Market adjustments and (losses) gain on sale:		
Residential	$ (9,613)	$ (3,521)
Commercial	(1,274)	(1,402)
Condo-conversion projects	(1,500)	(5,725)
Construction	(1,977)	(347)
	(14,364)	(10,995)
Other REO operations expenses	(7,499)	(10,378)
Net Loss on REO operations	$ (21,863)	$ (21,373)

CHARGE-OFFS

Residential charge-offs, net	(28,861)	(6,256)
Commercial charge-offs, net	(59,712)	(27,897)
Construction charge-offs, net	(183,600)	(7,735)
Consumer and finance leases charge-offs, net	(61,091)	(66,433)
Total charge-offs, net	(333,264)	(108,321)
TOTAL CREDIT LOSSES (1)	$ (355,127)	$ (129,694)
LOSS RATIO PER CATEGORY (2):		
Residential	1.08%	0.29%
Commercial	0.96%	0.53%
Construction	11.65%	0.92%
Consumer	3.04%	3.18%
TOTAL CREDIT LOSS RATIO (3)	**2.62%**	**1.04%**

(1) Equal to REO operations (losses) gains plus Charge-offs, net.

(2) Calculated as net charge-offs plus market adjustments and gains (losses) on sale of REO divided by average loans and repossessed assets.

(3) Calculated as net charge-offs plus net loss on REO operations divided by average loans and repossessed assets.

Operational Risk

The Corporation faces ongoing and emerging risk and regulatory pressure related to the activities that surround the delivery of banking and financial products. Coupled with external influences such as market conditions, security risks,

and legal risk, the potential for operational and reputational loss has increased. In order to mitigate and control operational risk, the Corporation has developed, and continues to enhance, specific internal controls, policies and

134

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procedures that are designated to identify and manage operational risk at appropriate levels throughout the organization. The purpose of these mechanisms is to provide reasonable assurance that the Corporation s business operations are functioning within the policies and limits established by management.

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

Legal and Compliance Risk

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

Impact of Inflation and Changing Prices

The financial statements and related data presented herein have been prepared in conformity with GAAP, which require 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.

Concentration Risk

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

As of December 31, 2009, the Corporation had $1.2 billion outstanding of credit facilities granted to the Puerto Rico Government and/or its political subdivisions. A substantial portion of these credit facilities are obligations that have a specific source of income or revenues identified for their repayment, such as sales and property taxes collected by the central Government and/or municipalities. Another portion of these obligations consist of loans to public corporations that obtain revenues from rates charged for services or products, such as electric power utilities. Public corporations have varying degrees of independence from the central Government and many receive appropriations or other payments from it. The Corporation also has loans to various municipalities in Puerto Rico for which the good faith, credit and unlimited taxing power of the applicable municipality has been pledged to their repayment.

Aside from loans extended to the Puerto Rico Government and its political subdivisions, the largest loan to one borrower as of December 31, 2009 in the amount of $321.5 million is with one mortgage originator in Puerto Rico, Doral Financial Corporation. This commercial loan is secured by individual mortgage loans on residential and commercial real estate. Of the total gross loan portfolio of $13.9 billion as of December 31, 2009, approximately 83% has credit risk concentration in Puerto Rico, 9% in the United States and 8% in the Virgin Islands.

Selected Quarterly Financial Data

Financial data showing results of the 2009 and 2008 quarters is presented below. In the opinion of management, all adjustments necessary for a fair presentation have been included. These results are unaudited.

	2009			
	March 31	June 30	September 30	December 31
	(Dollar in thousands, except for per share results)			
Interest income	$258,323	$252,780	$ 242,022	$243,449
Net interest income	121,598	131,014	129,133	137,297
Provision for loan losses	59,429	235,152	148,090	137,187
Net income (loss)	21,891	(78,658)	(165,218)	(53,202)
Net income (loss) attributable to common stockholders	6,773	(94,825)	(174,689)	(59,334)
Earnings (loss) per common share-basic	$ 0.07	$ (1.03)	$ (1.89)	$ (0.64)
Earnings (loss) per common share-diluted	$ 0.07	$ (1.03)	$ (1.89)	$ (0.64)

	2008			
	March 31	June 30	September 30	December 31
	(Dollar in thousands, except for per share results)			
Interest income	$279,087	$276,608	$288,292	$282,910
Net interest income	124,458	134,606	144,621	124,196
Provision for loan losses	45,793	41,323	55,319	48,513
Net income	33,589	32,994	24,546	18,808
Net income attributable to common stockholders	23,520	22,925	14,477	8,739
Earnings per common share-basic	$ 0.25	$ 0.25	$ 0.16	$ 0.09
Earnings per common share-diluted	$ 0.25	$ 0.25	$ 0.16	$ 0.09

Fourth Quarter Financial Summary

The financial results for the fourth quarter of 2009, as compared to the same period in 2008, were principally impacted by the following items on a pre-tax basis:

Net interest income increased 11% to $137.3 million for the fourth quarter of 2009 from $124.2 million for the fourth quarter of 2008. Net interest income for the fourth quarter of 2009 includes a net unrealized gain of $2.5 million, compared to a net unrealized loss of $5.3 million for the fourth quarter of 2008, a positive fluctuation of $7.8 million, related to the changes in valuation of derivatives instruments that enonomically hedge the Corporation s brokered CDs and medium term notes and unrealized gains and losses on liabilities measured at fair value. Compared with the fourth quarter of 2008, net interest income, excluding fair value adjustments on derivatives and financial liabilities measured at fair value, increased $5.3 million, or 4%. The Corporation benefited from lower funding costs related to continued low levels of interest rates and the mix of financing sources. Lower interest rate levels was reflected in the pricing of newly issued brokered CDs at rates significantly lower than rate levels for prior year s fourth quarter. The average cost of brokered CDs decreased by 154 basis points from 4.06% for the fourth quarter of 2008 to 2.52% for the fourth quarter of 2009. Also, the Corporation was able to reduce the average cost of its core deposits from 2.83% for prior year s fourth quarter to 1.95% for the fourth quarter of 2009. The decrease in funding costs was partially offset by a significant increase in non-performing loans and the repricing of floating-rate commercial and construction loans at lower rates due to decreases in market interest rates such as three-month LIBOR and the Prime rate, even though the Corporation is actively increasing spreads on loan renewals. The increase in net interest income was also associated with an increase of $429.6 million of interest-earning assets, over the prior year s fourth quarter. The

increase in interest-earnings assets was driven by a higher average loans volume, which increased by $847 million, driven by additional credit facilities extended to the Government of Puerto Rico. Partially offsetting the increase in average loans was a decrease in average investments of $417 million, driven mostly by the sales of approximately $1.7 billion of Agency MBS and calls of approximately $945 million of U.S. Agency debt securities that were more than purchases made during 2009.

Non-interest income increased to $38.8 million for the fourth quarter of 2009 from $19.4 million for prior year s fourth quarter. The variance is mainly related to a realized gain of $24.4 million on the sale of U.S. Agency MBS versus a realized gain on the sale of MBS of $11.0 million in prior year s fourth quarter. The

136

recent drop in mortgage pre-payments, as well as future pre-payment estimates, could result in the extension of the MBS portfolio s average life, which in turn would shift the balance sheet s interest rate gap position. In an effort to manage such risk, and take advantage of market opportunities, approximately $460 million of U.S. Agency MBS (mainly 30 Year fixed rate MBS with an aggregate weighted average rate of 5.33%) were sold in the fourth quarter of 2009, compared to approximately $284 million of U.S. Agency MBS sold in the prior year s fourth quarter. The realized gain on the sale of MBS during the fourth quarter of 2008 was partially offset by other-than-temporary impairment charges of $4.8 million related to auto industry corporate bonds and certain equity securities. There were no other-than- temporary impairments charges during the fourth quarter of 2009.

The provision for loan and lease losses amounted to $137.3 million, or 170% of net charge-offs, for the fourth quarter of 2009 compared to $48.5 million, or 172% of net charge-offs, for the fourth quarter of 2008. The increase, as compared to the fourth quarter of 2008, was mainly attributable to the significant increase in non-performing loans, increases in specific reserves for impaired commercial and construction loans, and the overall growth of the loan portfolio. Also, the migration of loans to higher risk categories and increases to loss factors used to determine the general reserve allowance contributed to the higher provision. The increase in loss factors was necessary to account for higher charge-offs and delinquency levels as well as for worsening trends in economic conditions in Puerto Rico and the United States.

Non-interest expenses increased 2% to $88.8 million from $87.0 million for the fourth quarter of 2008. The increase in the non-interest expense for the fourth quarter 2009, as compared to prior year s fourth quarter, was principally attributable to an increase of $11.5 million in the FDIC deposit insurance premium, which was partly related to increases in regular assessment rates by the FDIC in 2009. The aforementioned increase was partially offset by decreases in certain expenses such as: (i) a $5.3 million decrease in employees compensation and benefit expenses, due to a lower headcount and reductions in bonuses, incentive compensation and overtime costs, and (ii) a $4.5 million decrease in net loss on REO operations, mainly due to lower write-downs and expenses in the U.S. mainland.

Some infrequent transactions that affected quarterly periods shown in the above table include: (i) recognition of non-cash charges of approximately $152.2 million to increase the valuation allowance for the Corporation s deferred tax asset in the third quarter of 2009; (ii) the ecording of $8.9 million in the second quarter of 2009 for the accrual of the special assessment levied by the FDIC; (iii) the impairment of the core deposit intangible of FirstBank Florida for $4.0 million recorded in the first quarter of 2009; (iv) the reversal of $10.8 million of UTBs and related accrued interest of $3.5 million during the second quarter of 2009 for positions taken on income taxes returns due to the lapse of the statute of limitations for the 2004 taxable year; (v) the reversal of $2.9 million of UTBs, net of a payment made to the Puerto Rico Department of Treasury, in connection with the conclusion of an income tax audit related to the 2005, 2006, 2007 and 2008 taxable years; (vi) the reversal of $10.6 million of UTBs during the second quarter of 2008 for positions taken on income tax returns due to the lapse of the statute of limitations for the 2003 taxable year; (vii) the gain of $9.3 million on the mandatory redemption of a portion of the Corporation s investment in VISA as part of VISA s IPO in the first quarter of 2008 and (viii) the income tax benefit of $5.4 million recorded in the first quarter of 2008 in connection with an agreement entered into with the Puerto Rico Department of Treasury that established a multi-year allocation schedule for deductibility of the $74.25 million payment made by the Corporation during 2007 to settle a securities class action suit.

Changes in Internal Controls over Financial Reporting

Refer to Item 9A.

CEO and CFO Certifications

First BanCorp s Chief Executive Officer and Chief Financial Officer have filed with the Securities and Exchange Commission the certifications required by Section 302 of the Sarbanes-Oxley Act of 2002 as Exhibit 31.1 and 31.2 to this Annual Report on Form 10-K and the certifications required by Section III(b)(4) of the Emergency Stabilization Act of 2008 as Exhibit 99.1 and 99.2 to this Annual Report on Form 10-K.

137

Table of Contents

In addition, in 2009, First BanCorp s Chief Executive Officer certified to the New York Stock Exchange that he was not aware of any violation by the Corporation of the NYSE corporate governance listing standards.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

The information required herein is incorporated by reference to the information included under the sub caption Interest Rate Risk Management in the Management s Discussion and Analysis of Financial Condition and Results of Operations section in this Form 10-K.

Item 8. Financial Statements and Supplementary Data

The consolidated financial statements of First BanCorp, together with the report thereon of PricewaterhouseCoopers LLP, First BanCorp s independent registered public accounting firm, are included herein beginning on page F-1 of this Form 10-K.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Disclosure Controls and Procedures

First BanCorp s management, under the supervision and with the participation of its Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of First BanCorp s disclosure controls and procedures as such term is defined in Rules 13a-15(e) and 15d-15(e) promulgated under the Securities and Exchange Act of 1934, as amended (the Exchange Act), as of the end of the period covered by this Annual Report on Form 10-K. Based on this evaluation, our CEO and CFO concluded that, as of December 31, 2009, the Corporation s disclosure controls and procedures were effective and provide reasonable assurance that the information required to be disclosed by the Corporation in reports that the Corporation files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms and is accumulated and reported to the Corporation s management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

Management s Report on Internal Control over Financial Reporting

Our management s report on Internal Control over Financial Reporting is set forth in Item 8 and incorporated herein by reference.

The effectiveness of the Corporation s internal control over financial reporting as of December 31, 2009 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report as set forth in Item 8.

Changes in Internal Control over Financial Reporting

There have been no changes to the Corporation s internal control over financial reporting during our most recent quarter ended December 31, 2009 that have materially affected, or are reasonably likely to materially affect, the Corporation s internal control over financial reporting.

Item 9B. Other Information.

None.

Table of Contents

PART III

Item 10. Directors, Executive Officers and Corporate Governance

Information in response to this Item is incorporated herein by reference to the sections entitled Information with Respect to Nominees for Director of First BanCorp and Executive Officers of the Corporation, Corporate Governance and Related Matters and Section 16(a) Beneficial Ownership Reporting Compliance contained in First BanCorp s definitive Proxy Statement for use in connection with its 2010 Annual Meeting of stockholders (the Proxy Statement) to be filed with the Securities and Exchange Commission within 120 days of the close of First BanCorp s 2009 fiscal year.

Item 11. Executive Compensation

Information in response to this Item is incorporated herein by reference to the sections entitled Compensation Committee Interlocks and Insider Participation, Compensation of Directors, Compensation Discussion and Analysis, Compensation Committee Report and Tabular Executive Compensation Disclosure in First BanCorp s Proxy Statement.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Information in response to this Item is incorporated herein by reference to the section entitled Beneficial Ownership of Securities in First BanCorp s Proxy Statement.

Item 13. Certain Relationships and Related Transactions, and Director Independence

Information in response to this Item is incorporated herein by reference to the sections entitled Certain Relationships and Related Person Transactions and Corporate Governance and Related Matters in First BanCorp s Proxy Statement.

Item 14. Principal Accountant Fees and Services.

Information in response to this Item is incorporated herein by reference to the section entitled Audit Fees in First BanCorp s Proxy Statement.

PART IV

Item 15. Exhibits, Financial Statement Schedules

(a) List of documents filed as part of this report.

(1) *Financial Statements.*

The following consolidated financial statements of First BanCorp, together with the report thereon of First BanCorp s independent registered public accounting firm, PricewaterhouseCoopers LLP, dated March 1, 2010, are included herein beginning on page F-1:

Report of Independent Registered Public Accounting Firm.

Consolidated Statements of Financial Condition as of December 31, 2009 and 2008.

Consolidated Statements of (Loss) Income for Each of the Three Years in the Period Ended December 31, 2009.

Table of Contents

Consolidated Statements of Changes in Stockholders Equity for Each of the Three Years in the Period Ended December 31, 2009.

Consolidated Statements of Comprehensive (Loss) Income for each of the Three Years in the Period Ended December 31, 2009.

Consolidated Statements of Cash Flows for Each of the Three Years in the Period Ended December 31, 2009.

Notes to the Consolidated Financial Statements.

(2) Financial statement schedules.

All financial schedules have been omitted because they are not applicable or the required information is shown in the financial statements or notes thereto.

(3) Exhibits listed below are filed herewith as part of this Form 10-K or are incorporated herein by reference.

Index to Exhibits:

No.	Exhibit
3.1	Articles of Incorporation (1)
3.2	By-Laws of First BanCorp (1)
3.3	Certificate of Designation creating the 7.125% non-cumulative perpetual monthly income preferred stock, Series A (2)
3.4	Certificate of Designation creating the 8.35% non-cumulative perpetual monthly income preferred stock, Series B (3)
3.5	Certificate of Designation creating the 7.40% non-cumulative perpetual monthly income preferred stock, Series C (4)
3.6	Certificate of Designation creating the 7.25% non-cumulative perpetual monthly income preferred stock, Series D (5)
3.7	Certificate of Designation creating the 7.00% non-cumulative perpetual monthly income preferred stock, Series E (6)
3.8	Certificate of Designation creating the fixed-rate cumulative perpetual preferred stock, Series F (7)
4.0	Form of Common Stock Certificate(9)
4.1	Form of Stock Certificate for 7.125% non-cumulative perpetual monthly income preferred stock, Series A (2)
4.2	Form of Stock Certificate for 8.35% non-cumulative perpetual monthly income preferred stock, Series B (3)
4.3	Form of Stock Certificate for 7.40% non-cumulative perpetual monthly income preferred stock, Series C (4)
4.4	

	Form of Stock Certificate for 7.25% non-cumulative perpetual monthly income preferred stock, Series D (5)
4.5	Form of Stock Certificate for 7.00% non-cumulative perpetual monthly income preferred stock, Series E (10)
4.6	Form of Stock Certificate for Fixed Rate Cumulative Perpetual Preferred Stock, Series F (1)
4.7	Warrant dated January 16, 2009 to purchase shares of First BanCorp (8)
4.8	Letter Agreement, dated January 16, 2009, including Securities Purchase Agreement Standard Terms attached thereto as Exhibit A, between First BanCorp and the United States Department of the Treasury (14)
10.1	FirstBank s 1997 Stock Option Plan(11)
10.2	First BanCorp s 2008 Omnibus Incentive Plan(12)

140

No.	Exhibit
10.3	Investment agreement between The Bank of Nova Scotia and First BanCorp dated February 15, 2007, including the Form of Stockholder Agreement(13)
10.4	Employment Agreement Aurelio Alemán(11)
10.5	Amendment No. 1 to Employment Agreement Aurelio Alemán(15)
10.6	Amendment No. 2 to Employment Agreement Aurelio Alemán
10.7	Employment Agreement Randolfo Rivera(11)
10.8	Amendment No. 1 to Employment Agreement Randolfo Rivera (15)
10.9	Amendment No. 2 to Employment Agreement Randolfo Rivera
10.10	Employment Agreement Lawrence Odell(16)
10.11	Amendment No. 1 to Employment Agreement Lawrence Odell(16)
10.12	Amendment No. 2 to Employment Agreement Lawrence Odell(15)
10.13	Amendment No. 3 to Employment Agreement Lawrence Odell
10.14	Employment Agreement Orlando Berges(17)
10.15	Service Agreement Martinez Odell & Calabria(16)
10.16	Amendment No. 1 to Service Agreement Martinez Odell & Calabria(16)
10.17	Amendment No. 2 to Service Agreement Martinez Odell & Calabria
12.1	Ratio of Earnings to Fixed Charges and Preference Dividends
14.1	Code of Ethics for CEO and Senior Financial Officers (1)
21.1	List of First BanCorp s subsidiaries
31.1	Section 302 Certification of the CEO
31.2	Section 302 Certification of the CFO
32.1	Section 906 Certification of the CEO
32.2	Section 906 Certification of the CFO
99.1	Certification of the CEO Pursuant to Section III(b)(4) of the Emergency Stabilization Act of 2008 and 31 CFR § 30.15

99.2 Certification of the CFO Pursuant to Section III(b)(4) of the Emergency Stabilization Act of 2008 and 31 CFR § 30.15

99.3 Policy Statement and Standards of Conduct for Members of Board of Directors, Executive Officers and Principal Shareholders(18)

99.4 Independence Principles for Directors of First BanCorp (19)

(1) Incorporated by reference from the Form 10-K for the year ended December 31, 2008 filed by the Corporation on March 2, 2009.

(2) Incorporated by reference to First BanCorp s registration statement on Form S-3 filed by the Corporation on March 30, 1999.

(3) Incorporated by reference to First BanCorp s registration statement on Form S-3 filed by the Corporation on September 8, 2000.

(4) Incorporated by reference to First BanCorp s registration statement on Form S-3 filed by the Corporation on May 18, 2001.

(5) Incorporated by reference to First BanCorp s registration statement on Form S-3/A filed by the Corporation on January 16, 2002.

141

Table of Contents

(6) Incorporated by reference to Form 8-A filed by the Corporation on September 26, 2003.

(7) Incorporated by reference to Exhibit 3.1 from the Form 8-K filed by the Corporation on January 20, 2009.

(8) Incorporated by reference to Exhibit 4.1 from the Form 8-K filed by the Corporation on January 20, 2009.

(9) Incorporated by reference from Registration statement on Form S-4 filed by the Corporation on April 15, 1998

(10) Incorporated by reference to Exhibit 4.1 from the Form 8-K filed by the Corporation on September 5, 2003.

(11) Incorporated by reference from the Form 10-K for the year ended

December 31, 1998 filed by the Corporation on March 26, 1999.

(12) Incorporated by reference to Exhibit 10.1 from the Form 10-Q for the quarter ended March 31, 2008 filed by the Corporation on May 12, 2008.

(13) Incorporated by reference to Exhibit 10.01 from the Form 8-K filed by the Corporation on February 22, 2007.

(14) Incorporated by reference to Exhibit 10.1 from the Form 8-K filed by the Corporation on January 20, 2009.

(15) Incorporated by reference from the Form 10-Q for the quarter ended March 31, 2009 filed by the Corporation on May 11, 2009.

(16) Incorporated by reference from the Form 10-K for the year ended December 31,

2005 filed by the Corporation on February 9, 2007.

(17) Incorporated by reference from the Form 10-Q for the quarter ended June 30, 2009 filed by the Corporation on August 11, 2009.

(18) Incorporated by reference from the Form 10-K for the year ended December 31, 2003 filed by the Corporation on March 15, 2004.

(19) Incorporated by reference from the Form 10-K for the year ended December 31, 2007 filed by the Corporation on February 29, 2008.

142

Table of Contents

SIGNATURES

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

FIRST BANCORP.

By: /s/ Aurelio Alemán Date: 3/1/10

Aurelio Alemán
President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

/s/ Aurelio Alemán	Date: 3/1/10
Aurelio Alemán President and Chief Executive Officer	
/s/ Orlando Berges	Date: 3/1/10
Orlando Berges, CPA Executive Vice President and Chief Financial Officer	
/s/ José Menéndez-Cortada	Date: 3/1/10
José Menéndez-Cortada, Director and Chairman of the Board	
/s/ Fernando Rodríguez-Amaro	Date: 3/1/10
Fernando Rodríguez Amaro, Director	
/s/ Jorge L. Díaz	Date: 3/1/10
Jorge L. Díaz, Director	
/s/ Sharee Ann Umpierre-Catinchi	Date: 3/1/10
Sharee Ann Umpierre-Catinchi, Director	
/s/ José L. Ferrer-Canals	Date: 3/1/10

José L. Ferrer-Canals, Director

/s/ Frank Kolodziej Date: 3/1/10

Frank Kolodziej, Director

/s/ Héctor M. Nevares Date: 3/1/10

Héctor M. Nevares, Director

143

/s/ José F. Rodríguez	Date: 3/1/10
José F. Rodríguez, Director	
/s/ Pedro Romero	Date: 3/1/10
Pedro Romero, CPA Senior Vice President and Chief Accounting Officer	

144

Table of Contents

TABLE OF CONTENTS

First BanCorp Index to Consolidated Financial Statements

Management s Report on Internal Control over Financial Reporting	F-1
Report of Independent Registered Public Accounting Firm	F-2
Consolidated Statements of Financial Condition	F-4
Consolidated Statements of (Loss) Income	F-5
Consolidated Statements of Cash Flows	F-6
Consolidated Statements of Changes in Stockholders Equity	F-7
Consolidated Statements of Comprehensive (Loss) Income	F-8
Notes to Consolidated Financial Statements	F-9

Table of Contents

Management s Report on Internal Control Over Financial Reporting

To the Board of Directors and Stockholders of First BanCorp:

The management of First BanCorp (the Corporation) is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934 and for our assessment of internal control over financial reporting. The Corporation s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America (GAAP) and includes controls over the preparation of financial statements in accordance with the instructions for the Consolidated Financial Statements for Bank Holding Companies (Form FR Y-9C) to comply with the requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA).

Internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit the preparation of financial statements in accordance with GAAP, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

The management of First BanCorp has assessed the effectiveness of the Corporation s internal control over financial reporting as of December 31, 2009. In making this assessment, the Corporation used the criteria set forth by the Committee of the Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework.

Based on our assessment, management concluded that the Corporation maintained effective internal control over financial reporting as of December 31, 2009.

The effectiveness of the Corporation s internal control over financial reporting as of December 31, 2009 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which appears herein.

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

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

PricewaterhouseCoopers LLP
254 Muñoz Rivera Avenue
BBVA Tower, 9 th Floor
Hato Rey, PR 00918
Telephone (787) 754-9090
Facsimile (787) 766-1094

Report of Independent Registered Public Accounting Firm

To the Board of Directors and
Stockholders of First BanCorp

In our opinion, the accompanying consolidated statements of financial condition and the related consolidated statements of (loss) income, comprehensive (loss) income, changes in stockholders equity and cash flows present fairly, in all material respects, the financial position of First BanCorp and its subsidiaries (the Corporation) at December 31, 2009 and 2008, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2009 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2009, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Corporation s management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management s Report on Internal Control Over Financial Reporting. Our responsibility is to express opinions on these financial statements and on the Corporation s internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

As discussed in Note 1 to the consolidated financial statements, the Corporation changed the manner in which it accounts for uncertain tax positions and the manner in which it accounts for the financial assets and liabilities at fair value in 2007.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Management s assessment and our audit of First BanCorp s internal control over financial reporting also included controls over the preparation of financial statements in accordance with the instructions to the Consolidated Financial Statements for Bank Holding Companies (Form FR Y-9C) to comply with the reporting requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA). A company s internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that

transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

PricewaterhouseCoopers LLP
San Juan, Puerto Rico
March 1, 2010
CERTIFIED PUBLIC ACCOUNTANTS
(OF PUERTO RICO)
License No. 216 Expires Dec. 1, 2010
Stamp 2389662 of the P.R. Society of
Certified Public Accountants has been
affixed to the file copy of this report

F-3

Table of Contents

FIRST BANCORP
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

	December 31, 2009	December 31, 2008
	(In thousands, except for share information)	
ASSETS		
Cash and due from banks	$ 679,798	$ 329,730
Money market investments:		
Federal funds sold	1,140	54,469
Time deposits with other financial institutions	600	600
Other short-term investments	22,546	20,934
Total money market investments	24,286	76,003
Investment securities available for sale, at fair value:		
Securities pledged that can be repledged	3,021,028	2,913,721
Other investment securities	1,149,754	948,621
Total investment securities available for sale	4,170,782	3,862,342
Investment securities held to maturity, at amortized cost:		
Securities pledged that can be repledged	400,925	968,389
Other investment securities	200,694	738,275
Total investment securities held to maturity, fair value of $621,584 (2008 - $1,720,412)	601,619	1,706,664
Other equity securities	69,930	64,145
Loans, net of allowance for loan and lease losses of $528,120 (2008 - $281,526)	13,400,331	12,796,363
Loans held for sale, at lower of cost or market	20,775	10,403
Total loans, net	13,421,106	12,806,766
Premises and equipment, net	197,965	178,468
Other real estate owned	69,304	37,246
Accrued interest receivable on loans and investments	79,867	98,565
Due from customers on acceptances	954	504
Other assets	312,837	330,835
Total assets	$ 19,628,448	$ 19,491,268

LIABILITIES		
Deposits:		
Non-interest-bearing deposits	$ 697,022	$ 625,928
Interest-bearing deposits (including $0 and $1,150,959 measured at fair value as of December 31, 2009 and December 31, 2008, respectively)	11,972,025	12,431,502
Total deposits	12,669,047	13,057,430
Loans payable	900,000	
Securities sold under agreements to repurchase	3,076,631	3,421,042
Advances from the Federal Home Loan Bank (FHLB)	978,440	1,060,440
Notes payable (including $13,361 and $10,141 measured at fair value as of December 31, 2009 and December 31, 2008, respectively)	27,117	23,274
Other borrowings	231,959	231,914
Bank acceptances outstanding	954	504
Accounts payable and other liabilities	145,237	148,547
Total liabilities	18,029,385	17,943,151
Commitments and contingencies (Notes 28, 31 and 34)		
STOCKHOLDERS EQUITY		
Preferred stock, authorized 50,000,000 shares: issued and outstanding 22,404,000 shares (2008 - 22,004,000) at an aggregate liquidation value of $950,100 (2008 - $550,100)	928,508	550,100
Common stock, $1 par value, authorized 250,000,000 shares; issued 102,440,522 (2008 - 102,444,549)	102,440	102,444
Less: Treasury stock (at cost)	(9,898)	(9,898)
Common stock outstanding, 92,542,722 shares outstanding (2008 - 92,546,749)	92,542	92,546
Additional paid-in capital	134,223	108,299
Legal surplus	299,006	299,006
Retained earnings	118,291	440,777
Accumulated other comprehensive income, net of tax expense of $4,628 (2008 - $717)	26,493	57,389
Total stockholders equity	1,599,063	1,548,117
Total liabilities and stockholders equity	$ 19,628,448	$ 19,491,268

The accompanying notes are an integral part of these statements.

F-4

Table of Contents

FIRST BANCORP
CONSOLIDATED STATEMENTS OF (LOSS) INCOME

	Year Ended December 31,		
	2009	2008	2007
	(In thousands, except per share data)		
Interest income:			
Loans	$ 741,535	$ 835,501	$ 901,941
Investment securities	254,462	285,041	265,275
Money market investments	577	6,355	22,031
Total interest income	996,574	1,126,897	1,189,247
Interest expense:			
Deposits	314,487	414,838	528,740
Loans payable	2,331	243	
Federal funds purchased and securities sold under agreements to repurchase	114,651	133,690	148,309
Advances from FHLB	32,954	39,739	38,464
Notes payable and other borrowings	13,109	10,506	22,718
Total interest expense	477,532	599,016	738,231
Net interest income	519,042	527,881	451,016
Provision for loan and lease losses	579,858	190,948	120,610
Net interest (loss) income after provision for loan and lease losses	(60,816)	336,933	330,406
Non-interest income:			
Other service charges on loans	6,830	6,309	6,893
Service charges on deposit accounts	13,307	12,895	12,769
Mortgage banking activities	8,605	3,273	2,819
Net gain on sale of investments	86,804	27,180	3,184
Other-than-temporary impairment losses on investment securities:			
Total other-than-temporary impairment losses	(33,400)	(5,987)	(5,910)
Noncredit-related impairment portion on debt securities not expected to be sold (recognized in other comprehensive income)	31,742		
Net impairment losses on investment securities	(1,658)	(5,987)	(5,910)
Net gain on partial extinguishment and recharacterization of a secured commercial loan to a local financial institutions			2,497
Rental income	1,346	2,246	2,538
Gain on sale of credit card portfolio			2,819
			15,075

Insurance reimbursements and other agreements related to a contingency settlement			
Other non-interest income	27,030	28,727	24,472
Total non-interest income	142,264	74,643	67,156
Non-interest expenses:			
Employees compensation and benefits	132,734	141,853	140,363
Occupancy and equipment	62,335	61,818	58,894
Business promotion	14,158	17,565	18,029
Professional fees	15,217	15,809	20,751
Taxes, other than income taxes	15,847	16,989	15,364
Insurance and supervisory fees	45,605	15,990	12,616
Net loss on real estate owned (REO) operations	21,863	21,373	2,400
Other non-interest expenses	44,342	41,974	39,426
Total non-interest expenses	352,101	333,371	307,843
(Loss) income before income taxes	(270,653)	78,205	89,719
Income tax (expense) benefit	(4,534)	31,732	(21,583)
Net (loss) income	$ (275,187)	$ 109,937	$ 68,136
Preferred stock dividends and accretion of discount	46,888	40,276	40,276
Net (loss) income attributable to common stockholders	$ (322,075)	$ 69,661	$ 27,860
Net (loss) income per common share:			
Basic	$ (3.48)	$ 0.75	$ 0.32
Diluted	$ (3.48)	$ 0.75	$ 0.32
Dividends declared per common share	$ 0.14	$ 0.28	$ 0.28

The accompanying notes are an integral part of these statements.

Table of Contents

FIRST BANCORP
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31,		
	2009	2008	2007
		(In thousands)	
Cash flows from operating activities:			
Net (loss) income	$ (275,187)	$ 109,937	$ 68,136
Adjustments to reconcile net (loss) income to net cash provided by operating activities:			
Depreciation	20,774	19,172	17,669
Amortization and impairment of core deposit intangible	7,386	3,603	3,294
Provision for loan and lease losses	579,858	190,948	120,610
Deferred income tax expense (benefit)	16,054	(38,853)	13,658
Stock-based compensation recognized	92	9	2,848
Gain on sale of investments, net	(86,804)	(27,180)	(3,184)
Other-than-temporary impairments on available-for-sale securities	1,658	5,987	5,910
Derivative instruments and hedging activities (gain) loss	(15,745)	(26,425)	6,134
Net gain on sale of loans and impairments	(7,352)	(2,617)	(2,246)
Net gain on partial extinguishment and recharacterization of a secured commercial loan to a local financial institution			(2,497)
Net amortization of premiums and discounts and deferred loan fees and costs	606	(1,083)	(663)
Net increase in mortgage loans held for sale	(21,208)	(6,194)	
Amortization of broker placement fees	22,858	15,665	9,563
Accretion of basis adjustments on fair value hedges			(2,061)
Net amortization (accretion) of premium and discounts on investment securities	5,221	(7,828)	(42,026)
Gain on sale of credit card portfolio			(2,819)
Decrease in accrued income tax payable	(19,408)	(13,348)	(3,419)
Decrease in accrued interest receivable	18,699	9,611	4,397
Decrease in accrued interest payable	(24,194)	(31,030)	(13,808)
Decrease (increase) in other assets	28,609	(14,959)	4,408
Decrease in other liabilities	(8,668)	(9,501)	(123,611)
Total adjustments	518,436	65,977	(7,843)
Net cash provided by operating activities	243,249	175,914	60,293
Cash flows from investing activities:			
Principal collected on loans	3,010,435	2,588,979	3,084,530
Loans originated	(4,429,644)	(3,796,234)	(3,813,644)
Purchase of loans	(190,431)	(419,068)	(270,499)
Proceeds from sale of loans	43,816	154,068	150,707
Proceeds from sale of repossessed assets	78,846	76,517	52,768
Purchase of servicing assets		(621)	(1,851)

Proceeds from sale of available-for-sale securities	1,946,434	679,955	959,212
Purchases of securities held to maturity	(8,460)	(8,540)	(511,274)
Purchases of securities available for sale	(2,781,394)	(3,468,093)	(576,100)
Proceeds from principal repayments and maturities of securities held to maturity	1,110,245	1,586,799	623,374
Proceeds from principal repayments of securities available for sale	880,384	332,419	214,218
Additions to premises and equipment	(40,271)	(32,830)	(24,642)
Proceeds from sale/redemption of other investment securities	4,032	9,474	
(Increase) decrease in other equity securities	(5,785)	875	(23,422)
Net cash inflow on acquisition of business		5,154	
Net cash used in investing activities	(381,793)	(2,291,146)	(136,623)
Cash flows from financing activities:			
Net (decrease) increase in deposits	(393,636)	1,924,312	59,499
Net increase in loans payable	900,000		
Net (decrease) increase in federal funds purchased and securities sold under agreements to repurchase	(344,411)	326,396	(593,078)
Net FHLB advances (paid) taken	(82,000)	(42,560)	543,000
Repayments of notes payable and other borrowings			(150,000)
Dividends paid	(43,066)	(66,181)	(64,881)
Issuance of common stock			91,924
Issuance of preferred stock and associated warrant	400,000		
Exercise of stock options		53	
Other financing activities	8		
Net cash provided by (used in) financing activities	436,895	2,142,020	(113,536)
Net increase (decrease) in cash and cash equivalents	298,351	26,788	(189,866)
Cash and cash equivalents at beginning of year	405,733	378,945	568,811
Cash and cash equivalents at end of year	$ 704,084	$ 405,733	$ 378,945
Cash and cash equivalents include:			
Cash and due from banks	$ 679,798	$ 329,730	$ 195,809
Money market instruments	24,286	76,003	183,136
	$ 704,084	$ 405,733	$ 378,945

The accompanying notes are an integral part of these statements.

Table of Contents

FIRST BANCORP
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY

	Year Ended December 31,		
	2009	2008	2007
		(In thousands)	
Preferred Stock:			
Balance at beginning of year	$ 550,100	$ 550,100	$ 550,100
Issuance of preferred stock Series F	400,000		
Preferred stock discount Series F, net of accretion	(21,592)		
Balance at end of period	928,508	550,100	550,100
Common Stock outstanding:			
Balance at beginning of year	92,546	92,504	83,254
Issuance of common stock			9,250
Common stock issued under stock option plan		6	
Restricted stock grants		36	
Restricted stock forfeited	(4)		
Balance at end of year	92,542	92,546	92,504
Additional Paid-In-Capital:			
Balance at beginning of year	108,299	108,279	22,757
Issuance of common stock			82,674
Issuance of common stock warrants	25,820		
Shares issued under stock option plan		47	
Stock-based compensation recognized	92	9	2,848
Restricted stock grants		(36)	
Restricted stock forfeited	4		
Other	8		
Balance at end of year	134,223	108,299	108,279
Legal Surplus:			
Balance at beginning of year	299,006	286,049	276,848
Transfer from retained earnings		12,957	9,201
Balance at end of year	299,006	299,006	286,049
Retained Earnings:			
Balance at beginning of year	440,777	409,978	326,761
Net (loss) income	(275,187)	109,937	68,136
Cash dividends declared on common stock	(12,966)	(25,905)	(24,605)

Cash dividends declared on preferred stock	(30,106)	(40,276)	(40,276)
Cumulative adjustment for accounting change adoption of accounting for uncertainty in income taxes			(2,615)
Cumulative adjustment for accounting change adoption of fair value option			91,778
Accretion of preferred stock discount Series F	(4,227)		
Transfer to legal surplus		(12,957)	(9,201)
Balance at end of year	118,291	440,777	409,978
Accumulated Other Comprehensive Income (Loss), net of tax:			
Balance at beginning of year	57,389	(25,264)	(30,167)
Other comprehensive (loss) income, net of tax	(30,896)	82,653	4,903
Balance at end of year	26,493	57,389	(25,264)
Total stockholders equity	$ 1,599,063	$ 1,548,117	$ 1,421,646

The accompanying notes are an integral part of these statements.

F-7

Table of Contents

FIRST BANCORP
CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME

	Year Ended December 31,		
	2009	2008	2007
		(In thousands)	
Net (loss) income	$ (275,187)	$ 109,937	$ 68,136
Unrealized losses on available-for-sale debt securities on which an other-than-temporary impairment has been recognized:			
Noncredit-related impairment portion on debt securities not expected to be sold	(31,742)		
Reclassification adjustment for other-than-temporary impairment on debt securities included in net income	1,270		
All other unrealized gains and losses on available-for-sale securities:			
All other unrealized holding gains arising during the period	85,871	95,316	2,171
Reclassification adjustments for net gain included in net income	(82,772)	(17,706)	(3,184)
Reclassification adjustments for other-than-temporary impairment on equity securities	388	5,987	5,910
Income tax (expense) benefit related to items of other comprehensive income	(3,911)	(944)	6
Other comprehensive (loss) income for the year, net of tax	(30,896)	82,653	4,903
Total comprehensive (loss) income	$ (306,083)	$ 192,590	$ 73,039

The accompanying notes are an integral part of these statements.

Table of Contents

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 Nature of Business and Summary of Significant Accounting Policies

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP). The following is a description of First BanCorp s (First BanCorp or the Corporation) most significant policies:

Nature of business

First BanCorp is a publicly-owned, Puerto Rico-chartered financial holding company that is subject to regulation, supervision and examination by the Board of Governors of the Federal Reserve System. The Corporation is a full service provider of financial services and products with operations in Puerto Rico, the United States and the U.S. and British Virgin Islands.

The Corporation provides a wide range of financial services for retail, commercial and institutional clients. As of December 31, 2009, the Corporation controlled three wholly-owned subsidiaries: FirstBank Puerto Rico (FirstBank or the Bank), FirstBank Insurance Agency, Inc.(FirstBank Insurance Agency) and Grupo Empresas de Servicios Financieros (d/b/a PR Finance Group). FirstBank is a Puerto Rico-chartered commercial bank, FirstBank Insurance Agency is a Puerto Rico-chartered insurance agency and PR Finance Group is a domestic corporation. FirstBank is subject to the supervision, examination and regulation of both the Office of the Commissioner of Financial Institutions of the Commonwealth of Puerto Rico (OCIF) and the Federal Deposit Insurance Corporation (the FDIC). Deposits are insured through the FDIC Deposit Insurance Fund. FirstBank also operates in the state of Florida, (USA), subject to regulation and examination by the Florida Office of Financial Regulation and the FDIC, in the U.S. Virgin Islands, subject to regulation and examination by the United States Virgin Islands Banking Board, and in the British Virgin Islands, subject to regulation by the British Virgin Islands Financial Services Commission.

FirstBank Insurance Agency is subject to the supervision, examination and regulation by the Office of the Insurance Commissioner of the Commonwealth of Puerto Rico. PR Finance Group is subject to the supervision, examination and regulation of the OCIF.

FirstBank conducted its business through its main office located in San Juan, Puerto Rico, forty-eight full service banking branches in Puerto Rico, sixteen branches in the United States Virgin Islands (USVI) and British Virgin Islands (BVI) and ten branches in the state of Florida (USA). FirstBank had six wholly-owned subsidiaries with operations in Puerto Rico: First Leasing and Rental Corporation, a vehicle leasing company with two offices in Puerto Rico; First Federal Finance Corp. (d/b/a Money Express La Financiera), a finance company specializing in the origination of small loans with twenty-seven offices in Puerto Rico; First Mortgage, Inc. (First Mortgage), a residential mortgage loan origination company with thirty-eight offices in FirstBank branches and at stand alone sites; First Management of Puerto Rico, a domestic corporation; FirstBank Puerto Rico Securities Corp, a broker-dealer subsidiary created in March 2009 and engaged in municipal bond underwriting and financial advisory services on structured financings principally provided to government entities in the Commonwealth of Puerto Rico; and FirstBank Overseas Corporation, an international banking entity organized under the International Banking Entity Act of Puerto Rico. FirstBank had three subsidiaries with operations outside of Puerto Rico: First Insurance Agency VI, Inc., an insurance agency with three offices that sells insurance products in the USVI; First Express, a finance company specializing in the origination of small loans with three offices in the USVI; and First Trade, Inc., which is inactive.

Table of Contents

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Principles of consolidation

The consolidated financial statements include the accounts of the Corporation and its subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

Statutory business trusts that are wholly-owned by the Corporation and are issuers of trust preferred securities are not consolidated in the Corporation s consolidated financial statements in accordance with authoritative guidance issued by the Financial Accounting Standards Board (FASB) for consolidation of variable interest entities.

Reclassifications

For purposes of comparability, certain prior period amounts have been reclassified to conform to the 2009 presentation.

Use of estimates in the preparation of financial statements

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and cash equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, federal funds sold and short-term investments with original maturities of three months or less.

Securities purchased under agreements to resell

The Corporation purchases securities under agreements to resell the same securities. The counterparty retains control over the securities acquired. Accordingly, amounts advanced under these agreements represent short-term loans and are reflected as assets in the statements of financial condition. The Corporation monitors the market value of the underlying securities as compared to the related receivable, including accrued interest, and requests additional collateral when deemed appropriate. As of December 31, 2009 and 2008, there were no securities purchased under agreements to resell outstanding.

Investment securities

The Corporation classifies its investments in debt and equity securities into one of four categories:

Held-to-maturity Securities which the entity has the intent and ability to hold to maturity. These securities are carried at amortized cost. The Corporation may not sell or transfer held-to-maturity securities without calling into question its intent to hold other debt securities to maturity, unless a nonrecurring or unusual event that could not have been reasonably anticipated has occurred.

Trading Securities that are bought and held principally for the purpose of selling them in the near term. These securities are carried at fair value, with unrealized gains and losses reported in earnings. As of December 31, 2009 and 2008, the Corporation did not hold investment securities for trading purposes.

Available-for-sale Securities not classified as held-to-maturity or trading. These securities are carried at fair value, with unrealized holding gains and losses, net of deferred tax, reported in other comprehensive income as a separate component of stockholders equity and do not affect earnings until realized or are deemed to be other-than-temporarily impaired.

Other equity securities Equity securities that do not have readily available fair values are classified as other equity securities in the consolidated statements of financial condition. These securities are stated at the lower of

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

cost or realizable value. This category is principally composed of stock that is owned by the Corporation to comply with Federal Home Loan Bank (FHLB) regulatory requirements. Their realizable value equals their cost.

Premiums and discounts on investment securities are amortized as an adjustment to interest income on investments over the life of the related securities under the interest method. Net realized gains and losses and valuation adjustments considered other-than-temporary, if any, related to investment securities are determined using the specific identification method and are reported in non-interest income as net impairment losses on investment securities. Purchases and sales of securities are recognized on a trade-date basis.

Evaluation of other-than-temporary impairment (OTTI) on held-to-maturity and available-for-sale securities

On a quarterly basis, the Corporation performs an assessment to determine whether there have been any events or circumstances indicating that a security with an unrealized loss has suffered OTTI. A security is considered impaired if the fair value is less than its amortized cost basis.

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

The impairment analysis of fixed income securities places special emphasis on the analysis of the cash position of the issuer and its cash and capital generation capacity, which could increase or diminish the issuer s ability to repay its bond obligations, the length of time and the extent to which the fair value has been less than the amortized cost basis and changes in the near-term prospects of the underlying collateral, if applicable, such as changes in default rates, loss severity given default and significant changes in prepayment assumptions. In light of current volatile economic and financial market conditions, the Corporation also takes into consideration the latest information available about the overall financial condition of an issuer, credit ratings, recent legislation and government actions affecting the issuer s industry and actions taken by the issuer to deal with the present economic climate. In April 2009, the FASB amended the OTTI model for debt securities. OTTI losses are recognized in earnings if the Corporation has the intent to sell the debt security or it is more likely than not that it will be required to sell the debt security before recovery of its amortized cost basis. However, even if the Corporation does not expect to sell a debt security, expected cash flows to be received are evaluated to determine if a credit loss has occurred. An unrealized loss is generally deemed to be other-than-temporary and a credit loss is deemed to exist if the present value of the expected future cash flows is less than the amortized cost basis of the debt security. The credit loss component of an OTTI is recorded as a component of Net impairment losses on investment securities in the statements of (loss) income, while the remaining portion of the impairment loss is recognized in other comprehensive income, net of taxes. The previous amortized cost basis less the OTTI recognized in earnings is the new amortized cost basis of the investment. The new amortized cost basis is not adjusted for subsequent recoveries in fair value. However, for debt securities for which OTTI was recognized in earnings, the difference between the new amortized cost basis and the cash flows expected to be collected is accreted as interest income. For further disclosures, refer to Note 4 to the consolidated financial statements.

Prior to April 1, 2009, an unrealized loss was considered other-than-temporary and recorded in earnings if (i) it was probable that the holder would not collect all amounts due according to contractual terms of the debt security, or (ii) the fair value was below the amortized cost of the security for a prolonged period of time and the Corporation did not have the positive intent and ability to hold the security until recovery or maturity.

The impairment model for equity securities was not affected by the aforementioned FASB amendment. The impairment analysis of equity securities is performed and reviewed on an ongoing basis based on the latest financial information and any supporting research report made by a major brokerage firm. This analysis is very subjective and based, among other things, on relevant financial data such as capitalization, cash flow, liquidity, systematic risk, and debt outstanding of the issuer. Management also considers the issuer s industry trends, the historical performance of the stock, credit ratings as well as the Corporation s intent to hold the security for an extended period. If management believes there is a low probability of recovering book value in a reasonable time frame, then an impairment will be recorded by writing the security down to market value. As previously mentioned, equity securities are monitored on an ongoing basis but special attention is given to those securities that have experienced a decline in fair value for six

months or more. An impairment charge is generally recognized when the fair value of an equity security has remained significantly below cost for a period of twelve consecutive months or more.

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Loans

Loans are stated at the principal outstanding balance, net of unearned interest, unamortized deferred origination fees and costs and unamortized premiums and discounts. Fees collected and costs incurred in the origination of new loans are deferred and amortized using the interest method or a method which approximates the interest method over the term of the loan as an adjustment to interest yield. Unearned interest on certain personal, auto loans and finance leases is recognized as income under a method which approximates the interest method. When a loan is paid off or sold, any unamortized net deferred fee (cost) is credited (charged) to income.

Loans on which the recognition of interest income has been discontinued are designated as non-accruing. When loans are placed on non-accruing status, any accrued but uncollected interest income is reversed and charged against interest income. Consumer, construction, commercial and mortgage loans are classified as non-accruing when interest and principal have not been received for a period of 90 days or more or when there are doubts about the potential to collect all of the principal based on collateral deficiencies or, in other situations, when collection of all of the principal or interest is not expected due to deterioration in the financial condition of the borrower. Interest income on non-accruing loans is recognized only to the extent it is received in cash. However, where there is doubt regarding the ultimate collectability of loan principal, all cash thereafter received is applied to reduce the carrying value of such loans (i.e., the cost recovery method). Loans are restored to accrual status only when future payments of interest and principal are reasonably assured.

Loan and lease losses are charged and recoveries are credited to the allowance for loan and lease losses. Closed-end personal consumer loans are charged-off when payments are 120 days in arrears. Collateralized auto and finance leases are reserved at 120 days delinquent and charged-off to their estimated net realizable value when collateral deficiency is deemed uncollectible (i.e. when foreclosure is probable). Open-end (revolving credit) consumer loans are charged-off when payments are 180 days in arrears.

A loan is considered impaired when, based upon current information and events, it is probable that the Corporation will be unable to collect all amounts due (including principal and interest) according to the contractual terms of the loan agreement. The Corporation measures impairment individually for those commercial and construction loans with a principal balance of $1 million or more, including loans for which a charge-off has been recorded based upon the fair value of the underlying collateral, and also evaluates for impairment purposes certain residential mortgage loans with high delinquency and loan-to-value levels. Interest income on impaired loans is recognized based on the Corporation s policy for recognizing interest on accrual and non-accrual loans. Impaired loans also include loans that have been modified in troubled debt restructurings as a concession to borrowers experiencing financial difficulties. Troubled debt restructurings typically result from the Corporation s loss mitigation activities or programs sponsored by the Federal Government and could include rate reductions, principal forgiveness, forbearance and other actions intended to minimize the economic loss and to avoid foreclosure or repossession of collateral. Troubled debt restructurings are generally reported as non-performing loans and restored to accrual status when there is a reasonable assurance of repayment and the borrower has made payments over a sustained period, generally six months. However, a loan that has been formally restructured as to be reasonably assured of repayment and of performance according to its modified terms is not placed in non-accruing status, provided the restructuring is supported by a current, well documented credit evaluation of the borrower s financial condition taking into consideration sustained historical payment performance for a reasonable time prior to the restructuring.

Loans held for sale

Loans held for sale are stated at the lower-of-cost-or-market. The amount by which cost exceeds market value in the aggregate portfolio of loans held for sale, if any, is accounted for as a valuation allowance with changes therein included in the determination of net income.

Allowance for loan and lease losses

The Corporation maintains the allowance for loan and lease losses at a level considered adequate to absorb losses currently inherent in the loan and lease portfolio. The allowance for loan and lease losses provides for probable losses that have been identified with specific valuation allowances for individually evaluated impaired loans and for probable

losses believed to be inherent in the loan portfolio that have not been specifically identified. Internal risk ratings are assigned to each business loan at the time of approval and are subject to subsequent periodic reviews by

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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.

A specific valuation allowance is established for those commercial and real estate loans classified as impaired, primarily when the collateral value of the loan (if the impaired loan is determined to be collateral dependent) or the present value of the expected future cash flows discounted at the loan s effective rate is lower than the carrying amount of that loan. To compute the specific valuation allowance, commercial and real estate, including residential mortgage loans with a principal balance of $1 million or more are evaluated individually as well as smaller residential mortgage loans considered impaired based on their high delinquency and loan-to-value levels. When foreclosure is probable, the impairment is measured based on the fair value of the collateral. The fair value of the collateral is generally obtained from appraisals. Updated appraisals are obtained when the Corporation determines that loans are impaired and are updated annually thereafter. In addition, appraisals are also obtained for certain residential mortgage loans on a spot basis based on specific characteristics such as delinquency levels, age of the appraisal, and loan-to-value ratios. Deficiencies from the excess of the recorded investment in collateral dependent loans over the resulting fair value of the collateral are charged-off when deemed uncollectible.

For all other loans, which include, small, homogeneous loans, such as auto loans, consumer loans, finance lease loans, residential mortgages, and commercial and construction loans not considered impaired or in amounts under $1 million, the Corporation maintains a general valuation allowance. The methodology to compute the general valuation allowance has not change in the past 2 years. The Corporation updates the factors used to compute the reserve factors on a quarterly basis. The general reserve is primarily determined by applying loss factors according to the loan type and assigned risk category (pass, special mention and substandard not impaired; all doubtful loans are considered impaired). The general reserve for consumer loans is based on factors such as delinquency trends, credit bureau score bands, portfolio type, geographical location, bankruptcy trends, recent market transactions, and other environmental factors such as economic forecasts. The analysis of the residential mortgage pools are performed at the individual loan level and then aggregated to determine the expected loss ratio. The model applies risk-adjusted prepayment curves, default curves, and severity curves to each loan in the pool. The severity is affected by the expected house price scenario based on recent house price trends. Default curves are used in the model to determine expected delinquency levels. The risk-adjusted timing of liquidation and associated costs are used in the model and are risk-adjusted for the area in which the property is located (Puerto Rico, Florida, or Virgin Islands). For commercial loans, including construction loans, the general reserve is based on historical loss ratios, trends in non-accrual loans, loan type, risk-rating, geographical location, changes in collateral values for collateral dependent loans and gross product or unemployment data for the geographical region. The methodology of accounting for all probable losses in loans not individually measured for impairment purposes is made in accordance with authoritative accounting guidance that requires losses be accrued when they are probable of occurring and estimable.

Transfers and servicing of financial assets and extinguishment of liabilities

After a transfer of financial assets that qualifies for sale accounting, the Corporation derecognizes financial assets when control has been surrendered, and derecognizes liabilities when extinguished.

The transfer of financial assets in which the Corporation surrenders control over the assets is accounted for as a sale to the extent that consideration other than beneficial interests is received in exchange. The criteria that must be met to determine that the control over transferred assets has been surrendered, includes: (1) the assets must be isolated from creditors of the transferor, (2) the transferee must obtain the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the transferor cannot maintain effective control over the transferred assets through an agreement to repurchase them before their maturity. When the Corporation transfers financial assets and the transfer fails any one of the above criteria, the Corporation is prevented from derecognizing the transferred financial assets and the transaction is accounted for as a secured borrowing.

Servicing Assets

The Corporation recognizes as separate assets the rights to service loans for others, whether those servicing assets are originated or purchased. The Corporation is actively involved in the securitization of pools of FHA-insured and

VA-guaranteed mortgages for issuance of GNMA mortgage-backed securities. Also, certain conventional conforming-loans are sold to FNMA or FHLMC with servicing retained. When the Corporation securitizes or sells

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

mortgage loans, it allocates the cost of the mortgage loans between the mortgage loan pool sold and the retained interests, based on their relative fair values.

Servicing assets (MSRs) retained in a sale or securitization arise from contractual agreements between the Corporation and investors in mortgage securities and mortgage loans. The value of MSRs is derived from the net positive cash flows associated with the servicing contracts. Under these contracts, the Corporation performs loan servicing functions in exchange for fees and other remuneration. The servicing functions typically include: collecting and remitting loan payments, responding to borrower inquiries, accounting for principal and interest, holding custodial funds for payment of property taxes and insurance premiums, supervising foreclosures and property dispositions, and generally administering the loans. The servicing rights entitle the Corporation to annual servicing fees based on the outstanding principal balance of the mortgage loans and the contractual servicing rate. The servicing fees are credited to income on a monthly basis when collected and recorded as part of mortgage banking activities in the consolidated statements of (loss) income. In addition, the Corporation generally receives other remuneration consisting of mortgagor-contracted fees such as late charges and prepayment penalties, which are credited to income when collected.

Considerable judgment is required to determine the fair value of the Corporation s servicing assets. Unlike highly liquid investments, the market value of servicing assets cannot be readily determined because these assets are not actively traded in securities markets. The initial carrying value of the servicing assets is generally determined based on an allocation of the carrying amount of the loans sold (adjusted for deferred fees and costs related to loan origination activities) and the retained interest (MSRs) based on their relative fair value. The fair value of the MSRs is determined based on a combination of market information on trading activity (MSR trades and broker valuations), benchmarking of servicing assets (valuation surveys) and cash flow modeling. The valuation of the Corporation s MSRs incorporates two sets of assumptions: (1) market derived assumptions for discount rates, servicing costs, escrow earnings rate, float earnings rate and cost of funds and (2) market assumptions calibrated to the Company s loan characteristics and portfolio behavior for escrow balances, delinquencies and foreclosures, late fees, prepayments and prepayment penalties.

Once recorded, MSRs are periodically evaluated for impairment. Impairment occurs when the current fair value of the MSRs is less than its carrying value. If MSRs are impaired, the impairment is recognized in current-period earnings and the carrying value of the MSRs is adjusted through a valuation allowance. If the value of the MSRs subsequently increases, the recovery in value is recognized in current period earnings and the carrying value of the MSRs is adjusted through a reduction in the valuation allowance. For purposes of performing the MSR impairment evaluation, the servicing portfolio is stratified on the basis of certain risk characteristics such as region, terms and coupons. An other-than-temporary impairment analysis is prepared to evaluate whether a loss in the value of the MSRs, if any, is other than temporary or not. When the recovery of the value is unlikely in the foreseeable future, a write-down of the MSRs in the stratum to its estimated recoverable value is charged to the valuation allowance.

The servicing assets are amortized over the estimated life of the underlying loans based on an income forecast method as a reduction of servicing income. The income forecast method of amortization is based on projected cash flows. A particular periodic amortization is calculated by applying to the carrying amount of the MSRs the ratio of the cash flows projected for the current period to total remaining net MSR forecasted cash flow.

Premises and equipment

Premises and equipment are carried at cost, net of accumulated depreciation. Depreciation is provided on the straight-line method over the estimated useful life of each type of asset. Amortization of leasehold improvements is computed over the terms of the leases (contractual term plus lease renewals that are reasonably assured) or the estimated useful lives of the improvements, whichever is shorter. Costs of maintenance and repairs that do not improve or extend the life of the respective assets are expensed as incurred. Costs of renewals and betterments are capitalized. When assets are sold or disposed of, their cost and related accumulated depreciation are removed from the accounts and any gain or loss is reflected in earnings.

The Corporation has operating lease agreements primarily associated with the rental of premises to support the branch network or for general office space. Certain of these arrangements are non-cancelable and provide for rent

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

escalation and renewal options. Rent expense on non-cancelable operating leases with scheduled rent increases is recognized on a straight-line basis over the lease term.

Other real estate owned (OREO)

Other real estate owned, which consists of real estate acquired in settlement of loans, is recorded at the lower of cost (carrying value of the loan) or fair value minus estimated cost to sell the real estate acquired. Subsequent to foreclosure, gains or losses resulting from the sale of these properties and losses recognized on the periodic reevaluations of these properties are credited or charged to income. The cost of maintaining and operating these properties is expensed as incurred.

Goodwill and other intangible assets

Business combinations are accounted for using the purchase method of accounting. Assets acquired and liabilities assumed are recorded at estimated fair value as of the date of acquisition. After initial recognition, any resulting intangible assets are accounted for as follows:

Goodwill

The Corporation evaluates goodwill for impairment on an annual basis, or more often if events or circumstances indicate there may be an impairment. Goodwill impairment testing is performed at the segment (or reporting unit) level. Goodwill is assigned to reporting units at the date the goodwill is initially recorded. Once goodwill has been assigned to reporting units, it no longer retains its association with a particular acquisition, and all of the activities within a reporting unit, whether acquired or internally generated, are available to support the value of the goodwill. The Corporation s goodwill is mainly related to the acquisition of FirstBank Florida in 2005. Effective July 1, 2009, the operations conducted by FirstBank Florida as a separate entity were merged with and into FirstBank Puerto Rico.

The goodwill impairment analysis is a two-step process. The first step (Step 1) involves a comparison of the estimated fair value of the reporting unit (FirstBank Florida) to its carrying value, including goodwill. If the estimated fair value of a reporting unit exceeds its carrying value, goodwill is not considered impaired. If the carrying value exceeds estimated fair value, there is an indication of potential impairment and the second step is performed to measure the amount of the impairment.

The second step (Step 2) involves calculating an implied fair value of the goodwill for each reporting unit for which the first step indicated a potential impairment. The implied fair value of goodwill is determined in a manner similar to the calculation of the amount of goodwill in a business combination, by measuring the excess of the estimated fair value of the reporting unit, as determined in the first step, over the aggregate estimated fair values of the individual assets, liabilities and identifiable intangibles as if the reporting unit was being acquired in a business combination. If the implied fair value of goodwill exceeds the carrying value of goodwill assigned to the reporting unit, there is no impairment. If the carrying value of goodwill assigned to a reporting unit exceeds the implied fair value of the goodwill, an impairment charge is recorded for the excess. An impairment loss cannot exceed the carrying value of goodwill assigned to a reporting unit, and the loss establishes a new basis in the goodwill. Subsequent reversal of goodwill impairment losses is not permitted.

In determining the fair value of a reporting unit and based on the nature of the business and reporting unit s current and expected financial performance, the Corporation uses a combination of methods, including market price multiples of comparable companies, as well as discounted cash flow analysis (DCF). The Corporation evaluates the results obtained under each valuation methodology to identify and understand the key value drivers in order to ascertain that the results obtained are reasonable and appropriate under the circumstances.

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The computations require management to make estimates and assumptions. Critical assumptions that are used as part of these evaluations include:

- a selection of comparable publicly traded companies, based on nature of business, location and size;
- the discount rate applied to future earnings, based on an estimate of the cost of equity;
- the potential future earnings of the reporting unit; and
- the market growth and new business assumptions.

For purposes of the market comparable approach, valuation was determined by calculating median price to book value and price to tangible equity multiples of the comparable companies and applied these multiples to the reporting unit to derive an implied value of equity.

For purposes of the DCF analysis approach, the valuation is based on estimated future cash flows. The financial projections used in the DCF analysis for the reporting unit are based on the most recent (as of the valuation date). The growth assumptions included in these projections are based on management s expectations of the reporting unit s financial prospects as well as particular plans for the entity (i.e. restructuring plans). The cost of equity was estimated using the capital asset pricing model (CAPM) using comparable companies, an equity risk premium, the rate of return of a riskless asset, and a size premium. The discount rate was estimated to be 14.0 percent. The resulting discount rate was analyzed in terms of reasonability given current market conditions.

The Corporation conducted its annual evaluation of goodwill during the fourth quarter of 2009. The Step 1 evaluation of goodwill allocated to the Florida reporting unit, which is one level below the United States business segment, indicated potential impairment of goodwill. The Step 1 fair value for the unit under both valuation approaches (market and DCF) was below the carrying amount of its equity book value as of the valuation date (December 31), requiring the completion of Step 2. In accordance with accounting standards, the Corporation performed a valuation of all assets and liabilities of the Florida unit, including any recognized and unrecognized intangible assets, to determine the fair value of net assets. To complete Step 2, the Corporation subtracted from the unit s Step 1 fair value the determined fair value of the net assets to arrive at the implied fair value of goodwill. The results of the Step 2 analysis indicated that the implied fair value of goodwill exceeded the goodwill carrying value of $27 million, resulting in no goodwill impairment. The analysis of results for Step 2 indicated that the reduction in the fair value of the reporting unit was mainly attributable to the deteriorated fair value of the loan portfolios and not the fair value of the reporting unit as going concern. The discount in the loan portfolios is mainly attributable to market participants expected rates of returns, which affected the market discount on the Florida commercial mortgage and residential mortgage portfolios. The fair value of the loan portfolio determined for the Florida reporting unit represented a discount of 22.5%.

The reduction in the Florida unit Step 1 fair value was offset by a reduction in the fair value of its net assets, resulting in an implied fair value of goodwill that exceeded the recorded book value of goodwill. If the Step 1 fair value of the Florida unit declines further without a corresponding decrease in the fair value of its net assets or if loan discounts improve without a corresponding increase in the Step 1 fair value, the Corporation may be required to record a goodwill impairment charge. The Corporation engaged a third-party valuator to assist management in the annual evaluation of the Florida unit goodwill (including Step 1 and Step 2), including the valuation of loan portfolios as of the December 31 valuation date. In reaching its conclusion on impairment, management discussed with the valuator the methodologies, assumptions and results supporting the relevant values for the goodwill and determined that they were reasonable.

The goodwill impairment evaluation process requires the Corporation to make estimates and assumptions with regards to the fair value of the reporting units. Actual values may differ significantly from these estimates. Such differences could result in future impairment of goodwill that would, in turn, negatively impact the Corporation s results of operations and the reporting unit where goodwill is recorded.

Goodwill was not impaired as of December 31, 2009 or 2008, nor was any goodwill written-off due to impairment during 2009, 2008 and 2007.

Table of Contents

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Other Intangibles

Definite life intangibles, mainly core deposits, are amortized over their estimated life, generally on a straight-line basis, and are reviewed periodically for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable.

As a result of an impairment evaluation of core deposit intangibles, there was an impairment charge of $4.0 million recorded in 2009 related to core deposits of FirstBank Florida attributable to decreases in the base of acquired core deposits. The Corporation performed impairment tests for the year ended December 31, 2008 and 2007 and determined that no impairment was needed to be recognized for those periods for other intangible assets. For further disclosures, refer to Note 11 to the consolidated financial statements.

Securities sold under agreements to repurchase

The Corporation sells securities under agreements to repurchase the same or similar securities. Generally, similar securities are securities from the same issuer, with identical form and type, similar maturity, identical contractual interest rates, similar assets as collateral and the same aggregate unpaid principal amount. The Corporation retains control over the securities sold under these agreements. Accordingly, these agreements are considered financing transactions and the securities underlying the agreements remain in the asset accounts. The counterparty to certain agreements may have the right to repledge the collateral by contract or custom. Such assets are presented separately in the statements of financial condition as securities pledged to creditors that can be repledged.

Income taxes

The Corporation uses the asset and liability method for the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in the Corporation s financial statements or tax returns. Deferred income tax assets and liabilities are determined for differences between financial statement and tax bases of assets and liabilities that will result in taxable or deductible amounts in the future. The computation is based on enacted tax laws and rates applicable to periods in which the temporary differences are expected to be recovered or settled. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount that is more likely than not to be realized. In making such assessment, significant weight is given to evidence that can be objectively verified, including both positive and negative evidence. The accounting for income taxes authoritative guidance requires the consideration of all sources of taxable income available to realize the deferred tax asset, including the future reversal of existing temporary differences, future taxable income exclusive of reversing temporary differences and carryforwards, taxable income in carryback years and tax planning strategies. In estimating taxes, management assesses the relative merits and risks of the appropriate tax treatment of transactions taking into account statutory, judicial and regulatory guidance, and recognizes tax benefits only when deemed probable. Refer to Note 27 to the consolidated financial statements for additional information.

Effective January 1, 2007, the Corporation adopted authoritative guidance issued by the FASB that prescribes a comprehensive model for the financial statement recognition, measurement, presentation and disclosure of income tax uncertainties with respect to positions taken or expected to be taken on income tax returns. Under the authoritative accounting guidance, income tax benefits are recognized and measured upon a two-step model: 1) a tax position must be more likely than not to be sustained based solely on its technical merits in order to be recognized, and 2) the benefit is measured as the largest dollar amount of that position that is more likely than not to be sustained upon settlement. The difference between the benefit recognized in accordance with this model and the tax benefit claimed on a tax return is referred to as an Unrecognized Tax Benefit (UTB). The Corporation classifies interest and penalties, if any, related to UTBs as components of income tax expense. Refer to Note 27 for required disclosures and further information.

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Treasury stock

The Corporation accounts for treasury stock at par value. Under this method, the treasury stock account is increased by the par value of each share of common stock reacquired. Any excess paid per share over the par value is debited to additional paid-in capital for the amount per share that was originally credited. Any remaining excess is charged to retained earnings.

Stock-based compensation

Between 1997 and 2007, the Corporation had a stock option plan (the 1997 stock option plan) covering eligible employees. The Corporation accounted for stock options using the modified prospective method. Under the modified prospective method, compensation cost is recognized in the financial statements for all share-based payments granted after January 1, 2006. The 1997 stock option plan expired in the first quarter of 2007; all outstanding awards grants under this plan continue to be in full force and effect, subject to their original terms. No awards for shares could be granted under the 1997 stock option plan as of its expiration.

On April 29, 2008, the Corporation s stockholders approved the First BanCorp 2008 Omnibus Incentive Plan (the Omnibus Plan). The Omnibus Plan provides for equity-based compensation incentives (the awards) through the grant of stock options, stock appreciation rights, restricted stock, restricted stock units, performance shares, and other stock-based awards. On December 1, 2008, the Corporation granted 36, 243 shares of restricted stock under the Omnibus Plan to the Corporation s independent directors. Shares of restricted stock are measured based on the fair market values of the underlying stock at the grant dates. The restrictions on such restricted stock award will lapse ratably on an annual basis over a three-year period.

Stock-based compensation accounting guidance requires the Corporation to develop an estimate of the number of share-based awards that will be forfeited due to employee or director turnover. Changes in the estimated forfeiture rate may have a significant effect on share-based compensation, as the effect of adjusting the rate for all expense amortization is recognized in the period in which the forfeiture estimate is changed. If the actual forfeiture rate is higher than the estimated forfeiture rate, then an adjustment is made to increase the estimated forfeiture rate, which will result in a decrease to the expense recognized in the financial statements. If the actual forfeiture rate is lower than the estimated forfeiture rate, then an adjustment is made to decrease the estimated forfeiture rate, which will result in an increase to the expense recognized in the financial statements. When unvested options or shares of restricted stock are forfeited, any compensation expense previously recognized on the forfeited awards is reversed in the period of the forfeiture. For additional information regarding the Corporation s equity-based compensation refer to Note 22.

Comprehensive income

Comprehensive income for First BanCorp includes net income and the unrealized gain (loss) on available-for-sale securities, net of estimated tax effect.

Segment Information

The Corporation reports financial and descriptive information about its reportable segments (see Note 33). Operating segments are components of an enterprise about which separate financial information is available that is evaluated regularly by management in deciding how to allocate resources and in assessing performance. The Corporation s management determined that the segregation that best fulfills the segment definition described above is by 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. Starting in the fourth quarter of 2009, the Corporation has realigned its reporting segments to better reflect how it views and manages its business. Two additional operating segments were created to evaluate the operations conducted by the Corporation, outside of Puerto Rico. Operations conducted in the United States and in the Virgin Islands are now individually evaluated as separate operating segments. This realignment in the segment reporting essentially reflects the effect of restructuring initiatives, including the merger of FirstBank Florida operations with and into FirstBank, and will allow the Corporation to better present the results from its growth focus. Prior to 2009, the operating segments were driven primarily by the Corporation s legal entities. FirstBank operations conducted in the Virgin Islands and through its loan production office in Miami, Florida were reflected in the Corporation s then four reportable segments (Commercial and Corporate Banking; Mortgage Banking;

F-18

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Consumer (Retail) Banking; Treasury and Investments) while the operations conducted by FirstBank Florida were reported as part of a category named Other . Refer to Note 33 for additional information.

Derivative financial instruments

As part of the Corporation s overall interest rate risk management, the Corporation utilizes derivative instruments, including interest rate swaps, interest rate caps and options to manage interest rate risk. All derivative instruments are measured and recognized on the Consolidated Statements of Financial Condition at their fair value. On the date the derivative instrument contract is entered into, the Corporation may designate the derivative as (1) a hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment (fair value hedge), (2) a hedge of a forecasted transaction or of the variability of cash flows to be received or paid related to a recognized asset or liability (cash flow hedge) or (3) as a standalone derivative instrument, including economic hedges that the Corporation has not formally documented as a fair value or cash flow hedge. Changes in the fair value of a derivative instrument that is highly effective and that is designated and qualifies as a fair-value hedge, along with changes in the fair value of the hedged asset or liability that is attributable to the hedged risk (including gains or losses on firm commitments), are recorded in current-period earnings as interest income or interest expense depending upon whether an asset or liability is being hedged. Similarly, the changes in the fair value of standalone derivative instruments or derivatives not qualifying or designated for hedge accounting are reported in current-period earnings as interest income or interest expense depending upon whether an asset or liability is being economically hedged. Changes in the fair value of a derivative instrument that is highly effective and that is designated and qualifies as a cash-flow hedge, if any, are recorded in other comprehensive income in the stockholders equity section of the Consolidated Statements of Financial Condition until earnings are affected by the variability of cash flows (e.g., when periodic settlements on a variable-rate asset or liability are recorded in earnings). As of December 31, 2009 and 2008, all derivatives held by the Corporation were considered economic undesignated hedges recorded at fair value with the resulting gain or loss recognized in current period earnings.

Prior to entering into an accounting hedge transaction or designating a hedge, the Corporation formally documents the relationship between the hedging instrument and the hedged item, as well as the risk management objective and strategy for undertaking the hedge transaction. This process includes linking all derivative instruments that are designated as fair value or cash flow hedges, if any, to specific assets and liabilities on the statements of financial condition or to specific firm commitments or forecasted transactions along with a formal assessment at both inception of the hedge and on an ongoing basis as to the effectiveness of the derivative instrument in offsetting changes in fair values or cash flows of the hedged item. The Corporation discontinues hedge accounting prospectively when it determines that the derivative is not effective or will no longer be effective in offsetting changes in the fair value or cash flows of the hedged item, the derivative expires, is sold, or terminated, or management determines that designation of the derivative as a hedging instrument is no longer appropriate. When a fair value hedge is discontinued, the hedged asset or liability is no longer adjusted for changes in fair value and the existing basis adjustment is amortized or accreted over the remaining life of the asset or liability as a yield adjustment.

The Corporation occasionally purchases or originates financial instruments that contain embedded derivatives. At inception of the financial instrument, the Corporation assesses: (1) if the economic characteristics of the embedded derivative are clearly and closely related to the economic characteristics of the financial instrument (host contract), (2) if the financial instrument that embodies both the embedded derivative and the host contract is measured at fair value with changes in fair value reported in earnings, or (3) if a separate instrument with the same terms as the embedded instrument would not meet the definition of a derivative. If the embedded derivative does not meet any of these conditions, it is separated from the host contract and carried at fair value with changes recorded in current period earnings as part of net interest income. Information regarding derivative instruments is included in Note 32 to the Corporation s consolidated financial statements.

Effective January 1, 2007, the Corporation elected to early adopt authoritative guidance issued by the FASB that allows entities to choose to measure certain financial assets and liabilities at fair value with any changes in fair value reflected in earnings. The Corporation adopted the fair value option for callable fixed-rate medium-term notes and

callable brokered certificates of deposit that were hedged with interest rate swaps. One of the main considerations in the determination to adopt the fair value option for these instruments was to eliminate the operational procedures required by the long-haul method of accounting in terms of documentation, effectiveness assessment, and manual

Table of Contents

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

procedures followed by the Corporation to fulfill the requirements specified by authoritative guidance issued by the FASB for derivative instruments designated as fair value hedges.

With the Corporation s elimination of the use of the long-haul method in connection with the adoption of the fair value option, the Corporation no longer amortizes or accretes the basis adjustment for the financial liabilities elected to be measured at fair value. The basis adjustment amortization or accretion is the reversal of the basis differential between the market value and book value recognized at the inception of fair value hedge accounting as well as the change in value of the hedged brokered CDs and medium-term notes recognized since the implementation of the long-haul method. Since the time the Corporation implemented the long-haul method, it had recognized changes in the value of the hedged brokered CDs and medium-term notes based on the expected call date of the instruments. The adoption of the fair value option also required the recognition, as part of the initial adoption adjustment to retained earnings, of all of the unamortized placement fees that were paid to broker counterparties upon the issuance of the elected brokered CDs and medium-term notes. The Corporation previously amortized those fees through earnings based on the expected call date of the instruments. The option of using fair value accounting also requires that the accrued interest be reported as part of the fair value of the financial instruments elected to be measured at fair value. Refer to Note 29 to the consolidated financial statements for additional information.

Valuation of financial instruments

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

Effective January 1, 2007, the Corporation adopted authoritative guidance issued by the FASB for fair value measurements which 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 that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Three levels of inputs may be used to measure fair value:

Level 1 Inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2 Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; 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 3 Valuations are observed from unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

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

Callable Brokered CDs (Level 2 inputs)

The fair value of callable brokered CDs, which are included within deposits and elected to be measured at fair value, is determined using discounted cash flow analyses over the full term of the CDs. The valuation uses a Hull-White Interest Rate Tree approach for the CDs with callable option components, an industry-standard approach for valuing instruments with interest rate call options. The model assumes that the embedded options are exercised economically. The fair value of the CDs is computed using the outstanding principal amount. The discount rates used are based on US dollar LIBOR and swap rates. At-the-money implied swaption volatility term structure (volatility by time to maturity) is used to calibrate the model to current market prices and value the cancellation option in the deposits. The fair value does not incorporate the risk of nonperformance, since the callable brokered CDs are participated out by brokers in shares of less than $100,000 and insured by the FDIC. As of December 31,

F-20

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2009, there were no callable brokered CDs outstanding measured at fair value since they were all called during 2009.

Medium-Term Notes (Level 2 inputs)

The fair value of medium-term notes is determined using a discounted cash flow analysis over the full term of the borrowings. This valuation also uses the Hull-White Interest Rate Tree approach to value the option components of the term notes. The model assumes that the embedded options are exercised economically. The fair value of medium-term notes is computed using the notional amount outstanding. The discount rates used in the valuations are based on US dollar LIBOR and swap rates. At-the-money implied swaption volatility term structure (volatility by time to maturity) is used to calibrate the model to current market prices and value the cancellation option in the term notes. For the medium-term notes, the credit risk is measured using the difference in yield curves between swap rates and a yield curve that considers the industry and credit rating of the Corporation as issuer of the note at a tenor comparable to the time to maturity of the note and option.

Investment Securities

The fair value of investment securities is the market value based on quoted market prices, when available, or market prices for identical or comparable assets 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. Observable prices in the market already consider the risk of nonperformance. If listed prices or quotes are not available, fair value is based upon models that use unobservable inputs due to the limited market activity of the instrument (Level 3), as is the case with certain private label mortgage-backed securities held by the Corporation. Unlike U.S. agency mortgage-backed securities, the fair value of these private label securities cannot be readily determined because they are not actively traded in securities markets. Significant inputs used for fair value determination consist of specific characteristics such as information used in the prepayment model, which follows the amortizing schedule of the underlying loans, which is an unobservable input.

Private label mortgage-backed securities are collateralized by fixed-rate mortgages on single-family residential properties in the United States and the interest rate is variable, tied to 3-month LIBOR and limited to the weighted-average coupon of the underlying collateral. The market valuation is derived from a model and represents the estimated net cash flows over the projected life of the pool of underlying assets applying a discount rate that reflects market observed floating spreads over LIBOR, with a widening spread bias on a non-rated security and utilizes relevant assumptions such as prepayment rate, default rate, and loss severity on a loan level basis. The Corporation modeled the cash flow from the fixed-rate mortgage collateral using a static cash flow analysis according to collateral attributes of the underlying mortgage pool (i.e. loan term, current balance, note rate, rate adjustment type, rate adjustment frequency, rate caps, others) in combination with prepayment forecasts obtained from a commercially available prepayment model (ADCO). The variable cash flow of the security is modeled using the 3-month LIBOR forward curve. Loss assumptions were driven by the combination of default and loss severity estimates, taking into account loan credit characteristics (loan-to-value, state, origination date, property type, occupancy loan purpose, documentation type, debt-to-income ratio, other) to provide an estimate of default and loss severity. Refer to Note 4 for additional information.

Derivative Instruments

The fair value of most of the derivative instruments is based on observable market parameters and takes into consideration the credit risk component of paying counterparts when appropriate, except when collateral is pledged. That is, on interest rate swaps, the credit risk of both counterparts is included in the valuation; and on options and caps, only the seller s credit risk is considered. The Hull-White Interest Rate Tree approach is used to value the option components of derivative instruments, and discounting of the cash flows is performed using US dollar LIBOR-based discount rates or yield curves that account for the industry sector and the credit rating of the counterparty and/or the Corporation. Derivatives include interest rate swaps used for protection against rising interest rates and, prior to June 30, 2009, included interest rate swaps to economically hedge brokered CDs and medium-term notes. For these interest rate swaps, a credit component is not considered in the valuation since the Corporation fully collateralizes with investment securities any mark-to-market loss with the counterparty and, if there are market gains, the

counterparty must deliver collateral to the Corporation.

Table of Contents

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Certain derivatives with limited market activity, as is the case with derivative instruments named as reference caps, are valued using models that consider unobservable market parameters (Level 3). Reference caps are used mainly to hedge interest rate risk inherent in private label mortgage-backed securities, thus are tied to the notional amount of the underlying fixed-rate mortgage loans originated in the United States. Significant inputs used for fair value determination consist of specific characteristics such as information used in the prepayment model which follows the amortizing schedule of the underlying loans, which is an unobservable input. The valuation model uses the Black formula, which is a benchmark standard in the financial industry. The Black formula is similar to the Black-Scholes formula for valuing stock options except that the spot price of the underlying is replaced by the forward price. The Black formula uses as inputs the strike price of the cap, forward LIBOR rates, volatility estimates and discount rates to estimate the option value. LIBOR rates and swap rates are obtained from Bloomberg L.P. (Bloomberg) every day and build zero coupon curve based on the Bloomberg LIBOR/Swap curve. The discount factor is then calculated from the zero coupon curve. The cap is the sum of all caplets. For each caplet, the rate is reset at the beginning of each reporting period and payments are made at the end of each period. The cash flow of caplet is then discounted from each payment date.

Income recognition Insurance agencies business

Commission revenue is recognized as of the effective date of the insurance policy or the date the customer is billed, whichever is later. The Corporation also receives contingent commissions from insurance companies as additional incentive for achieving specified premium volume goals and/or the loss experience of the insurance placed by the Corporation. Contingent commissions from insurance companies are recognized when determinable, which is generally when such commissions are received or when the Corporation receives data from the insurance companies that allows the reasonable estimation of these amounts. The Corporation maintains an allowance to cover commissions that management estimates will be returned upon the cancellation of a policy.

Advertising costs

Advertising costs for all reporting periods are expensed as incurred.

Earnings per common share

Earnings per share-basic is calculated by dividing income attributable to common stockholders by the weighted average number of outstanding common shares. The computation of earnings per share-diluted is similar to the computation of earnings per share-basic except that the number of weighted average common shares is increased to include the number of additional common shares that would have been outstanding if the dilutive common shares had been issued. Potential common shares consist of common stock issuable under the assumed exercise of stock options, unvested shares of restricted stock, and outstanding warrants using the treasury stock method. This method assumes that the potential common shares are issued and the proceeds from the exercise, in addition to the amount of compensation cost attributable to future services, are used to purchase common stock at the exercise date. The difference between the number of potential shares issued and the shares purchased is added as incremental shares to the actual number of shares outstanding to compute diluted earnings per share. Stock options, unvested shares of restricted stock, and outstanding warrants that result in lower potential shares issued than shares purchased under the treasury stock method are not included in the computation of dilutive earnings per share since their inclusion would have an antidilutive effect in earnings per share.

Recently issued accounting pronouncements

The FASB have issued the following accounting pronouncements and guidance relevant to the Corporation s operations:

In May 2008, the FASB issued authoritative guidance on financial guarantee insurance contracts requiring that an insurance enterprise recognize a claim liability prior to an event of default (insured event) when there is evidence that credit deterioration has occurred in an insured financial obligation. This guidance also clarifies how the accounting and reporting by insurance entities applies to financial guarantee insurance contracts, including the recognition and measurement to be used to account for premium revenue and claim liabilities. FASB authoritative

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

guidance on the accounting for financial guarantee insurance contracts is effective for financial statements issued for fiscal years beginning after December 15, 2008, and all interim periods within those fiscal years, except for some disclosures about the insurance enterprise s risk-management activities which are effective since the first interim period after the issuance of this guidance. The adoption of this guidance did not have a significant impact on the Corporation s financial statements.

In June 2008, the FASB issued authoritative guidance for determining whether instruments granted in shared-based payment transactions are participating securities. This guidance applies to entities with outstanding unvested share-based payment awards that contain rights to nonforfeitable dividends. Furthermore, awards with dividends that do not need to be returned to the entity if the employee forfeits the award are considered participating securities. Accordingly, under this guidance unvested share-based payment awards that are considered to be participating securities must be included in the computation of earnings per share (EPS) pursuant to the two-class method as required by FASB guidance on earnings per share. FASB guidance on determining whether instruments granted in share based payment transactions are participating securities is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those years. The adoption of this Statement did not have an impact on the Corporation s financial statements since, as of December 31, 2009, the outstanding unvested shares of restricted stock do not contain rights to nonforfeitable dividends.

In April 2009, the FASB issued authoritative guidance for the accounting of assets acquired and liabilities assumed in a business combination that arise from contingencies. This guidance amends the provisions related to the initial recognition and measurement, subsequent measurement and disclosure of assets and liabilities arising from contingencies in a business combination. The guidance carries forward the requirement that acquired contingencies in a business combination be recognized at fair value on the acquisition date if fair value can be reasonably estimated during the allocation period. Otherwise, entities would typically account for the acquired contingencies based on a reasonable estimate in accordance with FASB guidance on the accounting for contingencies. This guidance is effective for assets or liabilities arising from contingencies in business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The adoption of this Statement did not have an impact on the Corporation s financial statements.

In April 2009, the FASB issued authoritative guidance for determining fair value when the volume and level of activity for the asset or liability have significantly decreased and identifying transactions that are not orderly. This guidance relates to determining fair values when there is no active market or where the price inputs being used represent distressed sales. It reaffirms the objective of fair value measurement, that is, to reflect how much an asset would be sold for in an orderly transaction (as opposed to a distressed or forced transaction) at the date of the financial statements under current market conditions. Specifically, it reaffirms the need to use judgment to ascertain if a formerly active market has become inactive and in determining fair values when markets have become inactive. This guidance is effective for interim and annual reporting periods ending after June 15, 2009 on a prospective basis. The adoption of this Statement did not impact the Corporation s fair value methodologies on its financial assets and laibilities.

In April 2009, the FASB amended the existing guidance on determining whether an impairment for investments in debt securities is OTTI and requires an entity to recognize the credit component of an OTTI of a debt security in earnings and the noncredit component in other comprehensive income (OCI) when the entity does not intend to sell the security and it is more likely than not that the entity will not be required to sell the security prior to recovery. This guidance also requires expanded disclosures and became effective for interim and annual reporting periods ending after June 15, 2009. In connection with this guidance, the Corporation recorded $1.3 million for the year ended December 31, 2009 of OTTI charges through earnings that represents the credit loss of available-for-sale private label mortgage-backed securities. This guidance does not amend existing recognition and measurement guidance related to an OTTI of equity securities. The expanded disclosures related to this new guidance are included in *Note 4 Investment Securities*.

In April 2009, the FASB amended the existing guidance on the disclosure about fair values of financial instruments, which requires entities to disclose the method(s) and significant assumptions used to estimate the fair value of financial instruments, in both interim financial statements as well as annual financial statements. This

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FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

guidance became effective for interim reporting periods ending after June 15, 2009. The adoption of the amended guidance expanded the Corporation s interim financial statement disclosures with regard to the fair value of financial instruments.

In May 2009, the FASB issued authoritative guidance on subsequent events, which establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. This guidance sets forth (i) the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, (ii) the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements and (iii) the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. This guidance is effective for interim or annual financial periods ending after June 15, 2009. There are not any material subsequent event that would require further disclosure.

In June 2009, the FASB amended the existing guidance on the accounting for transfers of financial assets, which improves the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial statements about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor s continuing involvement, if any, in transferred financial assets. This guidance is effective as of the beginning of each reporting entity s first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period and for interim and annual reporting periods thereafter. Subsequently in December 2009, the FASB amended the existing guidance issued in June 2009. Among the most significant changes and additions to this guidance includes changes to the conditions for sales of a financial assets which objective is to determine whether a transferor and its consolidated affiliates included in the financial statements have surrendered control over transferred financial assets or third-party beneficial interests; and the addition of the meaning of the term participating interest which represents a proportionate (pro rata) ownership interest in an entire financial asset. The Corporation is evaluating the impact the adoption of the guidance will have on its financial statements.

In June 2009, the FASB amended the existing guidance on the consolidation of variable interest, which improves financial reporting by enterprises involved with variable interest entities and addresses (i) the effects on certain provisions of the amended guidance, as a result of the elimination of the qualifying special-purpose entity concept in the accounting for transfer of financial assets guidance and (ii) constituent concerns about the application of certain key provisions of the guidance, including those in which the accounting and disclosures do not always provide timely and useful information about an enterprise s involvement in a variable interest entity. This guidance is effective as of the beginning of each reporting entity s first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. Subsequently in December 2009, the FASB amended the existing guidance issued in June 2009. Among the most significant changes and additions to this guidance includes the replacement of the quantitative-based risks and rewards calculation for determining which reporting entity, if any, has a controlling financial interest in a variable interest entity with an approach focused on identifying which reporting entity has the power to direct the activities of a variable interest entity that most significantly impact the entity s economic performance and the obligation to absorb losses of the entity or the right to receive benefits from the entity. The Corporation is evaluating the impact, if any, the adoption of this guidance will have on its financial statements.

In June 2009, the FASB issued authoritative guidance on the FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles. The FASB Accounting Standards Codification (Codification) is the single source of authoritative nongovernmental GAAP. Rules and interpretive releases of the SEC under the authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. The Codification project does not change GAAP in any way shape or form; it only reorganizes the existing pronouncements into one single source of U.S. GAAP. This guidance is effective for interim and annual periods ending after September 15, 2009. All existing accounting standards are superseded as described in this guidance. All

other accounting literature not included in the Codification is nonauthoritative. Following this guidance, the FASB will not issue new guidance in the form of Statements, FASB Staff Positions, or Emerging Issues Task Force Abstracts. Instead, it will issue Accounting Standards Updates (ASUs). The FASB will not consider ASUs as

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

authoritative in their own right. ASUs will serve only to update the Codification, provide background information about the guidance, and provide the bases for conclusions on the change(s) in the Codification.

In August 2009, the FASB updated the Codification in connection with the fair value measurement of liabilities to clarify that in circumstances in which a quoted price in an active market for the identical liability is not available, a reporting entity is required to measure fair value using one or more of the following techniques:

1. A valuation technique that uses:
   a. The quoted price of the identical liability when traded as an asset
   b. Quoted prices for similar liabilities or similar liabilities when traded as assets
2. Another valuation technique that is consistent with the principles of fair value measurement. Two examples would be an income approach, such as a present value technique, or a market approach, such as a technique that is based on the amount at the measurement date that the reporting entity would pay to transfer the identical liability or would receive to enter into the identical liability.

The update also clarifies that when estimating the fair value of a liability, a reporting entity is not required to include a separate input or adjustment to other inputs relating to the existence of a restriction that prevents the transfer of the liability. The update also clarifies that both a quoted price in an active market for the identical liability at the measurement date and the quoted price for the identical liability when traded as an asset in an active market when no adjustment to the quoted price of the asset are required are Level 1 fair value measurements. This update is effective for the first reporting period (including interim periods) beginning after issuance. The adoption of this guidance did not impact the Corporation s fair value methodologies on its financial liabilities.

In September 2009, the FASB updated the Codification to reflect SEC staff pronouncements on earnings-per-share calculations. According to the update, the SEC staff believes that when a public company redeems preferred shares, the difference between the fair value of the consideration transferred to the holders of the preferred stock and the carrying amount on the balance sheet after issuance costs of the preferred stock should be added to or subtracted from net income before doing an earnings per share calculation. The SEC s staff also thinks it is not appropriate to aggregate preferred shares with different dividend yields when trying to determine whether the if-converted method is dilutive to the earnings per-share calculation. As of December 31, 2009, the Corporation has not been involved in a redemption or induced conversion of preferred stock.

In January 2010, the FASB updated the Codification to provide guidance on accounting for distributions to shareholders with components of stock and cash. This guidance clarifies that the stock portion of a distribution to shareholders that allows them to elect to receive cash or stock with a potential limitation on the total amount of cash that all shareholders can elect to receive in the aggregate is considered a share issuance that is reflected in EPS prospectively and is not a stock dividend. The new guidance is effective for interim and annual periods ending on or after December 15, 2009, and would be applied on a retrospective basis. The adoption of this guidance did not impact the Corporation s financial statements.

In January 2010, the FASB updated the Codification to provide guidance to improve disclosure requirements related to fair value measurements and require reporting entities to make new disclosures about recurring or nonrecurring fair-value measurements including significant transfers into and out of Level 1 and Level 2 fair-value measurements and information on purchases, sales, issuances, and settlements on a gross basis in the reconciliation of Level 3 fair-value measurements. The FASB also clarified existing fair-value measurement disclosure guidance about the level of disaggregation, inputs, and valuation techniques. Entities will be required to separately disclose significant transfers into and out of Level 1 and Level 2 measurements in the fair-value hierarchy and the reasons for the transfers. Significance will be determined based on earnings and total assets or total liabilities or, when changes in fair value are recognized in other comprehensive income, based on total equity. A reporting entity must disclose and consistently follow its policy for determining when transfers between levels are recognized. Acceptable methods for determining when to recognize transfers include: (i) actual date of the event or change in circumstances causing the transfer; (ii) beginning of the reporting period; and (iii) end of the reporting period. Currently, entities are only

required to disclose activity in Level 3 measurements in the fair-value hierarchy on a net basis. This guidance will require separate disclosures for purchases, sales, issuances, and settlements of assets. Entities will also have to

Table of Contents

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

disclose the reasons for the activity and apply the same guidance on significance and transfer policies required for transfers between Level 1 and 2 measurements. The guidance requires disclosure of fair-value measurements by class instead of major category. A class is generally a subset of assets and liabilities within a financial statement line item and is based on the specific nature and risks of the assets and liabilities and their classification in the fair-value hierarchy. When determining classes, reporting entities must also consider the level of disaggregated information required by other applicable GAAP. For fair-value measurements using significant observable inputs (Level 2) or significant unobservable inputs (Level 3), this guidance requires reporting entities to disclose the valuation technique and the inputs used in determining fair value for each class of assets and liabilities. If the valuation technique has changed in the reporting period (e.g., from a market approach to an income approach) or if an additional valuation technique is used, entities are required to disclose the change and the reason for making the change. Except for the detailed Level 3 roll forward disclosures, the guidance is effective for annual and interim reporting periods beginning after December 15, 2009 (first quarter of 2010 for public companies with calendar year-ends). The new disclosures about purchases, sales, issuances, and settlements in the roll forward activity for Level 3 fair-value measurements are effective for interim and annual reporting periods beginning after December 15, 2010 (first quarter of 2011 for public companies with calendar year-ends). Early adoption is permitted. In the initial adoption period, entities are not required to include disclosures for previous comparative periods; however, they are required for periods ending after initial adoption. The Corporation is evaluating the impact the adoption of this guidance will have on its financial statements.

Table of Contents

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2 Restrictions on Cash and Due from Banks

The Corporation s bank subsidiary, FirstBank, is required by law, as enforced by the OCIF, to maintain minimum average weekly reserve balances to cover demand deposits. The amount of those minimum average reserve balances for the week that covered December 31, 2009 was $91.3 million (2008 $233.7 million). As of December 31, 2009 and 2008, the Bank complied with the requirement. Cash and due from banks as well as other short-term, highly liquid securities are used to cover the required average reserve balances.

As of December 31, 2009 and 2008, and as required by the Puerto Rico International Banking Law, the Corporation maintained separately for two of its international banking entities (IBEs), $600,000 in time deposits, which were considered restricted assets equally split between the two IBEs.

Note 3 Money Market Investments

Money market investments are composed of federal funds sold, time deposits with other financial institutions and short-term investments with original maturities of three months or less.

Money market investments as of December 31, 2009 and 2008 were as follows:

	2009	2008
	Balance (Dollars in thousands)	
Federal funds sold, interest 0.01% (2008 - 0.01%)	$ 1,140	$ 54,469
Time deposits with other financial institutions, weighted-average interest rate 0.24% (2008-interest 1.05%)	600	600
Other short-term investments, weighted-average interest rate of 0.18% (2008-weighted-average interest rate of 0.21%)	22,546	20,934
	$ 24,286	$ 76,003

As of December 31, 2009, $0.95 million of the Corporation s money market investments was pledged as collateral for interest rate swaps. As of December 31, 2008, none of the Corporation s money market investments were pledged.

Table of Contents

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 4 Investment Securities

Investment Securities Available for Sale

The amortized cost, non-credit loss component of OTTI securities recorded in OCI, gross unrealized gains and losses recorded in OCI, approximate fair value, weighted-average yield and contractual maturities of investment securities available for sale as of December 31, 2009 and 2008 were as follows:

	December 31, 2009						December 31, 2008				
		Non-Credit Loss Component of OTTI Recorded in OCI	Gross Unrealized			Weighted		Gross Unrealized			Weighte
	Amortized cost		gains	losses	Fair value	average yield%	Amortized cost	gains	losses	Fair value	averag yield%
	(Dollars in thousands)										
bligations of .S. Government ponsored gencies:											
fter 1 to 5 years	$ 1,139,577	$	$ 5,562	$	$ 1,145,139	2.12	$	$	$	$	
uerto Rico overnment bligations:											
ue within one ear	12,016		1	28	11,989	1.82	4,593	46		4,639	6.18
fter 1 to 5 years	113,232		302	47	113,487	5.40	110,624	259	479	110,404	5.41
fter 5 to 0 years	6,992		328	90	7,230	5.88	6,365	283	128	6,520	5.80
fter 10 years	3,529		91		3,620	5.42	15,789	45	264	15,570	5.30
nited States and uerto Rico overnment bligations	1,275,346		6,284	165	1,281,465	2.44	137,371	633	871	137,133	5.44
ortgage-backed ecurities: HLMC ertificates:											
ue within one ear							37			37	5.94
fter 1 to 5 years	30				30	5.54	157	2		159	7.07
fter 5 to 0 years							31	3		34	8.40
fter 10 years	705,818		18,388	1,987	722,219	4.66	1,846,386	45,743	1	1,892,128	5.46

	705,848		18,388	1,987	722,249	4.66	1,846,611	45,748	1	1,892,358	5.46
GNMA ertificates:											
Due within one ear							45	1		46	5.72
After 1 to 5 years	69		3		72	6.56	180	6		186	6.71
After 5 to 0 years	808		39		847	5.47	566	9		575	5.33
After 10 years	407,565		10,808	980	417,393	5.12	331,594	10,283	10	341,867	5.38
	408,442		10,850	980	418,312	5.12	332,385	10,299	10	342,674	5.38
FNMA ertificates:											
After 1 to 5 years							53	5		58	10.20
After 5 to 0 years	101,781		3,716	91	105,406	4.55	269,716	4,678		274,394	4.96
After 10 years	1,374,533		30,629	2,776	1,402,386	4.51	1,071,521	28,005	1	1,099,525	5.60
	1,476,314		34,345	2,867	1,507,792	4.51	1,341,290	32,688	1	1,373,977	5.47
Collateralized Mortgage Obligations ssued or uaranteed by FHLMC, FNMA nd GNMA:											
After 10 years	156,086		633	412	156,307	0.99					
Other mortgage ass-through trust ertificates:											
After 10 years	117,198	32,846	2		84,354	2.30	144,217	2	30,236	113,983	5.43
Total nortgage-backed ecurities	2,863,888	32,846	64,218	6,246	2,889,014	4.35	3,664,503	88,737	30,248	3,722,992	5.46
Corporate bonds:											
After 5 to 0 years							241			241	7.70
After 10 years							1,307			1,307	7.97
Corporate bonds							1,548			1,548	7.93

quity securities without ontractual naturity) (1)	427		81	205	303		814		145	669	2.38
otal investment ecurities vailable for sale	$ 4,139,661	$ 32,846	$ 70,583	$ 6,616	$ 4,170,782	3.76	$ 3,804,236	$ 89,370	$ 31,264	$ 3,862,342	5.46

(1) Represents common shares of other financial institutions in Puerto Rico.

Maturities of mortgage-backed securities are based on contractual terms assuming no prepayments. Expected maturities of investments might differ from contractual maturities because they may be subject to prepayments and/or call options. 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.

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The aggregate amortized cost and approximate market value of investment securities available for sale as of December 31, 2009, by contractual maturity, are shown below:

	Amortized Cost	Fair Value
	(In thousands)	
Within 1 year	$ 12,016	$ 11,989
After 1 to 5 years	1,252,908	1,258,728
After 5 to 10 years	109,581	113,483
After 10 years	2,764,729	2,786,279
Total	4,139,234	4,170,479
Equity securities	427	303
Total investment securities available for sale	$ 4,139,661	$ 4,170,782

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 December 31, 2009 and 2008. It also includes debt securities for which an OTTI was recognized and only the amount related to a credit loss was recognized in earnings:

	As of December 31, 2009					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
Debt securities						
Puerto Rico Government obligations	$ 14,760	$ 118	$ 9,113	$ 47	$ 23,873	$ 165
Mortgage-backed securities						
FHLMC	236,925	1,987			236,925	1,987
GNMA	72,178	980			72,178	980
FNMA	415,601	2,867			415,601	2,867
Collateralized mortgage obligations issued or guaranteed by FHLMC, FNMA and GNMA	105,075	412			105,075	412
Other mortgage pass-through trust certificates			84,105	32,846	84,105	32,846
Equity securities	90	205			90	205

	$ 844,629	$ 6,569	$ 93,218	$ 32,893	$ 937,847	$ 39,462

	As of December 31, 2008					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
Debt securities						
Puerto Rico Government obligations	$	$	$ 13,288	$ 871	$ 13,288	$ 871
Mortgage-backed securities						
FHLMC	68	1			68	1
GNMA	903	10			903	10
FNMA	361	1	21		382	1
Other mortgage pass-through trust certificates			113,685	30,236	113,685	30,236
Equity securities	318	145			318	145
	$ 1,650	$ 157	$ 126,994	$ 31,107	$ 128,644	$ 31,264

F-29

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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 December 31, 2009 and 2008 were as follows:

	December 31, 2009					December 31, 2008				
	Amortized cost	Gross Unrealized gains	Gross Unrealized losses	Fair value	Weighted average yield%	Amortized cost	Gross Unrealized gains	Gross Unrealized losses	Fair value	Weighted average yield%
	(Dollars in thousands)									
U.S. Treasury securities:										
Due within 1 year	$ 8,480	$ 12	$	$ 8,492	0.47	$ 8,455	$ 34	$	$ 8,489	1.07
Obligations of other U.S. Government sponsored agencies:										
After 10 years						945,061	5,281	728	949,614	5.77
Puerto Rico Government obligations:										
After 5 to 10 years	18,584	564	93	19,055	5.86	17,924	480	97	18,307	5.85
After 10 years	4,995	77		5,072	5.50	5,145	35		5,180	5.50
United States and Puerto Rico Government obligations	32,059	653	93	32,619	4.38	976,585	5,830	825	981,590	5.73
Mortgage-backed securities:										
FHLMC certificates:										
After 1 to 5 years	5,015	78		5,093	3.79	8,338	71	5	8,404	3.83
FNMA certificates:										
After 1 to 5 years	4,771	100		4,871	3.87	7,567	88		7,655	3.85
After 5 to 10 years	533,593	19,548		553,141	4.47	686,948	9,227		696,175	4.46
After 10 years	24,181	479		24,660	5.30	25,226	247	25	25,448	5.31

Mortgage-backed securities	567,560	20,205		587,765	4.49	728,079	9,633	30	737,682	4.48
Corporate bonds:										
After 10 years	2,000		800	1,200	5.80	2,000		860	1,140	5.80
Total investment securities held-to-maturity	$ 601,619	$ 20,858	$ 893	$ 621,584	4.49	$ 1,706,664	$ 15,463	$ 1,715	$ 1,720,412	5.19

Maturities of mortgage-backed securities are based on contractual terms assuming no prepayments. Expected maturities of investments might differ from contractual maturities because they may be subject to prepayments and/or call options as was the case with approximately $945 million of U.S. government agency debt securities called during 2009.

The aggregate amortized cost and approximate market value of investment securities held to maturity as of December 31, 2009, by contractual maturity are shown below:

	Amortized Cost	**Fair Value**
	(In thousands)	
Within 1 year	$ 8,480	$ 8,492
After 1 to 5 years	9,786	9,964
After 5 to 10 years	552,177	572,196
After 10 years	31,176	30,932
Total investment securities held to maturity	$ 601,619	$ 621,584

From time to time the Corporation has securities held to maturity with an original maturity of three months or less that are considered cash and cash equivalents and classified as money market investments in the Consolidated Statements of Financial Condition. As of December 31, 2009 and 2008, the Corporation had no outstanding securities held to maturity that were classified as cash and cash equivalents.

Table of Contents

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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 December 31, 2009 and 2008:

	As of December 31, 2009					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
Debt securities						
Puerto Rico Government obligations	$	$	$ 4,678	$ 93	$ 4,678	$ 93
Corporate bonds			1,200	800	1,200	800
	$	$	$ 5,878	$ 893	$ 5,878	$ 893

	As of December 31, 2008					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
Debt securities						
U.S. Government sponsored agencies	$	$	$ 7,262	$ 728	$ 7,262	$ 728
Puerto Rico Government obligations			4,436	97	4,436	97
Mortgage-backed securities						
FHLMC			600	5	600	5
FNMA			6,825	25	6,825	25
Corporate bonds			1,140	860	1,140	860
	$	$	$ 20,263	$ 1,715	$ 20,263	$ 1,715

Assessment for OTTI

On a quarterly basis, the Corporation performs an assessment to determine whether there have been any events or economic circumstances indicating that a security with an unrealized loss has suffered OTTI. A debt security is considered impaired if the fair value is less than its amortized cost basis at the reporting date. The accounting literature requires the Corporation to assess whether the unrealized loss is other-than-temporary. Prior to April 1, 2009, unrealized losses that were determined to be temporary were recorded, net of tax, in other comprehensive income for available for sale securities, whereas unrealized losses related to held-to-maturity securities determined to be temporary were not recognized. Regardless of whether the security was classified as available for sale or held to maturity, unrealized losses that were determined to be other-than-temporary were recorded through earnings. An unrealized loss was considered other-than-temporary if (i) it was probable that the holder would not collect all

amounts due according to the contractual terms of the debt security, or (ii) the fair value was below the amortized cost of the debt security for a prolonged period of time and the Corporation did not have the positive intent and ability to hold the security until recovery or maturity.

In April 2009, the FASB amended the OTTI model for debt securities. Under the new guidance, OTTI losses must be recognized in earnings if an investor has the intent to sell the debt security or it is more likely than not that it will be required to sell the debt security before recovery of its amortized cost basis. However, even if an investor does not expect to sell a debt security, it must evaluate expected cash flows to be received and determine if a credit loss has occurred.

Under the new guidance, an unrealized loss is generally deemed to be other-than-temporary and a credit loss is deemed to exist if the present value of the expected future cash flows is less than the amortized cost basis of the debt security. As a result of the Corporation s adoption of this new guidance, the credit loss component of an OTTI is recorded as a component of Net impairment losses on investment securities in the accompanying consolidated statements of (loss) income, while the remaining portion of the impairment loss is recognized in OCI, provided the

Table of Contents

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Corporation does not intend to sell the underlying debt security and it is more likely than not that the Corporation will not have to sell the debt security prior to recovery.

Debt securities issued by U.S. government agencies, government-sponsored entities and the U.S. Treasury accounted for more than 94% of the total available-for-sale and held-to-maturity portfolio as of December 31, 2009 and no credit losses are expected, given the explicit and implicit guarantees provided by the U.S. federal government. The Corporation s assessment was concentrated mainly on private label MBS of approximately $117 million for which the Corporation evaluates credit losses on a quarterly basis. The Corporation considered the following factors in determining whether a credit loss exists and the period over which the debt security is expected to recover:

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

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

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

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

For the year ended December 31, 2009, the Corporation recorded OTTI losses on available-for-sale debt securities as follows:

(In thousands)	Private label MBS **2009**
Total other-than-temporary impairment losses	(33,012)
Unrealized other-than-temporary impairment losses recognized in OCI (1)	31,742
Net impairment losses recognized in earnings (2)	$ (1,270)

(1) Represents the noncredit component impact of the OTTI on private label MBS

(2) Represents the credit component of the OTTI on private label MBS

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

(In thousands)	2009
Credit losses at the beginning of the period	$
Additions:	
Credit losses related to debt securities for which an OTTI was not previously recognized	1,270
Ending balance of credit losses on debt securities held for which a portion of an OTTI was recognized in OCI	$ 1,270

As of December 31, 2009, debt securities with OTTI, for which a loss related to credit was recognized in earnings, consisted entirely of private label MBS. Private label MBS are mortgage pass-through certificates bought from R&G Financial Corporation (R&G Financial), a Puerto Rican financial institution. During the second quarter

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

of 2009, the Corporation received from R&G Financial a payment of $4.2 million to eliminate the 10% recourse provision contained in the private label MBS.

Private label MBS are collateralized by fixed-rate mortgages on single-family residential properties in the United States and the interest rate 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. Refer to Note 1 for detailed information about the methodology used to determine the fair value of private label MBS.

Based on the expected cash flows derived from the model, and since the Corporation does not have the intention to sell the securities and has sufficient capital and liquidity to hold these securities until a recovery of the fair value occurs, only the credit loss component was reflected in earnings. Significant assumptions in the valuation of the private label MBS as of December 31, 2009 were as follow:

	Weighted Average	Range	
Discount rate	15%		15%
Prepayment rate	21%	13.06%	50.25%
Projected Cumulative Loss Rate	4%	0.22%	10.56%

For the years ended December 31, 2009 and 2008, the Corporation recorded OTTI of approximately $0.4 million and $1.8 million, respectively, on certain equity securities held in its available-for-sale investment portfolio related to financial institutions in Puerto Rico. Also, OTTI of $4.2 million was recorded in 2008 related to auto industry corporate bonds that were subsequently sold in 2009. Management concluded that the declines in value of the securities were other-than-temporary; as such, the cost basis of these securities was written down to the market value as of the date of the analysis and is reflected in earnings as a realized loss.

Total proceeds from the sale of securities available for sale during 2009 amounted to approximately $1.9 billion (2008 $680.0 million). The following table summarizes the realized gains and losses on sales of securities available for sale for the years indicated:

	Year ended December 31,	
(In thousands)	2009	2008
Realized gains	$ 82,772	$ 17,896
Realized losses		(190)
Net realized security gains	$ 82,772	$ 17,706

The following table states the name of issuers, and the aggregate amortized cost and market value of the securities of such issuers (includes available-for-sale and held-to-maturity securities), when the aggregate amortized cost of such securities exceeds 10% of stockholders equity. This information excludes securities of the U.S. and P.R. Government. Investments in obligations issued by a state of the U.S. and its political subdivisions and agencies that are payable and secured by the same source of revenue or taxing authority, other than the U.S. Government, are considered securities of a single issuer and include debt and mortgage-backed securities.

	2009		2008	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(In thousands)			
FHLMC	$1,350,291	$1,369,535	$1,862,939	$1,908,024
GNMA	474,349	483,964	332,385	342,674

FNMA	2,629,187	2,684,065	2,978,102	3,025,549

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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 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 December 31, 2009 and 2008, the Corporation had investments in FHLB stock with a book value of $68.4 million ($54 million FHLB-New York and $14.4 million FHLB-Atlanta) and $62.6 million, respectively. The net realizable value is a reasonable proxy for the fair value of these instruments. Dividend income from FHLB stock for 2009, 2008 and 2007 amounted to $3.1 million, $3.7 million and $2.9 million, respectively.

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

There is no secondary market for the FHLB stock and it does not have a readily determinable fair value. The stock is a par stock sold and redeemed at par. It can only be sold to/from the FHLB s or a member institution. From an OTTI analysis perspective, the relevant consideration for determination is the ultimate recoverability of par value.

The economic conditions of late 2008 affected the FHLB s, resulting in the recording of losses on private-label MBS portfolios. In the midst of the mortgage market crisis the FHLB of Atlanta temporarily suspended dividend payments on their stock in the fourth quarter of 2008 and in the first quarter of 2009. In the second and third quarter of 2009, they were re-instated. The FHLB of NY has not suspended payment of dividends. Third and fourth quarter dividends were reduced, and by the first quarter 2009 they were increased.

The financial situation has since shown signs of improvement, and so have the financial results of the FHLB s. The FHLB of Atlanta reported preliminary financial results with an 11.7% year-over-year increase in net income to $283.5 million for the year ended December 31, 2009, while the FHLB of NY announce a 120% year-over-year increase in net income to $570.8 million for the same period. At December 31, 2009, both Banks met their regulatory capital-to-assets ratios and liquidity requirements.

The FHLB s primary source of funding is debt obligations, which continue to be rated Aaa and AAA by Moody s and Standard and Poor s respectively. The Corporation expects to recover the par value of its investments in FHLB stocks in its entirety, therefore no OTTI is deemed to be required.

The Corporation has other equity securities that do not have a readily available fair value. The carrying value of such securities as of December 31, 2009 and 2008 was $1.6 million. During 2009, the Corporation realized a gain of $3.8 million on the sale of VISA Class A stock. As of December 31, 2009 the Corporation still held 119,234 VISA Class C shares. Also, during the first quarter of 2008, the Corporation realized a one-time gain of $9.3 million on the mandatory redemption of part of its investment in VISA, Inc., which completed its initial public offering (IPO) in March 2008.

Table of Contents

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 6 Interest and Dividend on Investments

A detail of interest on investments and FHLB dividend income follows:

	Year Ended December 31,		
	2009	2008	2007
		(In thousands)	
Interest on money market investments:			
Taxable	$ 568	$ 1,369	$ 4,805
Exempt	9	4,986	17,226
	577	6,355	22,031
Mortgage-backed securities:			
Taxable	30,854	2,517	2,044
Exempt	172,923	199,875	110,816
	203,777	202,392	112,860
PR Government obligations, U.S. Treasury securities and U.S. Government agencies:			
Taxable	2,694	3,657	
Exempt	44,510	74,667	148,986
	47,204	78,324	148,986
Equity securities:			
Taxable	69	38	
Exempt	37	6	3
	106	44	3
Other investment securities (including FHLB dividends):			
Taxable	3,375	4,281	3,426
Exempt			
	3,375	4,281	3,426
Total interest and dividends on investments	$ 255,039	$ 291,396	$ 287,306

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table summarizes the components of interest and dividend income on investments:

	Year Ended December 31,		
	2009	2008	2007
		(In thousands)	
Interest income on investment securities and money market investments	$ 248,563	$ 291,732	$ 287,990
Dividends on FHLB stock	3,082	3,710	2,861
Net interest settlement on interest rate caps		237	
Interest income excluding unrealized gain (loss) on derivatives (economic hedges)	251,645	295,679	290,851
Unrealized gain (loss) on derivatives (economic hedges) from interest rate caps	3,394	(4,283)	(3,545)
Total interest income and dividends on investments	$ 255,039	$ 291,396	$ 287,306

Note 7 Loans Receivable

The following is a detail of the loan portfolio:

	December 31,	
	2009	2008
	(In thousands)	
Residential mortgage loans, mainly secured by first mortgages	$ 3,595,508	$ 3,481,325
Commercial loans:		
Construction loans	1,492,589	1,526,995
Commercial mortgage loans	1,590,821	1,535,758
Commercial and Industrial loans (1)	5,029,907	3,857,728
Loans to local financial institutions collateralized by real estate mortgages	321,522	567,720
Commercial loans	8,434,839	7,488,201
Finance leases	318,504	363,883
Consumer loans	1,579,600	1,744,480
Loans receivable	13,928,451	13,077,889
Allowance for loan and lease losses	(528,120)	(281,526)

Loans receivable, net	13,400,331	12,796,363
Loans held for sale	20,775	10,403
Total loans	$ 13,421,106	$ 12,806,766

(1) As of December 31, 2009, includes $1.2 billion of commercial loans that are secured by real estate but are not dependent upon the real estate for repayment.

As of December 31, 2009 and 2008, the Corporation had net deferred origination fees on its loan portfolio amounting to $5.2 million and $3.7 million, respectively. Total loan portfolio is net of unearned income of $49.0 million and $62.6 million as of December 31, 2009 and 2008, respectively.

As of December 31, 2009, loans in which the accrual of interest income had been discontinued amounted to $1.6 billion (2008 $587.2 million). If these loans were accruing interest, the additional interest income realized would have been $57.9 million (2008 $29.7 million; 2007 $22.7 million). Past due and still accruing loans, which are contractually delinquent 90 days or more, amounted to $165.9 million as of December 31, 2009 (2008 $471.4 million).

As of December 31, 2009, the Corporation was servicing residential mortgage loans owned by others aggregating $1.1 billion (2008 $826.9 million) and construction and commercial loans owned by others aggregating $123.4 million (2008 $74.5 million).

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

As of December 31, 2009, the Corporation was servicing commercial loan participations owned by others aggregating $235.0 million (2008 $191.2 million).

Various loans secured by first mortgages were assigned as collateral for CDs, individual retirement accounts and advances from the Federal Home Loan Bank. The mortgages pledged as collateral amounted to $1.9 billion as of December 31, 2009 (2008 $2.5 billion).

The Corporation s primary lending area is Puerto Rico. The Corporation s Puerto Rico banking subsidiary, First Bank, also lends in the U.S. and British Virgin Islands markets and in the United States (principally in the state of Florida). Of the total gross loan portfolio of $13.9 billion as of December 31, 2009, approximately 83% have credit risk concentration in Puerto Rico, 9% in the United States and 8% in the Virgin Islands.

As of December 31, 2009, the Corporation had $1.2 billion outstanding of credit facilities granted to the Puerto Rico Government and/or its political subdivisions. A substantial portion of these credit facilities are obligations that have a specific source of income or revenues identified for their repayment, such as sales and property taxes collected by the central Government and/or municipalities. Another portion of these obligations consists of loans to public corporations that obtain revenues from rates charged for services or products, such as electric power utilities. Public corporations have varying degrees of independence from the central Government and many receive appropriations or other payments from it. The Corporation also has loans to various municipalities in Puerto Rico for which the good faith, credit and unlimited taxing power of the applicable municipality have been pledged to their repayment.

Aside from loans extended to the Puerto Rico Government and its political subdivisions, the largest loan to one borrower as of December 31, 2009 in the amount of $321.5 million is with one mortgage originator in Puerto Rico, Doral Financial Corporation. This commercial loan is secured by individual mortgage loans on residential and commercial real estate. During the second quarter of 2009, the Corporation completed a transaction with R&G Financial that involved the purchase of approximately $205 million of residential mortgage loans that previously served as collateral for a commercial loan extended to R&G. The purchase price of the transaction was retained by the Corporation to fully pay off the loan, thereby significantly reducing the Corporation s exposure to a single borrower.

Note 8 Allowance for loan and lease losses

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

	Year Ended December 31,		
	2009	**2008**	**2007**
		(In thousands)	
Balance at beginning of year	$ 281,526	$ 190,168	$ 158,296
Provision for loan and lease losses	579,858	190,948	120,610
Losses charged against the allowance	(344,422)	(117,072)	(94,830)
Recoveries credited to the allowance	11,158	8,751	6,092
Other adjustments[1]		8,731	
Balance at end of year	$ 528,120	$ 281,526	$ 190,168

(1) Carryover of the allowance for loan losses related to a $218 million auto loan portfolio

acquired in the
third quarter of
2008.

Table of Contents

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The allowance for impaired loans is part of the allowance for loan and lease losses. The allowance for impaired loans covers those loans for which management has determined that it is probable that the debtor will be unable to pay all the amounts due in accordance with the contractual terms of the loan agreement, and does not necessarily represent loans for which the Corporation will incur a loss. As of December 31, 2009, 2008 and 2007, impaired loans and their related allowance were as follows:

	Year Ended December 31,		
	2009	2008	2007
		(In thousands)	
Impaired loans with valuation allowance, net of charge-offs	$ 1,060,088	$ 384,914	$ 66,941
Impaired loans without valuation allowance, net of charge-offs	596,176	116,315	84,877
Total impaired loans	$ 1,656,264	$ 501,229	$ 151,818
Allowance for impaired loans	182,145	83,353	7,523
During the year:			
Average balance of impaired loans	1,022,051	302,439	116,362
Interest income recognized on impaired loans (1)	21,160	12,974	6,588

(1) For 2009 excludes interest income of approximately $4.7 million, related to $761.5 million non-performing loans, that was applied against the related principal balance under the cost-recovery method.

The following tables show the activity for impaired loans and related specific reserve during 2009:

Impaired Loans:	**(In thousands)**
Balance at beginning of year	$ 501,229
Loans determined impaired during the year	1,466,805
Net charge-offs (1)	(244,154)
Loans sold, net of charge-offs of $49.6 million (2)	(39,374)

Loans foreclosed, paid in full and partial payments		(28,242)
Balance at end of year	$	1,656,264

(1) Approximately $114.2 million, or 47%, is related to construction loans in Florida and $44.6 million, or 18%, is related to construction loans in Puerto Rico.

(2) Related to five construction projects sold in Florida.

Specific Reserve:		**(In thousands)**
Balance at beginning of year	$	83,353
Provision for loan losses		342,946
Net charge-offs		(244,154)
Balance at end of year	$	182,145

The Corporation provides homeownership preservation assistance to its customers through a loss mitigation program in Puerto Rico and through programs sponsored by the Federal Government. Due to the nature of the borrower s financial condition, the restructure or loan modification through these program as well as other restructurings of individual commercial, commercial mortgage loans, construction loans and residential mortgages in the U.S. mainland fit the definition of Troubled Debt Restructuring (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 loans and modifications of the loan rate. As of December 31, 2009, the Corporation s TDR loans consisted of $124.1 million of residential mortgage loans, $42.1 million commercial and industrial loans, $68.1 million commercial mortgage loans and $101.7 million of construction loans. Outstanding unfunded loan commitments on TDR loans amounted to $1.3 million as of December 31, 2009.

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Included in the $101.7 million of construction TDR loans are certain impaired condo-conversion loans restructured into two separate agreements (loan splitting) in the fourth quarter of 2009. Each of these loans were restructured into two notes; one that represents the portion of the loan that is expected to be fully collected along with contractual interest and the second note that represents the portion of the original loan that was charged-off. The renegotiations of these loans have been made after analyzing the borrowers and guarantors capacity to serve the debt and ability to perform under the modified terms. As part of the renegotiation of the loans, the first note of each loan have been placed on a monthly payment that amortize the debt over 25 years at a market rate of interest. An interest rate reduction was granted for the second note. The following tables provide additional information about the volume of this type of loan restructurings and the effect on the allowance for loan and lease losses in 2009.

	(In thousands)
Principal balance deemed collectible	$ 22,374
Amount charged-off	$ (29,713)

Specific Reserve:	**(In thousands)**
Balance at beginning of year	$ 14,375
Provision for loan losses	17,213
Charge-offs	(29,713)
Balance at end of year	$ 1,875

The loans comprising the $22.4 million that have been deemed collectible continue to be individually evaluated for impairment purposes. These transactions contributed to a $29.9 million decrease in non-performing loans during the last quarter of 2009.

Note 9 Related Party Transactions

The Corporation granted loans to its directors, executive officers and certain related individuals or entities in the ordinary course of business. The movement and balance of these loans were as follows:

	Amount (In thousands)
Balance at December 31, 2007	$ 182,573
New loans	44,963
Payments	(48,380)
Other changes	
Balance at December 31, 2008	179,156
New loans	3,549
Payments	(6,405)
Other changes	(152,130)

Balance at December 31, 2009	$	24,170

These loans do not involve more than normal risk of collectibility and management considers that they present terms that are no more favorable than those that would have been obtained if transactions had been with unrelated parties. The amounts reported as other changes include changes in the status of those who are considered related parties, mainly due to the resignation of an independent director in 2009.

From time to time, the Corporation, in the ordinary course of its business, obtains services from related parties or makes contributions to non-profit organizations that have some association with the Corporation. Management believes the terms of such arrangements are consistent with arrangements entered into with independent third parties.

Table of Contents

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 10 Premises and Equipment

Premises and equipment is comprised of:

	Useful Life In Years	As of December 31, 2009	2008
		(Dollars in thousands)	
Buildings and improvements	10 - 40	$ 90,158	$ 84,282
Leasehold improvements	1 - 15	57,522	52,945
Furniture and equipment	3 - 10	123,582	119,419
		271,262	256,646
Accumulated depreciation		(155,459)	(133,109)
		115,803	123,537
Land		28,327	24,791
Projects in progress		53,835	30,140
Total premises and equipment, net		$ 197,965	$ 178,468

Depreciation and amortization expense amounted to $20.8 million, $19.2 million and $17.7 million for the years ended December 31, 2009, 2008 and 2007, respectively.

Note 11 Goodwill and Other Intangibles

Goodwill as of December 31, 2009 and 2008 amounted to $28.1 million, recognized as part of Other Assets . The Corporation s conducted its annual evaluation of goodwill and intangible during the fourth quarter of 2009. The Step 1 evaluation of goodwill of the Florida reporting unit indicated potential impairment of goodwill; however, impairment was not indicated based upon the results of the Step 2 analysis. Goodwill was not impaired as of December 31, 2009 or 2008, nor was any goodwill written-off due to impairment during 2009, 2008 and 2007. Refer to Note 1 for additional details about the methodology used for the goodwill impairment analysis.

As of December 31, 2009, the gross carrying amount and accumulated amortization of core deposit intangibles was $41.8 million and $25.2 million, respectively, recognized as part of Other Assets in the Consolidated Statements of Financial Condition (December 31, 2008 $45.8 million and $21.8 million, respectively). For the year ended December 31, 2009, the amortization expense of core deposit intangibles amounted to $3.4 million (2008 $3.6 million; 2007 $3.3 million). As a result of an impairment evaluation of core deposit intangibles, there was an impairment charge of $4.0 million recognized during 2009 related to core deposits in FirstBank Florida attributable to decreases in the base of core deposits acquired and recorded as part of other non-interest expenses in the Statement of (Loss) Income.

The following table presents the estimated aggregate annual amortization expense of the core deposit intangible:

	Amount (In thousands)
2010	$ 2,557
2011	2,522
2012	2,522

2013	2,522
2014 and thereafter	6,477

F-40

Table of Contents

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 12 Servicing Assets

As disclosed in Note 1, the Corporation is actively involved in the securitization of pools of FHA-insured and VA-guaranteed mortgages for issuance of GNMA mortgage-backed securities. Also, certain conventional conforming-loans are sold to FNMA or FHLMC with servicing retained. The Corporation recognizes as separate assets the rights to service loans for others, whether those servicing assets are originated or purchased.

The changes in servicing assets are shown below:

	Year Ended December 31,		
	2009	2008	2007
		(In thousands)	
Balance at beginning of year	$ 8,151	$ 7,504	$ 5,317
Capitalization of servicing assets	6,072	1,559	1,285
Servicing assets purchased		621	1,962
Amortization	(2,321)	(1,533)	(1,060)
Balance before valuation allowance at end of year	11,902	8,151	7,504
Valuation allowance for temporary impairment	(745)	(751)	(336)
Balance at end of year	$ 11,157	$ 7,400	$ 7,168

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. Other-than-temporary impairments, if any, are recognized as a direct write-down of the servicing assets.

Changes in the impairment allowance were as follows:

	Year Ended December 31,		
	2009	2008	2007
		(In thousands)	
Balance at beginning of year	$ 751	$ 336	$ 57
Temporary impairment charges	2,537	1,437	461
Recoveries	(2,543)	(1,022)	(182)
Balance at end of year	745	751	$ 336

The components of net servicing income are shown below:

	Year Ended December 31,		
	2009	2008	2007
		(In thousands)	
Servicing fees	$ 3,082	$ 2,565	$ 2,133
Late charges and prepayment penalties	581	513	503
Servicing income, gross	3,663	3,078	2,636
Amortization and impairment of servicing assets	(2,315)	(1,948)	(1,339)

Servicing income, net	$ 1,348	$ 1,130	$ 1,297

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

	Maximum	Minimum
2009:		
Constant prepayment rate:		
Government guaranteed mortgage loans	24.8%	14.3%
Conventional conforming mortgage loans	21.9%	16.4%
Conventional non-conforming mortgage loans	20.1%	12.8%
Discount rate:		
Government guaranteed mortgage loans	13.6%	11.8%
Conventional conforming mortgage loans	9.3%	9.2%
Conventional non-conforming mortgage loans	13.2%	13.1%
2008:		
Constant prepayment rate:		
Government guaranteed mortgage loans	22.1%	13.6%
Conventional conforming mortgage loans	17.7%	10.2%
Conventional non-conforming mortgage loans	14.5%	9.0%
Discount rate:		
Government guaranteed mortgage loans	10.5%	10.1%
Conventional conforming mortgage loans	9.3%	9.3%
Conventional non-conforming mortgage loans	13.4%	13.2%
2007:		
Constant prepayment rate:		
Government guaranteed mortgage loans	17.2%	11.0%
Conventional conforming mortgage loans	13.2%	8.8%
Conventional non-conforming mortgage loans	13.2%	10.6%
Discount rate:		
Government guaranteed mortgage loans	10.0%	10.0%
Conventional conforming mortgage loans	9.0%	9.0%
Conventional non-conforming mortgage loans	13.7%	13.0%

At December 31, 2009, fair values of the Corporation s servicing assets were based on a valuation model that incorporates market driven assumptions, adjusted by the particular characteristics of the Corporation s servicing portfolio, regarding discount rates and mortgage prepayment rates. The weighted-averages of the key economic assumptions used by the Corporation in its valuation model and the sensitivity of the current fair value to immediate 10 percent and 20 percent adverse changes in those assumptions for mortgage loans at December 31, 2009, were as follows:

(Dollars in thousands)	
Carrying amount of servicing assets	$11,157
Fair value	$12,920
Weighted-average expected life (in years)	6.6
Constant prepayment rate (weighted-average annual rate)	15.4%
Decrease in fair value due to 10% adverse change	$ 745

Decrease in fair value due to 20% adverse change	$ 1,388
Discount rate (weighted-average annual rate)	11.10%
Decrease in fair value due to 10% adverse change	$ 149
Decrease in fair value due to 20% adverse change	$ 632

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

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 13 Deposits and Related Interest

Deposits and related interest consist of the following:

	December 31, 2009	December 31, 2008
	(In thousands)	
Type of account and interest rate:		
Non-interest bearing checking accounts	$ 697,022	$ 625,928
Savings accounts - 0.50% to 2.52% (2008 - 0.80% to 3.75%)	1,774,273	1,288,179
Interest bearing checking accounts - 0.50% to 2.79% (2008 - 0.75% to 3.75%)	985,470	726,731
Certificates of deposit - 0.15% to 7.00% (2008 - 0.75% to 7.00%)	1,650,866	1,986,770
Brokered certificates of deposit[(1)] - 0.25% to 5.30% (2008 - 2.15% to 6.00%)	7,561,416	8,429,822
	$ 12,669,047	$ 13,057,430

(1) Includes $0 and $1,150,959 measured at fair value as of December 31, 2009 and 2008, respectively.

The weighted average interest rate on total deposits as of December 31, 2009 and 2008 was 2.06% and 3.63%, respectively.

As of December 31, 2009, the aggregate amount of overdrafts in demand deposits that were reclassified as loans amounted to $16.5 million (2008 $12.8 million).

The following table presents a summary of CDs, including brokered CDs, with a remaining term of more than one year as of December 31, 2009:

	Total (In thousands)
Over one year to two years	$ 1,786,651
Over two years to three years	1,048,911
Over three years to four years	279,467
Over four years to five years	42,382
Over five years	13,806
Total	$ 3,171,217

As of December 31, 2009, CDs in denominations of $100,000 or higher amounted to $8.6 billion (2008 $9.6 billion) including brokered CDs of $7.6 billion (2008 $8.4 billion) at a weighted average rate of 2.13% (2008 4.03%) 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. As of December 31, 2009, unamortized broker placement fees amounted to $23.2 million (2008 $21.6 million), which are amortized over the contractual maturity of the brokered CDs under the interest method. During 2009, all of the $1.1 billion of brokered CDs measured at fair value that were outstanding at December 31, 2008 were called. The Corporation exercised its call option on

swapped-to-floating brokered CDs after the cancellation of interest rate swaps by counterparties due to lower levels of 3-month LIBOR. Some of these brokered CDs were replaced by new brokered CDs not hedged with interest rate swaps and not measured at fair value, causing the increase in the unamortized balance of broker placement fees.

As of December 31, 2009, deposit accounts issued to government agencies with a carrying value of $447.5 million (2008 $564.3 million) were collateralized by securities and loans with an amortized cost of $539.1 million (2008 $600.5 million) and estimated market value of $541.9 million (2008 $604.6 million), and by municipal obligations with a carrying value and estimated market value of $66.3 million (2008 $32.4 million).

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

A table showing interest expense on deposits follows:

	Year Ended December 31,		
	2009	2008	2007
		(In thousands)	
Interest-bearing checking accounts	$ 19,995	$ 12,914	$ 11,365
Savings	19,032	18,916	15,037
Certificates of deposit	50,939	73,466	82,761
Brokered certificates of deposit	224,521	309,542	419,577
Total	$ 314,487	$ 414,838	$ 528,740

The interest expense on deposits includes the market valuation of interest rate swaps that economically hedge brokered CDs, the related interest exchanged, the amortization of broker placement fees related to brokered CDs not measured at fair value and changes in the fair value of callable brokered CDs measured at fair value.

The following are the components of interest expense on deposits:

	Year Ended December 31,		
	2009	2008	2007
		(In thousands)	
Interest expense on deposits	$ 295,004	$ 407,830	$ 515,394
Amortization of broker placement fees(1)	22,858	15,665	9,056
Interest expense on deposits excluding net unrealized (gain) loss on derivatives and brokered CDs measured at fair value	317,862	423,495	524,450
Net unrealized (gain) loss on derivatives and brokered CDs measured at fair value	(3,375)	(8,657)	4,290
Total interest expense on deposits	$ 314,487	$ 414,838	$ 528,740

(1) Related to brokered CDs not measured at fair value.

Total interest expense on deposits includes net cash settlements on interest rate swaps that economically hedge brokered CDs that for the year ended December 31, 2009 amounted to net interest realized of $5.5 million (2008 net interest realized of $35.6 million; 2007 net interest incurred of $12.3 million).

Note 14 Loans Payable

As of December 31, 2009, loans payable consisted of $900 million in short-term borrowings under the FED Discount Window Program bearing interest at 1.00%. The Corporation participates in the Borrower-in-Custody (BIC) Program of the FED. Through the BIC Program, a broad range of loans (including commercial, consumer and mortgages) may be pledged as collateral for borrowings through the FED Discount Window. As of December 31, 2009 collateral pledged related to this credit facility amounted to $1.2 billion, mainly commercial, consumer and mortgage loan .

Note 15 Securities Sold Under Agreements to Repurchase

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

	December, 31	
	2009	2008
	(Dollars in thousands)	
Repurchase agreements, interest ranging from 0.23% to 5.39% (2008 - 2.29% to 5.39%) (1)	$ 3,076,631	$ 3,421,042

(1) As of December 31, 2009, includes $1.4 billion with an average rate of 4.29%, which lenders have the right to call before their contractual maturities at various dates beginning on February 1, 2010

The weighted-average interest rates on repurchase agreements as of December 31, 2009 and 2008 were 3.34% and 3.85%, respectively. Accrued interest payable on repurchase agreements amounted to $18.1 million and $21.2 million as of December 31, 2009 and 2008, respectively.

F-44

Table of Contents

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Repurchase agreements mature as follows:

	December 31, 2009 (In thousands)
One to thirty days	$ 196,628
Over thirty to ninety days	380,003
Over ninety days to one year	100,000
One to three years	1,600,000
Three to five years	800,000
Total	$ 3,076,631

The following securities were sold under agreements to repurchase:

	December 31, 2009			
Underlying Securities	**Amortized Cost of Underlying Securities**	**Balance of Borrowing**	**Approximate Fair Value of Underlying Securities**	**Weighted Average Interest Rate of Security**
	(Dollars in thousands)			
U.S. Treasury securities and obligations of other U.S. Government Sponsored Agencies	$ 871,725	$ 794,267	$ 875,835	2.15%
Mortgage-backed securities	2,504,941	2,282,364	2,560,374	4.37%
Total	$ 3,376,666	$ 3,076,631	$ 3,436,209	
Accrued interest receivable	$ 13,720			

	December 31, 2008			
Underlying Securities	**Amortized Cost of Underlying Securities**	**Balance of Borrowing**	**Approximate Fair Value of Underlying Securities**	**Weighted Average Interest Rate of Security**
	(Dollars in thousands)			
U.S. Treasury securities and obligations of other U.S. Government Sponsored Agencies	$ 511,621	$ 459,289	$ 514,796	5.77%
Mortgage-backed securities	3,299,221	2,961,753	3,376,421	5.34%

Total	$ 3,810,842	$ 3,421,042	$ 3,891,217
Accrued interest receivable	$ 20,856		

The maximum aggregate balance outstanding at any month-end during 2009 was $4.1 billion (2008 $4.1 billion). The average balance during 2009 was $3.6 billion (2008 $3.6 billion). The weighted average interest rate during 2009 and 2008 was 3.22% and 3.71%, respectively.

As of December 31, 2009 and 2008, the securities underlying such agreements were delivered to the dealers with which the repurchase agreements were transacted.

Repurchase agreements as of December 31, 2009, grouped by counterparty, were as follows:

(Dollars in thousands) Counterparty	**Amount**	**Weighted-Average Maturity (In Months)**
Credit Suisse First Boston	$ 1,051,731	24
Citigroup Global Markets	600,000	38
Barclays Capital	500,000	24
JP Morgan Chase	475,000	27
Dean Witter / Morgan Stanley	349,900	27
UBS Financial Services, Inc.	100,000	31
	$ 3,076,631	

F-45

Table of Contents

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 16 Advances from the Federal Home Loan Bank (FHLB)

Following is a summary of the advances from the FHLB:

	December, 31 2009	December, 31 2008
	(Dollars in thousands)	
Fixed-rate advances from FHLB with a weighted-average interest rate of 3.21% (2008 - 3.09%)	$ 978,440	$ 1,060,440

Advances from FHLB mature as follows:

	December, 31 2009 (In thousands)
One to thirty days	$ 5,000
Over thirty to ninety days	13,000
Over ninety days to one year	307,000
One to three years	445,000
Three to five years	208,440
Total	$ 978,440

Advances are received from the FHLB under an Advances, Collateral Pledge and Security Agreement (the Collateral Agreement). Under the Collateral Agreement, the Corporation is required to maintain a minimum amount of qualifying mortgage collateral with a market value of generally 125% or higher than the outstanding advances. As of December 31, 2009, the estimated value of specific mortgage loans pledged as collateral amounted to $1.1 billion (2008 $1.7 billion), as computed by the FHLB for collateral purposes. The carrying value of such loans as of December 31, 2009 amounted to $1.8 billion (2008 $2.4 billion). In addition, securities with an approximate estimated value of $4.1 million (2008 $5.6 million) and a carrying value of $4.1 million (2008 $5.7 million) were pledged to the FHLB. As of December 31, 2009, the Corporation had additional capacity of approximately $378 million on this credit facility based on collateral pledged at the FHLB, including a haircut reflecting the perceived risk associated with holding the collateral. Haircut refers to the percentage by which an asset s market value is reduced for purpose of collateral levels. Advances may be repaid prior to maturity, in whole or in part, at the option of the borrower upon payment of any applicable fee specified in the contract governing such advance. In calculating the fee due consideration is given to (i) all relevant factors, including but not limited to, any and all applicable costs of repurchasing and/or prepaying any associated liabilities and/or hedges entered into with respect to the applicable advance; and (ii) the financial characteristics, in their entirety, of the advance being prepaid; and (iii), in the case of adjustable-rate advances, the expected future earnings of the replacement borrowing as long as the replacement borrowing is at least equal to the original advance s par amount and the replacement borrowing s tenor is at least equal to the remaining maturity of the prepaid advance.

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 17 Notes Payable

Notes payable consist of:

	December 31, 2009	December 31, 2008
	(Dollars in thousands)	
Callable step-rate notes, bearing step increasing interest from 5.00% to 7.00% (5.50% as of December 31, 2009 and 2008) maturing on October 18, 2019, measured at fair value	$ 13,361	$ 10,141
Dow Jones Industrial Average (DJIA) linked principal protected notes:		
Series A maturing on February 28, 2012	6,542	6,245
Series B maturing on May 27, 2011	7,214	6,888
	$ 27,117	$ 23,274

Note 18 Other Borrowings

Other borrowings consist of:

	December 31, 2009	December 31, 2008
	(Dollars in thousands)	
Junior subordinated debentures due in 2034, interest-bearing at a floating-rate of 2.75% over 3-month LIBOR (3.00% as of December 31, 2009 and 4.62% as of December 31, 2008)	$ 103,093	$ 103,048
Junior subordinated debentures due in 2034, interest-bearing at a floating-rate of 2.50% over 3-month LIBOR (2.75% as of December 31, 2009 and 4.00% as of December 31, 2008)	128,866	128,866
	$ 231,959	$ 231,914

Note 19 Unused Lines of Credit

The Corporation maintains unsecured uncommitted lines of credit with other banks. As of December 31, 2009, the Corporation s total unused lines of credit with these banks amounted to $165 million (2008 $220 million). As of December 31, 2009, the Corporation has an available line of credit with the FHLB-New York guaranteed with excess collateral already pledged, in the amount of $378.6 million (2008 $626.9 million).

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 20 Earnings per Common Share

The calculations of earnings per common share for the years ended December 31, 2009, 2008 and 2007 follow:

	Year Ended December 31,		
	2009	2008	2007
	(In thousands, except per share data)		
Net (Loss) Income:			
Net (loss) income	$ (275,187)	$ 109,937	$ 68,136
Less: Preferred stock dividends [1]	(42,661)	(40,276)	(40,276)
Less: Preferred stock discount accretion	(4,227)		
Net (loss) income attributable to common stockholders	$ (322,075)	$ 69,661	$ 27,860
Weighted-Average Shares:			
Basic weighted-average common shares outstanding	92,511	92,508	86,549
Average potential common shares		136	317
Diluted weighted-average number of common shares outstanding	92,511	92,644	86,866
(Loss) Earnings per common share:			
Basic	$ (3.48)	$ 0.75	$ 0.32
Diluted	$ (3.48)	$ 0.75	$ 0.32

(1) For the year ended December 31, 2009, preferred stock dividends include $12.6 million of Series F Preferred Stock cumulative preferred dividends not declared as of the end of the year. Refer to Note 23 for additional information related to the Series F Preferred Stock issued to the U.S. Treasury in connection with the Trouble Asset Relief Program (TARP) Capital Purchase Program.

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

Potential common shares consist of common stock issuable under the assumed exercise of stock options, unvested shares of restricted stock, and outstanding warrants using the treasury stock method. This method assumes that the potential common shares are issued and the proceeds from the exercise, in addition to the amount of compensation cost attributable to future services, are used to purchase common stock at the exercise date. The difference between the number of potential shares issued and the shares purchased is added as incremental shares to the actual number of shares outstanding to compute diluted earnings per share. Stock options, unvested shares of restricted stock, and outstanding warrants that result in lower potential shares issued than shares purchased under the treasury stock method are not included in the computation of dilutive earnings per share since their inclusion would have an antidilutive effect on earnings per share. For the year ended December 31, 2009, there were 2,481,310 outstanding stock options, warrants outstanding to purchase 5,842,259 shares of common stock related to the TARP Capital Purchase Program and 32,216 shares of restricted stock that were excluded from the computation of diluted earnings per common share because the Corporation reported a net loss attributable to common stockholders for the year and their inclusion would have an antidilutive effect. Refer to Note 23 for additional information related to the issuance of the Series F Preferred Stock and Warrants (as hereinafter defined) under the TARP Capital Purchase Program. For the year ended December 31, 2008, there were 2,020,600 weighted-average outstanding stock options, which were excluded from the computation of dilutive earnings per share since their inclusion would have an antidilutive effect on earnings per share.

Note 21 Regulatory Capital Requirements

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

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

capital amounts and classification are also subject to qualitative judgment by the regulators about components, risk weightings and other factors.

Capital standards established by regulations require the Corporation to maintain minimum amounts and ratios of Tier 1 capital to total average assets (leverage ratio) and ratios of Tier 1 and total capital to risk-weighted assets, as defined in the regulations. The total amount of risk-weighted assets is computed by applying risk-weighting factors to the Corporation s assets and certain off-balance sheet items, which vary from 0% to 200% depending on the nature of the asset.

As of December 31, 2009 the Corporation was in compliance with the minimum regulatory capital requirements.

As of December 31, 2009 and 2008, the Corporation and each of its subsidiary banks were categorized as well-capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since December 31, 2009 that management believes have changed any subsidiary bank s capital category.

The Corporation s and its banking subsidiary s regulatory capital positions were as follows:

			Regulatory Requirements			
			For Capital Adequacy Purposes		To be Well-Capitalized	
	Actual					
	Amount	Ratio	Amount	Ratio	Amount	Ratio
			(Dollars in thousands)			
At December 31, 2009						
Total Capital (to Risk-Weighted Assets)						
First BanCorp	$1,922,138	13.44%	$1,144,280	8%	N/A	N/A
FirstBank	$1,838,378	12.87%	$1,142,795	8%	$1,428,494	10%
Tier I Capital (to Risk-Weighted Assets)						
First BanCorp	$1,739,363	12.16%	$ 572,140	4%	N/A	N/A
First Bank	$1,670,878	11.70%	$ 571,398	4%	$ 857,097	6%
Leverage ratio						
First BanCorp	$1,739,363	8.91%	$ 740,844	4%	N/A	N/A
FirstBank	$1,670,878	8.53%	$ 783,087	4%	$ 978,859	5%
At December 31, 2008						
Total Capital (to Risk-Weighted Assets)						
First BanCorp	$1,762,474	12.80%	$1,100,990	8%	N/A	N/A
FirstBank	$1,602,538	12.23%	$1,048,065	8%	$1,310,082	10%
Tier I Capital (to Risk-Weighted Assets)						
First BanCorp	$1,589,854	11.55%	$ 550,495	4%	N/A	N/A
FirstBank	$1,438,265	10.98%	$ 524,033	4%	$ 786,049	6%
Leverage ratio						
First BanCorp	$1,589,854	8.30%	$ 765,935	4%	N/A	N/A
FirstBank	$1,438,265	7.90%	$ 728,409	4%	$ 910,511	5%

F-49

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 22 Stock Option Plan

Between 1997 and January 2007, the Corporation had a stock option plan (the 1997 stock option plan) that authorized the granting of up to 8,696,112 options on shares of the Corporation s common stock to eligible employees. The options granted under the plan could not exceed 20% of the number of common shares outstanding. Each option provides for the purchase of one share of common stock at a price not less than the fair market value of the stock on the date the option was granted. Stock options were fully vested upon grant. The maximum term to exercise the options is ten years. The stock option plan provides for a proportionate adjustment in the exercise price and the number of shares that can be purchased in the event of a stock dividend, stock split, reclassification of stock, merger or reorganization and certain other issuances and distributions such as stock appreciation rights.

Under the 1997 stock option plan, the Compensation and Benefits Committee (the Compensation Committee) had the authority to grant stock appreciation rights at any time subsequent to the grant of an option. Pursuant to stock appreciation rights, the optionee surrenders the right to exercise an option granted under the plan in consideration for payment by the Corporation of an amount equal to the excess of the fair market value of the shares of common stock subject to such option surrendered over the total option price of such shares. Any option surrendered is cancelled by the Corporation and the shares subject to the option are not eligible for further grants under the option plan. During the second quarter of 2008, the Compensation Committee approved the grant of stock appreciation rights to an executive officer. The employee surrendered the right to exercise 120,000 stock options in the form of stock appreciation rights for a payment of $0.2 million. On January 21, 2007, the 1997 stock option plan expired; all outstanding awards granted under this plan continue in full force and effect, subject to their original terms. No awards for shares could be granted under the 1997 stock option plan as of its expiration.

On April 29, 2008, the Corporation s stockholders approved the First BanCorp 2008 Omnibus Incentive Plan (the Omnibus Plan). The Omnibus Plan provides for equity-based compensation incentives (the awards) through the grant of stock options, stock appreciation rights, restricted stock, restricted stock units, performance shares, and other stock-based awards. This plan allows the issuance of up to 3,800,000 shares of common stock, subject to adjustments for stock splits, reorganization and other similar events. The Corporation s Board of Directors, upon receiving the relevant recommendation of the Compensation Committee, has the power and authority to determine those eligible to receive awards and to establish the terms and conditions of any awards subject to various limits and vesting restrictions that apply to individual and aggregate awards. Shares delivered pursuant to an Award may consist, in whole or in part, of authorized and unissued shares of Common Stock or shares of Common Stock acquired by the Corporation. During the fourth quarter of 2008, the Corporation granted 36,243 shares of restricted stock with a fair value of $8.69 under the Omnibus Plan to the Corporation s independent directors. The following table shows the activity of restricted stock during 2009.

	Number of Restricted Shares
Beginning of year	36,243
Restricted shares forfeited	(4,027)
End of period outstanding	32,216
End of period vested restricted shares	10,739

For the years ended December 31, 2009 and 2008, the Corporation recognized $92,361 and $8,750, respectively, of stock-based compensation expense related to the aforementioned restricted stock awards. The total unrecognized compensation cost related to these non-vested restricted shares was $213,889 as of December 31, 2009 and is expected to be recognized over the next 1.9 year.

The Corporation accounts for stock options using the modified prospective method. There were no stock options granted during 2009 and 2008, therefore no compensation associated with stock options was recorded in those years. The compensation expense associated with stock options for the 2007 year was approximately $2.8 million. All employee stock options granted during 2007 were fully vested at the time of grant.

F-50

Table of Contents

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Stock-based compensation accounting guidance requires the Corporation to develop an estimate of the number of share-based awards which will be forfeited due to employee or director turnover. Quarterly changes in the estimated forfeiture rate may have a significant effect on share-based compensation, as the effect of adjusting the rate for all expense amortization is recognized in the period in which the forfeiture estimate is changed. If the actual forfeiture rate is higher than the estimated forfeiture rate, then an adjustment is made to increase the estimated forfeiture rate, which will result in a decrease to the expense recognized in the financial statements. If the actual forfeiture rate is lower than the estimated forfeiture rate, then an adjustment is made to decrease the estimated forfeiture rate, which will result in an increase to the expense recognized in the financial statements. When unvested options or shares of restricted stock are forfeited, any compensation expense previously recognized on the forfeited awards is reversed in the period of the forfeiture. During 2009, as shown above, 4,027 unvested shares of restricted stock were forfeited resulting in the reversal of $9,722 of previously recorded stock-based compensation expense.

The activity of stock options during the year ended December 31, 2009 is set forth below:

	For the Year Ended December 31, 2009			
	Number of Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value (In thousands)
Beginning of year	3,910,910	$ 12.82		
Options cancelled	(1,429,600)	11.69		
End of period outstanding and exercisable	2,481,310	$ 13.46	5.2	$

The fair value of options granted in 2007, which was estimated using the Black-Scholes option pricing method, and the assumptions used are as follows:

	2007
Weighted-average stock price at grant date and exercise price	$ 9.20
Stock option estimated fair value	$ 2.40 - $2.45
Weighted-average estimated fair value	$ 2.43
Expected stock option term (years)	4.31 - 4.59
Expected volatility	32%
Weighted-average expected volatility	32%
Expected dividend yield	3.0%
Weighted-average expected dividend yield	3.0%
Risk-free interest rate	5.1%

The Corporation uses empirical research data to estimate option exercises and employee termination within the valuation model; separate groups of employees that have similar historical exercise behavior are considered separately for valuation purposes. The expected volatility is based on the historical implied volatility of the Corporation s common stock at each grant date; otherwise, historical volatilities based upon 260 observations (working days) were obtained from Bloomberg L.P. (Bloomberg) and used as inputs in the model. The dividend yield is based on the historical 12-month dividend yield observable at each grant date. The risk-free rate for the period is based on historical zero coupon curves obtained from Bloomberg at the time of grant based on the option s expected term.

Cash proceeds from 6,000 options exercised in 2008 amounted to approximately $53,000 and did not have any intrinsic value. No stock options were exercised during 2009 or 2007.

Note 23 Stockholders Equity

Common stock

The Corporation has 250,000,000 authorized shares of common stock with a par value of $1 per share. As of December 31, 2009, there were 102,440,522 (2008 102,444,549) shares issued and 92,542,722 (2008 92,546,749) shares outstanding. In February 2009, the Corporation s Board of Directors declared a first quarter cash

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

dividend of $0.07 per common share which was paid on March 31, 2009 to common stockholders of record on March 15, 2009 and in May 2009 declared a second quarter dividend of $0.07 per common share which was paid on June 30, 2009 to common stockholders of record on June 15, 2009. On July 30, 2009, the Corporation announced the suspension of common and preferred dividends effective with the preferred dividend for the month of August 2009.

On December 1, 2008, the Corporation granted 36,243 shares of restricted stock under the Omnibus Plan to the Corporation s independent directors, of which 4,027 were forfeited in 2009 due to the departure of a director. The restrictions on such restricted stock award lapse ratably on an annual basis over a three-year period. The shares of restricted stock may vest more quickly in the event of death, disability, retirement, or a change in control. Based on particular circumstances evaluated by the Compensation Committee as they may relate to the termination of a restricted stock holder, the Corporation s Board of Directors may, with the recommendation of the Compensation Committee, grant the full vesting of the restricted stock held upon termination of employment. Holders of restricted stock have the right to dividends or dividend equivalents, as applicable, during the restriction period. Such dividends or dividend equivalents will accrue during the restriction period, but not be paid until restrictions lapse. The holder of restricted stocks has the right to vote the shares.

Stock repurchase plan and treasury stock

The Corporation has a stock repurchase program under which from time to time it repurchases shares of common stock in the open market and holds them as treasury stock. No shares of common stock were repurchased during 2009 and 2008 by the Corporation. As of December 31, 2009 and 2008, of the total amount of common stock repurchased in prior years, 9,897,800 shares were held as treasury stock and were available for general corporate purposes.

Preferred stock

The Corporation has 50,000,000 authorized shares of preferred stock with a par value of $1, redeemable at the Corporation s option subject to certain terms. This stock may be issued in series and the shares of each series shall have such rights and preferences as shall be fixed by the Board of Directors when authorizing the issuance of that particular series. As of December 31, 2009, 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, which trade on the NYSE. The liquidation value per share is $25. Annual dividends of $1.75 per share (Series E), $1.8125 per share (Series D), $1.85 per share (Series C), $2.0875 per share (Series B) and $1.78125 per share (Series A) are payable monthly, if declared by the Board of Directors. Dividends declared on the non-convertible non-cumulative preferred stock for 2009, 2008 and 2007 amounted to $23.5 million, $40.3 million and $40.3 million, respectively.

In January 2009, in connection with the TARP Capital Purchase Program, established as part of the Emergency Economic Stabilization Act of 2008, the Corporation issued to the U.S. Treasury 400,000 shares of its Fixed Rate Cumulative Perpetual Preferred Stock, Series F, $1,000 liquidation preference value per share. The Series F Preferred Stock has a call feature after three years. In connection with this investment, the Corporation also issued to the U.S. Treasury a 10-year warrant (the Warrant) to purchase 5,842,259 shares of the Corporation s common stock at an exercise price of $10.27 per share. The Corporation registered the Series F Preferred Stock, the Warrant and the shares of common stock underlying the Warrant for sale under the Securities Act of 1933. The Corporation recorded the total $400 million of the preferred shares and the Warrant at their relative fair values of $374.2 million and $25.8 million, respectively. The preferred shares were valued using a discounted cash flow analysis and applying a discount rate of 10.9%. The difference from the par amount of the preferred shares is accreted to preferred stock over five years using the interest method with a corresponding adjustment to preferred dividends. The Cox-Rubinstein binomial model was used to estimate the value of the Warrant with a strike price calculated, pursuant to the Securities Purchase Agreement with the U.S. Treasury, based on the average closing prices of the common stock on the 20 trading days ending the last day prior to the date of approval to participate in the Program. No credit risk was assumed given the Corporation s availability of authorized, but unissued common shares; as well as its intention of reserving sufficient shares to satisfy

the exercise of the warrants. The volatility parameter input was the historical 5-year common stock price volatility.

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Series F Preferred Stock qualifies as Tier 1 regulatory capital. Cumulative dividends on the Series F Preferred Stock accrue on the liquidation preference amount on a quarterly basis at a rate of 5% per annum for the first five years, and thereafter at a rate of 9% per annum, but will only be paid when, as and if declared by the Corporation s Board of Directors out of assets legally available therefore. The Series F Preferred Stock ranks pari passu with the Corporation s existing Series A through E, in terms of dividend payments and distributions upon liquidation, dissolution and winding up of the Corporation. The Purchase Agreement relating to this issuance contains limitations on the payment of dividends on common stock, including limiting regular quarterly cash dividends to an amount not exceeding the last quarterly cash dividend paid per share, or the amount publicly announced (if lower), of common stock prior to October 14, 2008, which is $0.07 per share. For the year ended December 31, 2009, preferred stock dividends of Series F Preferred Stock amounted to $19.2 million, including $12.6 million of cumulative preferred dividends not declared as of the end of the period.

The Warrant has a 10-year term and is exercisable at any time. The exercise price and the number of shares issuable upon exercise of the Warrant are subject to certain anti-dilution adjustments.

The possible future issuance of equity securities through the exercise of the Warrant could affect the Corporation s current stockholders in a number of ways, including by:

diluting the voting power of the current holders of common stock (the shares underlying the warrant represent approximately 6% of the Corporation s shares of common stock as of December 31, 2009);

diluting the earnings per share and book value per share of the outstanding shares of common stock; and

making the payment of dividends on common stock more expensive.

As mentioned above, on July 30, 2009, the Corporation announced the suspension of dividends for common and all its outstanding series of preferred stock. This suspension was effective with the dividends for the month of August 2009, on the Corporation s five outstanding series of non-cumulative preferred stock and dividends for the Corporation s outstanding Series F Cumulative Preferred Stock and the Corporation s common stock. As a result of the dividend suspension, the terms of the Series F Cumulative Preferred Stock include limitations on the resumption of the payment of cash dividends and purchases of outstanding shares of common and preferred stock.

Legal surplus

The Banking Act of the Commonwealth of Puerto Rico requires that a minimum of 10% of FirstBank s net income for the year be transferred to legal surplus until such surplus equals the total of paid-in-capital on common and preferred stock. Amounts transferred to the legal surplus account from the retained earnings account are not available for distribution to the stockholders.

Table of Contents

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 24 Employees Benefit Plan

FirstBank provides contributory retirement plans pursuant to Section 1165(e) of the Puerto Rico Internal Revenue Code for Puerto Rico employees and Section 401(k) of the U.S. Internal Revenue Code for U.S.Virgin Islands and U.S. employees (the Plans). All employees are eligible to participate in the Plans after three months of service for purposes of making elective deferral contributions and one year of service for purposes of sharing in the Bank s matching, qualified matching and qualified nonelective contributions. Under the provisions of the Plans, the Bank contributes 25% of the first 4% of the participant s compensation contributed to the Plans on a pre-tax basis. Participants are permitted to contribute up to $9,000 for 2009 and 2010, $10,000 for 2011 and 2012 and $12,000 beginning on January 1, 2013 ($16,500 for 2009 for U.S.V.I. and U.S. employees). Additional contributions to the Plans are voluntarily made by the Bank as determined by its Board of Directors. The Bank had a total plan expense of $1.6 million for the year ended December 31, 2009, $1.5 million for 2008 and $1.4 million for 2007.

FirstBank Florida provides a contributory retirement plan pursuant to Section 401(k) of the U.S. Internal Revenue Code for its U.S. employees (the Plan). All employees are eligible to participate in the Plan after six months of service. Under the provisions of the Plan, FirstBank Florida contributes 100% of the first 3% of the participant s contribution and 50% of the next 2% participant s contribution up to a maximum of 4% of the participant s compensation. Participants are permitted to contribute up to $16,500 per year (participants over 50 years of age are permitted an additional $5,500 contribution). FirstBank Florida had total plan expenses of approximately $151,000 for 2009, approximately $157,000 for 2008 and approximately $114,000 for 2007.

Note 25 Other Non-interest Income

A detail of other non-interest income follows:

	Year Ended December 31,		
	2009	2008	2007
		(In thousands)	
Other commissions and fees	$ 469	$ 420	$ 273
Insurance income	8,668	10,157	10,877
Other	17,893	18,150	13,322
Total	$ 27,030	$ 28,727	$ 24,472

Note 26 Other Non-interest Expenses

A detail of other non-interest expenses follows:

	Year Ended December 31,		
	2009	2008	2007
		(In thousands)	
Servicing and processing fees	$ 10,174	$ 9,918	$ 6,574
Communications	8,283	8,856	8,562
Depreciation and expenses on revenue earning equipment	1,341	2,227	2,144
Supplies and printing	3,073	3,530	3,402
Core deposit intangible impairment	3,988		
Other	17,483	17,443	18,744
Total	$ 44,342	$ 41,974	$ 39,426

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 27 Income Taxes

Income tax expense includes Puerto Rico and Virgin Islands income taxes as well as applicable U.S. federal and state taxes. The Corporation is subject to Puerto Rico income tax on its income from all sources. As a Puerto Rico corporation, First BanCorp is treated as a foreign corporation for U.S. income tax purposes and is generally subject to United States income tax only on its income from sources within the United States or income effectively connected with the conduct of a trade or business within the United States. Any such tax paid is creditable, within certain conditions and limitations, against the Corporation s Puerto Rico tax liability. The Corporation is also subject to U.S.Virgin Islands taxes on its income from sources within that jurisdiction. Any such tax paid 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 1994, as amended (the PR Code), the Corporation and its subsidiaries are treated as separate taxable entities and are not entitled to file consolidated tax returns and, thus, the Corporation is not able to utilize losses from one subsidiary to offset gains in another subsidiary. Accordingly, in order to obtain a tax benefit from a net operating loss, a particular subsidiary must be able to demonstrate sufficient taxable income within the applicable carry forward period (7 years under the PR Code). The PR Code provides a dividend received deduction of 100% on dividends received from controlled subsidiaries subject to taxation in Puerto Rico and 85% on dividends received from other taxable domestic corporations. Dividend payments from a U.S. subsidiary to the Corporation are subject to a 10% withholding tax based on the provisions of the U.S. Internal Revenue Code.

Under the PR Code, First BanCorp is subject to a maximum statutory tax rate of 39%. In 2009 the Puerto Rico Government approved Act No. 7 (the Act), to stimulate Puerto Rico s economy and to reduce the Puerto Rico Government s fiscal deficit. The Act imposes a series of temporary and permanent measures, including the imposition of a 5% surtax over the total income tax determined, which is applicable to corporations, among others, whose combined income exceeds $100,000, effectively resulting in an increase in the maximum statutory tax rate from 39% to 40.95% and an increase in capital gain statutory tax rate from 15% to 15.75%. This temporary measure is effective for tax years that commenced after December 31, 2008 and before January 1, 2012. The PR Code also includes an alternative minimum tax of 22% that applies if the Corporation s regular income tax liability is less than the alternative minimum tax requirements.

The Corporation has maintained an effective tax rate lower than the maximum statutory rate mainly by investing in government obligations and mortgage-backed securities exempt from U.S. and Puerto Rico income taxes and by doing business through International Banking Entities (IBEs) of the Corporation and the Bank and through the Bank s subsidiary, FirstBank Overseas Corporation, in which the interest income and gain on sales is exempt from Puerto Rico and U.S. income taxation. Under the Act, all IBEs are subject to the special 5% tax on their net income not otherwise subject to tax pursuant to the PR Code. This temporary measure is also effective for tax years that commenced after December 31, 2008 and before January 1, 2012. The IBEs and FirstBank Overseas Corporation were created under the International Banking Entity Act of Puerto Rico, which provides for total Puerto Rico tax exemption on net income derived by IBEs operating in Puerto Rico. IBEs that operate as a unit of a bank pay income taxes at normal rates to the extent that the IBEs net income exceeds 20% of the bank s total net taxable income.

The effect of a higher temporary statutory tax rate over the normal statutory tax rate resulted in an additional income tax benefit of $10.4 million for 2009 that was partially offset by an income tax provision of $6.6 million related to the special 5% tax on the operations FirstBank Overseas Corporation.

The components of income tax expense for the years ended December 31 are summarized below:

	Year Ended December 31,		
	2009	**2008**	**2007**
		(In thousands)	
Current income tax benefit (expense)	$ 11,520	$ (7,121)	$ (7,925)

Deferred income tax (expense) benefit	(16,054)	38,853	(13,658)
Total income tax (expense) benefit	$ (4,534)	$ 31,732	$ (21,583)

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The differences between the income tax expense applicable to income before provision for income taxes and the amount computed by applying the statutory tax rate in Puerto Rico were as follows:

	Year Ended December 31,					
	2009		2008		2007	
	Amount	% of Pre-Tax Income	Amount	% of Pre-Tax Income	Amount	% of Pre-Tax Income
			(Dollars in thousands)			
Computed income tax at statutory rate	$ 110,832	40.95%	$ (30,500)	(39.0)%	$ (34,990)	(39.0)%
Federal and state taxes	(311)	(0.1)%		0.0%	(227)	(0.3)%
Non-tax deductible expenses		0.0%		0.0%	(1,111)	(1.2)%
Benefit of net exempt income	52,293	19.3%	49,799	63.7%	23,974	26.7%
Deferred tax valuation allowance	(184,397)	(68.1)%	(2,446)	(3.1)%	1,250	1.4%
Net operating loss carry forward		0.0%	(402)	(0.5)%	(7,003)	(7.8)%
Reversal of Unrecognized Tax Benefits	18,515	6.8%	10,559	13.5%		0.0%
Settlement payment closing agreement		0.0%	5,395	6.9%		0.0%
Other-net	(1,466)	(0.5)%	(673)	(0.8)%	(3,476)	(3.9)%
Total income tax (provision) benefit	$ (4,534)	(1.7)%	$ 31,732	40.7%	$ (21,583)	(24.1)%

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and their tax bases. Significant components of the Corporation s deferred tax assets and liabilities as of December 31, 2009 and 2008 were as follows:

	December 31,	
	2009	2008
	(In thousands)	
Deferred tax asset:		
Allowance for loan and lease losses	$ 212,933	$ 106,879
Unrealized losses on derivative activities	1,028	1,912
Deferred compensation	41	682
Legal reserve	500	211
Reserve for insurance premium cancellations	649	679
Net operating loss and donation carryforward available	68,572	1,286
Impairment on investments	4,622	5,910
Tax credits available for carryforward	3,838	5,409
Unrealized net loss on available-for-sale securities	20	22

Realized loss on investments	142	136
Settlement payment closing agreement	7,313	9,652
Interest expense accrual Unrecognized Tax Benefits		2,658
Other reserves and allowances	12,665	7,010
Deferred tax asset	312,323	142,446
Deferred tax liability:		
Unrealized gain on available-for-sale securities	4,629	716
Differences between the assigned values and tax bases of assets and liabilities recognized in purchase business combinations	3,015	4,715
Unrealized gain on other investments	468	578
Other	3,342	1,123
Deferred tax liability	11,454	7,132
Valuation allowance	(191,672)	(7,275)
Deferred income taxes, net	$ 109,197	$ 128,039

For 2009, the Corporation recorded income tax expense of $4.5 million compared to an income tax benefit of $31.7 million for 2008. The fluctuation in income tax expense mainly resulted from a $184.4 million non-cash increase of the valuation allowance for the Corporation s deferred tax asset. The increase in the valuation allowance does not have any impact on the Corporation s liquidity or cash flow, nor does such an allowance preclude the Corporation from using tax losses, tax credits or other deferred tax assets in the future. As of December 31, 2009, the deferred tax asset, net of a valuation allowance of $191.7 million, amounted to $109.2 million compared to $128.0 million as of December 31, 2008.

Table of Contents

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Accounting for income taxes requires that companies assess whether a valuation allowance should be recorded against their deferred tax assets based on the consideration of all available evidence, using a more likely than not realization standard. The valuation allowance should be sufficient to reduce the deferred tax asset to the amount that is more likely than not to be realized. In making such assessment, significant weight is to be given to evidence that can be objectively verified, including both positive and negative evidence. The accounting for income taxes guidance requires the consideration of all sources of taxable income available to realize the deferred tax asset, including the future reversal of existing temporary differences, future taxable income exclusive of reversing temporary differences and carryforwards, taxable income in carryback years and tax planning strategies. In assessing the weight of positive and negative evidence, a significant negative factor that resulted in the increase of the valuation allowance was that the Corporation s banking subsidiary FirstBank Puerto Rico was in a three-year historical cumulative loss as of the end of the year 2009, mainly as a result of charges to the provision for loan and lease losses, especially in the construction portfolio both in Puerto Rico and the United States, resulting from the economic downturn. As of December 31, 2009, management concluded that $109.2 million of the deferred tax assets will be realized. In assessing the likelihood of realizing the deferred tax assets, management has considered all four sources of taxable income mentioned above and even though sufficient profits are expected in the next seven years to realized the deferred tax asset, given current uncertain economic conditions, the Company has only relied on tax-planning strategies as the main source of taxable income to realize the deferred tax asset amount. Among the most significant tax-planning strategies identified are: (i) sale of appreciated assets, (ii) consolidation of profitable and unprofitable companies (in Puerto Rico each Company files a separate tax return; no consolidated tax returns are permitted), and (iii) deferral of deductions without affecting its utilization. Management will continue monitoring the likelihood of realizing the deferred tax assets in future periods. If future events differ from management s December 31, 2009 assessment, an additional valuation allowance may need to be established which may have a material adverse effect on the Corporation s results of operations. Similarly, to the extent the realization of a portion, or all, of the tax asset becomes more likely than not based on changes in circumstances (such as, improved earnings, changes in tax laws or other relevant changes), a reversal of that portion of the deferred tax asset valuation allowance will then be recorded.

The tax effect of the unrealized holding gain or loss on securities available-for-sale, excluding that on securities held by the Corporation s international banking entities which is exempt, was computed based on a 15.75% capital gain tax rate, and is included in accumulated other comprehensive income as part of stockholders equity.

At December 31, 2009, the Corporation s deferred tax asset related to loss and other carry-forwards was $74 million. This was comprised of net operating loss carry-forward of $68.1 million, which will begin expiring in 2016, an alternative minimum tax credit carry-forward of $1.6 million, an extraordinary tax credit carryover of $3.8 million, and a charitable contribution carry-forward of $0.5 million which will begin expiring in 2014.

In June 2006, the FASB issued authoritative guidance that prescribes a comprehensive model for the financial statement recognition, measurement, presentation and disclosure of income tax uncertainties with respect to positions taken or expected to be taken on income tax returns. Under the authoritative accounting guidance, income tax benefits are recognized and measured based upon a two-step model: 1) a tax position must be more likely than not to be sustained based solely on its technical merits in order to be recognized, and 2) the benefit is measured as the largest dollar amount of that position that is more likely than not to be sustained upon settlement. The difference between the benefit recognized in accordance with this model and the tax benefit claimed on a tax return is referred to as an UTB.

During the second quarter of 2009, the Corporation reversed UTBs by $10.8 million and related accrued interest of $5.3 million due to the lapse of the statute of limitations for the 2004 taxable year. Also, in July 2009, the

Table of Contents

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Corporation entered into an agreement with the Puerto Rico Department of the Treasury to conclude an income tax audit and to eliminate all possible income and withholding tax deficiencies related to taxable years 2005, 2006, 2007 and 2008. As a result of such agreement, the Corporation reversed during the third quarter of 2009 the remaining UTBs and related interest by approximately $2.9 million, net of the payment made to the Puerto Rico Department of the Treasury in connection with the conclusion of the tax audit. There were no UTBs outstanding as of December 31, 2009. The beginning UTB balance of $15.6 million as of December 31, 2008 (excluding accrued interest of $6.8 million) reconciles to the ending balance in the following table.

Reconciliation of the Change in Unrecognized Tax Benefits

(In thousands)	
Balance at beginning of year	$ 15,600
Increases related to positions taken during prior years	173
Decreases related to positions taken during prior years	(317)
Expiration of statute of limitations	(10,733)
Audit settlement	(4,723)
Balance at end of year	$

The Corporation classified all interest and penalties, if any, related to tax uncertainties as income tax expense. As of December 31, 2008, the Corporation s accrual for interest that relates to tax uncertainties amounted to $6.8 million. As of December 31, 2008, there is no need to accrue for the payment of penalties. For the year ended on December 31, 2009, the total amount of accrued interest reversed by the Corporation through income tax expense was $6.8 million. The amount of UTBs may increase or decrease for various reasons, including changes in the amounts for current tax year positions, the expiration of open income tax returns due to the expiration of statutes of limitations, changes in management s judgment about the level of uncertainty, the status of examinations, litigation and legislative activity and the addition or elimination of uncertain tax positions.

Note 28 Lease Commitments

As of December 31, 2009, certain premises are leased with terms expiring through the year 2034. The Corporation has the option to renew or extend certain leases beyond the original term. Some of these leases require the payment of insurance, increases in property taxes and other incidental costs. As of December 31, 2009, the obligation under various leases follows:

	Amount (In thousands)
2010	$ 10,342
2011	7,680
2012	6,682
2013	4,906
2014	3,972
2015 and later years	30,213
Total	$ 63,795

Rental expense included in occupancy and equipment expense was $11.8 million in 2009 (2008 $11.6 million; 2007 $11.2 million).

Note 29 Fair Value

In February 2007, the FASB issued authoritative guidance which permits the measurement of selected eligible financial instruments at fair value at specified election dates. The Corporation elected to adopt the fair value option for certain of its brokered CDs and medium-term notes.

The following table summarizes the impact of adopting the fair value option for certain brokered CDs and medium-term notes on January 1, 2007. Amounts shown represent the carrying value of the affected instruments before and after the changes in accounting resulting from the adoption of the fair value option.

Table of Contents

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Transition Impact	Ending Statement of Financial Condition as of December 31, 2006 (Prior to Adoption) (1)	Net Increase in Retained Earnings Upon Adoption	Opening Statement of Financial Condition as of January 1, 2007 (After Adoption of Fair Value Option)
		(In thousands)	
Callable brokered CDs	$ (4,513,020)	$ 149,621	$ (4,363,399)
Medium-term notes	(15,637)	840	(14,797)
Cumulative-effect adjustment (pre-tax)		150,461	
Tax impact		(58,683)	
Cumulative-effect adjustment (net of tax) increased to retained earnings		$ 91,778	

(1) Net of debt issue costs, placement fees and basis adjustment as of December 31, 2006.

Fair Value Option

Callable Brokered CDs and Certain Medium-Term Notes

The Corporation elected the fair value option for certain financial liabilities that were hedged with interest rate swaps that were previously designated for fair value hedge accounting. As of December 31, 2009 and December 31, 2008, these liabilities included certain medium-term notes with a fair value of $13.4 million and $10.1 million, respectively, and principal balance of $15.4 million recorded in notes payable. As of December 31, 2008, liabilities recognized at fair value also included callable brokered CDs with an aggregate fair value of $1.15 billion and principal balance of $1.13 billion, recorded in interest-bearing deposits. Interest paid/accrued on these instruments is recorded as part of interest expense and the accrued interest is part of the fair value of the liabilities measured at fair value. Electing the fair value option allows the Corporation to eliminate the burden of complying with the requirements for hedge accounting (e.g., documentation and effectiveness assessment) without introducing earnings volatility. Interest rate risk on the callable brokered CDs measured at fair value was economically hedged with callable interest rate swaps, with the same terms and conditions, until they were all called during 2009. The Corporation did not elect the fair value option for the vast majority of other brokered CDs because these are not hedged by derivatives.

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

Fair Value Measurement

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

Level 1 Valuations of Level 1 assets and liabilities are obtained from readily available pricing sources for market transactions involving identical assets or liabilities. Level 1 assets and liabilities include equity securities that are traded in an active exchange market, as well as certain U.S. Treasury and other U.S. government and agency securities and corporate debt securities that are traded by dealers or brokers in active markets.

Level 2 Valuations of Level 2 assets and liabilities are based on observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include (i) mortgage-backed securities for which the fair value is estimated based on the value of identical or comparable assets, (ii) debt securities with quoted prices that are traded less frequently than exchange-traded instruments and (iii) derivative contracts and financial liabilities (e.g., callable brokered CDs and medium-term notes elected to be

Table of Contents

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

measured at fair value) whose value is determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data.

Level 3 Valuations of Level 3 assets and liabilities are based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models for which the determination of fair value requires significant management judgment or estimation.

Estimated Fair Value of Financial Instruments

The information about the estimated fair value of financial instruments required by GAAP is presented hereunder. The aggregate fair value amounts presented do not necessarily represent management s estimate of the underlying value of the Corporation.

The estimated fair value is subjective in nature and involves uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in the underlying assumptions used in calculating fair value could significantly affect the results. In addition, the fair value estimates are based on outstanding balances without attempting to estimate the value of anticipated future business.

The following table presents the estimated fair value and carrying value of financial instruments as of December 31, 2009 and December 31, 2008.

	Total Carrying Amount in Statement of Financial Condition 12/31/2009	Fair Value Estimated 12/31/2009	Total Carrying Amount in Statement of Financial Condition 12/31/2008	Fair Value Estimated 12/31/2008
	(In thousands)			
Assets:				
Cash and due from banks and money market investments	$ 704,084	$ 704,084	$ 405,733	$ 405,733
Investment securities available for sale	4,170,782	4,170,782	3,862,342	3,862,342
Investment securities held to maturity	601,619	621,584	1,706,664	1,720,412
Other equity securities	69,930	69,930	64,145	64,145
Loans receivable, including loans held for sale	13,949,226		13,088,292	
Less: allowance for loan and lease losses	(528,120)		(281,526)	
Loans, net of allowance	13,421,106	12,811,010	12,806,766	12,416,603
Derivatives, included in assets	5,936	5,936	8,010	8,010
Liabilities:				
Deposits	12,669,047	12,801,811	13,057,430	13,221,026
Loans payable	900,000	900,000		
Securities sold under agreements to repurchase	3,076,631	3,242,110	3,421,042	3,655,652
Advances from FHLB	978,440	1,025,605	1,060,440	1,079,298
Notes Payable	27,117	25,716	23,274	18,755

Other borrowings	231,959	80,267	231,914	81,170
Derivatives, included in liabilities	6,467	6,467	8,505	8,505

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

Table of Contents

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	As of December 31, 2009 Fair Value Measurements Using				As of December 31, 2008 Fair Value Measurements Using			
(In thousands)	Level 1	Level 2	Level 3	Assets / Liabilities at Fair Value	Level 1	Level 2	Level 3	Assets / Liabilities at Fair Value
Assets:								
Securities available for sale :								
Equity securities	$303	$	$	$ 303	$ 669	$	$	$ 669
Corporate Bonds					1,548			1,548
U.S. agency debt and MBS		3,949,799		3,949,799		3,609,009		3,609,009
Puerto Rico Government Obligations		136,326		136,326		137,133		137,133
Private label MBS			84,354	84,354			113,983	113,983
Derivatives, included in assets		1,737	4,199	5,936		7,250	760	8,010
Liabilities:								
Callable brokered CDs						1,150,959		1,150,959
Medium-term notes		13,361		13,361		10,141		10,141
Derivatives, included in liabilities		6,467		6,467		8,505		8,505

F-61

Table of Contents

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Changes in Fair Value for the Year Ended December 31, 2009, for Items Measured at Fair Value Pursuant to Election of the Fair Value Option		
(In thousands)	Unrealized Gains and Interest Expense included in Interest Expense on Deposits[1]	Unrealized Losses and Interest Expense included in Interest Expense on Notes Payable[1]	Total Changes in Fair Value Unrealized Gains (Losses) and Interest Expense included in Current-Period Earnings[1]
Callable brokered CDs	$ (2,068)	$	$ (2,068)
Medium-term notes		(4,069)	(4,069)
	$ (2,068)	$ (4,069)	$ (6,137)

(1) Changes in fair value for the year ended December 31, 2009 include interest expense on callable brokered CDs of $10.8 million and interest expense on medium-term notes of $0.8 million. Interest expense on callable brokered CDs and medium-term notes that have been elected to be carried at fair value are recorded in

interest expense in the Consolidated Statements of Income based on such instruments contractual coupons.

	Changes in Fair Value for the Year Ended December 31, 2008, for Items Measured at Fair Value Pursuant to Election of the Fair Value Option		
(In thousands)	Unrealized Losses and Interest Expense included in Interest Expense on Deposits[1]	Unrealized Gains and Interest Expense included in Interest Expense on Notes Payable[1]	Total Changes in Fair Value Unrealized (Losses) Gains and Interest Expense included in Current-Period Earnings[1]
Callable brokered CDs	$ (174,208)	$	$ (174,208)
Medium-term notes		3,316	3,316
	$ (174,208)	$ 3,316	$ (170,892)

(1) Changes in fair value for the year ended December 31, 2008 include interest expense on callable brokered CDs of $120.0 million and interest expense on medium-term notes of $0.8 million. Interest expense on callable brokered CDs and medium-term

notes that have been elected to be carried at fair value are recorded in interest expense in the Consolidated Statements of Income based on such instruments contractual coupons.

Changes in Fair Value for the Year Ended December 31, 2007, for Items Measured at Fair Value Pursuant to Election of the Fair Value Option

(In thousands)	Unrealized Losses and Interest Expense included in Interest Expense on Deposits[1]	Unrealized Gains and Interest Expense included in Interest Expense on Notes Payable[1]	Total Changes in Fair Value Unrealized (Losses) Gains and Interest Expense included in Current-Period Earnings[1]
Callable brokered CDs	$ (298,641)	$	$ (298,641)
Medium-term notes		(294)	(294)
	$ (298,641)	$ (294)	$ (298,935)

(1) Changes in fair value for the year ended December 31, 2007 include interest expense on callable brokered CDs of $227.5 million and interest expense on medium-term notes of $0.8 million.

Interest expense on callable brokered CDs and medium-term notes that have been elected to be carried at fair value are recorded in interest expense in the Consolidated Statements of Income based on such instruments contractual coupons.

Table of Contents

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The table below presents a reconciliation for all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the years ended December 31, 2009, 2008 and 2007.

Level 3 Instruments Only	**Total Fair Value Measurements (Year Ended December 31, 2009)**		**Total Fair Value Measurements (Year Ended December 31, 2008)**		**Total Fair Value Measurements (Year Ended December 31, 2007)**	
(In thousands)	**Derivatives[1]**	**Securities Available For Sale[2]**	**Derivatives[1]**	**Securities Available For Sale[2]**	**Derivatives[1]**	**Securities Available For Sale[2]**
Beginning balance	$ 760	$ 113,983	$ 5,102	$ 133,678	$ 9,087	$ 370
Total gains or (losses) (realized/unrealized):						
Included in earnings	3,439	(1,270)	(4,342)		(3,985)	
Included in other comprehensive income		(2,610)		(1,830)		(28,407)
New instruments acquired						182,376
Principal repayments and amortization		(25,749)		(17,865)		(20,661)
Ending balance	$ 4,199	$ 84,354	$ 760	$ 113,983	$ 5,102	$ 133,678

(1) Amounts related to the valuation of interest rate cap agreements.

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

The table below summarizes changes in unrealized gains and losses recorded in earnings for the years ended December 31, 2009 and 2008 for Level 3 assets and liabilities that are still held at the end of each year.

Level 3 Instruments Only	**Changes in Unrealized Gains (Losses) (Year Ended December 31, 2009)**		**Changes in Unrealized Losses (Year Ended December 31, 2008)**		**Changes in Unrealized Losses (Year Ended December 31, 2007)**	
(In thousands)	**Derivatives**	**Securities Available For Sale**	**Derivatives**	**Securities Available For Sale**	**Derivatives**	**Securities Available For Sale**
Changes in unrealized losses relating to assets still held at reporting date[1]:						

Interest income on loans	$ 45	$	$ (59)	$	$ (440)	$
Interest income on investment securities	3,394		(4,283)		(3,545)	
Net impairment losses on investment securities (credit component)		(1,270)				
	$ 3,439	$ (1,270)	$ (4,342)	$	$ (3,985)	$

(1) Unrealized losses of $2.6 million, $1.8 million and $28.4 million on Level 3 available-for-sale securities was recognized as part of other comprehensive income for the years ended December 31, 2009, 2008 and 2007, respectively.

Additionally, fair value is used on a no-recurring basis to evaluate certain assets in accordance with GAAP. Adjustments to fair value usually result from the application of lower-of-cost-or-market accounting (e.g., loans held for sale carried at the lower of cost or fair value and repossessed assets) or write-downs of individual assets (e.g., goodwill, loans).

As of December 31, 2009, 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 December 31, 2009			**Losses recorded for the Year Ended December 31, 2009**
	Level 1	**Level 2**	**Level 3**	
			(In thousands)	
Loans receivable (1)	$	$	$ 1,103,069	$ 144,024
Other Real Estate Owned (2)			69,304	8,419
Core deposit intangible (3)			6,683	3,988
Loans held for sale (4)		20,775		58

(1) Mainly impaired commercial and construction loans. The

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

(2) The fair value is derived from appraisals that take into consideration prices in observed transactions involving similar assets in similar locations but adjusted for specific characteristics and assumptions of the properties (e.g. absorption rates), which are not market observable. Losses are related to market valuation adjustments after the transfer from the loan to the Other Real Estate

Owned (OREO) portfolio.

(3) Amount represents core deposit intangible of First Bank Florida. The impairment was generally measured based on internal information about decreases in the base of core deposits acquired upon the acquisition of First Bank Florida.

(4) Fair value is primarily derived from quotations based on the mortgage-backed securities market.

Table of Contents

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

As of December 31, 2008, 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 December 31, 2008			Losses recorded for the Year Ended December 31, 2008
	Level 1	Level 2	Level 3	
			(In thousands)	
Loans receivable (1)	$	$	$209,900	$ 51,037
Other Real Estate Owned (2)			37,246	7,698

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

(2) The fair value is derived from appraisals that

take into consideration prices in observed transactions involving similar assets in similar locations but adjusted for specific characteristics and assumptions of the properties (e.g. absorption rates), which are not market observable. Valuation allowance is based on market valuation adjustments after the transfer from the loan to the OREO portfolio.

As of December 31, 2007, 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 December 31, 2007			**Losses recorded for the Year Ended December 31, 2007**
	Level 1	**Level 2**	**Level 3**	
			(In thousands)	
Loans receivable (1)	$	$59,418	$	$ 5,187

(1) Mainly impaired commercial and construction loans. The impairment was measured based on the fair value of the collateral which was derived from appraisals that take into

consideration
prices in
observed
transactions
involving
similar assets in
similar
locations.

The following is a description of the valuation methodologies used for instruments for which an estimated fair value is presented as well as for instruments for which the Corporation has elected the fair value option. 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 U.S. Government obligations, which have a contractual maturity of three months or less. The fair value of these securities is based on quoted market prices in active markets that incorporate the risk of nonperformance.

Investment securities available for sale and held to maturity

The fair value of investment securities is the market value based on quoted market prices, when available, or market prices for identical or comparable assets 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. Observable prices in the market already consider the risk of nonperformance. If listed prices or quotes are not available, fair value is based upon models that use unobservable inputs due to the limited market activity of the instrument, as is the case with certain private label mortgage-backed securities held by the Corporation. Refer to Notes 1 and 4 for additional information about the fair value of private label mortgage-backed securities.

F-64

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Other equity securities

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

Loans receivable, including loans held for sale

The fair value of all loans was estimated using discounted cash flow analyses, using 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, credit cards and automobile. These asset categories were further segmented into fixed- and adjustable-rate categories. The fair values of performing fixed-rate and adjustable-rate loans were calculated by discounting expected cash flows through the estimated maturity date. 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 prepayment experiences of generic U.S. mortgage-backed securities pools with similar characteristics (e.g. coupon and original term) and adjusted based on the Corporation s historical data. Discount rates were based on the Treasury and LIBOR/Swap Yield Curves at the date of the analysis, and included appropriate adjustments for expected credit losses and liquidity.

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. For deposits with stated maturities, but that reprice at least quarterly, the fair value is also estimated to be the recorded amounts at the reporting date.

The fair values of retail fixed-rate time deposits, with stated maturities, are based on the present value of the future cash flows expected to be paid on the deposits. The cash flows were based on contractual maturities; no early repayments are assumed. Discount rates were based on the LIBOR yield curve.

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

The fair value of brokered CDs, which are included within deposits, is determined using discounted cash flow analyses over the full term of the CDs. The valuation uses a Hull-White Interest Rate Tree approach, an industry-standard approach for valuing instruments with interest rate call options. The fair value of the CDs is computed using the outstanding principal amount. The discount rates used are based on US dollar LIBOR and swap rates. At-the-money implied swaption volatility term structure (volatility by time to maturity) is used to calibrate the model to current market prices. The fair value does not incorporate the risk of nonperformance, since brokered CDs are generally participated out by brokers in shares of less than $100,000 and insured by the FDIC.

Loans payable

Loans payable consisted of short-term borrowings under the FED Discount Window Program. Due to the short-term nature of these borrowings, their outstanding balances are estimated to be the fair value.

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

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

unwinding the transactions as of the end of the reporting period. Securities sold under agreements to repurchase are fully collateralized by investment securities.

Advances from FHLB

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

Derivative instruments

The fair value of most of the derivative instruments is based on observable market parameters and takes into consideration the credit risk component of paying counterparts when appropriate, except when collateral is pledged. That is, on interest rate swaps, the credit risk of both counterparts is included in the valuation; and on options and caps, only the seller s credit risk is considered. The Hull-White Interest Rate Tree approach is used to value the option components of derivative instruments, and discounting of the cash flows is performed using US dollar LIBOR-based discount rates or yield curves that account for the industry sector and the credit rating of the counterparty and/or the Corporation. Derivatives include interest rate swaps used for protection against rising interest rates and, prior to June 30, 2009, included interest rate swaps to economically hedge brokered CDs and medium-term notes. For these interest rate swaps, a credit component was not considered in the valuation since the Corporation has fully collateralized with investment securities any mark to market loss with the counterparty and, if there were market gains, the counterparty had to deliver collateral to the Corporation.

Certain derivatives with limited market activity, as is the case with derivative instruments named as reference caps, are valued using models that consider unobservable market parameters (Level 3). Reference caps are used mainly to hedge interest rate risk inherent in private label mortgage-backed securities, thus are tied to the notional amount of the underlying fixed-rate mortgage loans originated in the United States. Significant inputs used for fair value determination consist of specific characteristics such as information used in the prepayment model which follows the amortizing schedule of the underlying loans, which is an unobservable input. The valuation model uses the Black formula, which is a benchmark standard in the financial industry. The Black formula is similar to the Black-Scholes formula for valuing stock options except that the spot price of the underlying is replaced by the forward price. The Black formula uses as inputs the strike price of the cap, forward LIBOR rates, volatility estimates and discount rates to estimate the option value. LIBOR rates and swap rates are obtained from Bloomberg L.P. (Bloomberg) every day and build zero coupon curve based on the Bloomberg LIBOR/Swap curve. The discount factor is then calculated from the zero coupon curve. The cap is the sum of all caplets. For each caplet, the rate is reset at the beginning of each reporting period and payments are made at the end of each period. The cash flow of each caplet is then discounted from each payment date.

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 resulted in an unrealized gain of approximately $0.5 million as of December 31, 2009, of which an unrealized loss of $1.9 million was recorded in 2009, an unrealized gain of $1.5 million was recorded in 2008 and an unrealized gain of $0.9 million was recorded in 2007.

Term notes payable

The fair value of term notes is determined using a discounted cash flow analysis over the full term of the borrowings. This valuation also uses the Hull-White Interest Rate Tree approach to value the option components of the term notes. The model assumes that the embedded options are exercised economically. The fair value of medium-term notes is computed using the notional amount outstanding. The discount rates used in the valuations are based on US dollar LIBOR and swap rates. At-the-money implied swaption volatility term structure (volatility by time to maturity) is used to calibrate the model to current market prices and value the cancellation option in the term notes. For the medium-term notes, the credit risk is measured using the difference in yield curves between swap rates and a

yield curve that considers the industry and credit rating of the Corporation as issuer of the note at a tenor

Table of Contents

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

comparable to the time to maturity of the note and option. The net loss from fair value changes attributable to the Corporation s own credit to the medium-term notes for which the Corporation has elected the fair value option amounted to $3.1 million for 2009, compared to an unrealized gain of $4.1 million for 2008 and an unrealized gain of $1.6 million for 2007. The cumulative mark-to-market unrealized gain on the medium-term notes since measured at fair value attributable to credit risk amounted to $2.6 million as of December 31, 2009.

Other borrowings

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

Note 30 Supplemental Cash Flow Information

Supplemental cash flow information follows:

	Year Ended December 31,		
	2009	2008	2007
	(In thousands)		
Cash paid for:			
Interest on borrowings	$494,628	$687,668	$721,545
Income tax	7,391	3,435	10,142
Non-cash investing and financing activities:			
Additions to other real estate owned	98,554	61,571	17,108
Additions to auto repossessions	80,568	87,116	104,728
Capitalization of servicing assets	6,072	1,559	1,285
Loan securitizations	305,378		
Recharacterization of secured commercial loans as securities collateralized by loans			183,830
Non-cash acquisition of mortgage loans that previously served as collateral of a commercial loan to a local financial institution	205,395		

On January 28, 2008, the Corporation completed the acquisition of Virgin Islands Community Bank (VICB), with operations in St. Croix, U.S. Virgin Islands, at a purchase price of $2.5 million. The Corporation acquired cash of approximately $7.7 million from VICB.

Note 31 Commitments and Contingencies

The following table presents a detail of commitments to extend credit, standby letters of credit and commitments to sell loans:

	December 31,	
	2009	2008
	(In thousands)	
Financial instruments whose contract amounts represent credit risk:		
Commitments to extend credit:		
To originate loans	$ 255,598	$518,281
Unused credit card lines		22
Unused personal lines of credit	33,313	50,389
Commercial lines of credit	1,187,004	863,963

Commercial letters of credit	48,944	33,632
Standby letters of credit	103,904	102,178
Commitments to sell loans	13,158	50,500

The Corporation s exposure to credit loss in the event of nonperformance by the other party to the financial instrument on commitments to extend credit and standby letters of credit is represented by the contractual amount of

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

those instruments. Management uses the same credit policies and approval process in entering into commitments and conditional obligations as it does for on-balance sheet instruments.

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. 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, at any time and without cause, cancel the unused credit facility. Generally, the Corporation s mortgage banking activities do not enter into interest rate lock agreements with its prospective borrowers. The amount of any collateral obtained if deemed necessary by the Corporation upon an extension of credit is based on management s credit evaluation of the borrower. Rates charged on loans that are finally disbursed are the rates being offered at the time the loans are closed; therefore, no fee is charged on these commitments.

In general, commercial and standby letters of credit are issued to facilitate foreign and domestic trade transactions. Normally, commercial and standby letters of credit are short-term commitments used to finance commercial contracts for the shipment of goods. The collateral for these letters of credit includes cash or available commercial lines of credit. The fair value of commercial and standby letters of credit is based on the fees currently charged for such agreements, which ,as of December 31, 2009 and 2008, was not significant.

The Corporation obtained from GNMA, Commitment Authority to issue GNMA mortgage-backed securities. Under this program, as of December 31, 2009, the Corporation had securitized approximately $305.4 million of FHA/VA mortgage loan production into GNMA mortgage-backed securities.

Lehman Brothers Special Financing, Inc. (Lehman) was the counterparty to the Corporation on certain interest rate swap agreements. During the third quarter of 2008, Lehman failed to pay the scheduled net cash settlement due to the Corporation, which constitutes an event of default under those interest rate swap agreements. The Corporation terminated all interest rate swaps with Lehman and replaced them with other counterparties under similar terms and conditions. In connection with the unpaid net cash settlement due as of December 31, 2009 under the swap agreements, the Corporation has an unsecured counterparty exposure with Lehman, which filed for bankruptcy on October 3, 2008, of approximately $1.4 million. This exposure was reserved in the third quarter of 2008. The Corporation had pledged collateral of $63.6 million with Lehman to guarantee its performance under the swap agreements in the event payment thereunder was required. The book value of pledged securities with Lehman as of December 31, 2009 amounted to approximately $64.5 million.

The Corporation believes that the securities pledged as collateral should not be part of the Lehman bankruptcy estate given the fact that the posted collateral constituted a performance guarantee under the swap agreements, was not part of a financing agreement, and ownership of the securities was never transferred to Lehman. Upon termination of the interest rate swap agreements, Lehman s obligation was to return the collateral to the Corporation. During the fourth quarter of 2009, the Corporation discovered that Lehman Brothers, Inc., acting as agent of Lehman, had deposited the securities in a custodial account at JP Morgan/Chase, and that, shortly before the filing of the Lehman bankruptcy proceedings, it had provided instructions to have most of the securities transferred to Barclay s Capital in New York. After Barclay s refusal to turn over the securities, the Corporation, during the month of December 2009, filed a lawsuit against Barclay s Capital in federal court in New York demanding the return of the securities. While the Corporation believes it has valid reasons to support its claim for the return of the securities, there are no assurances that it will ultimately succeed in its litigation against Barclay s Capital to recover all or a substantial portion of the securities.

Additionally, the Corporation continues to pursue its claim filed in January 2009 in the proceedings under the Securities Protection Act with regard to Lehman Brothers Incorporated in Bankruptcy Court, Southern District of New York. The Corporation can provide no assurances that it will be successful in recovering all or

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

substantial portion of the securities through these proceedings. An estimated loss was not accrued as the Corporation is unable to determine the timing of the claim resolution or whether it will succeed in recovering all or a substantial portion of the collateral or its equivalent value. If additional relevant negative facts become available in future periods, a need to recognize a partial or full reserve of this claim may arise. Considering that the investment securities have not yet been recovered by the Corporation, despite its efforts in this regard, the Corporation decided to classify such investments as non-performing during the second quarter of 2009.

Note 32 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 change in response to changes in interest rates. The overall objective of the Corporation s interest rate risk management activities is to reduce the variability of earnings caused by changes in interest rates.

The Corporation uses various financial instruments, including derivatives, to manage the interest rate risk primarily related to the values of its medium-term notes and for protection of rising interest rates in connection with private label MBS.

The Corporation designates a derivative as a fair value hedge, cash flow hedge or as an economic undesignated hedge when it enters into the derivative contract. As of December 31, 2009 and 2008, 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 against rising interest rates. Specifically, the interest rate on certain private label mortgage pass-through securities and certain of the Corporation s commercial loans to other financial institutions is generally a variable rate limited to the weighted-average coupon of the pass-through certificate or referenced residential mortgage collateral, less a contractual servicing fee.

Interest rate swaps Interest rate swap agreements generally involve the exchange of fixed and floating-rate interest payment obligations without the exchange of the underlying notional principal amount. As of December 31, 2009, most of the interest rate swaps outstanding are used for protection against rising interest rates. In the past, interest rate swaps volume was much higher since they were used to convert fixed-rate brokered CDs (liabilities), mainly those with long-term maturities, to a variable rate and mitigate the interest rate risk inherent in variable rate loans. However, most of these interest rate swaps were called during 2009, in the face of lower interest rate levels, and as a consequence the Corporation exercised its call option on the swapped-to-floating brokered CDs. Similar to unrealized gains and losses arising from changes in fair value, net interest settlements on interest rate swaps are recorded as an adjustment to interest income or interest expense depending on whether an asset or liability is being economically hedged.

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

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

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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 as of December 31, 2009 and December 31, 2008:

	Notional Amounts	
	As of December 31, 2009	As of December 31, 2008
	(In thousands)	
Economic undesignated hedges:		
Interest rate contracts:		
Interest rate swap agreements used to hedge fixed-rate brokered CDs, notes payable and loans	$ 79,567	$ 1,184,820
Written interest rate cap agreements	102,521	128,043
Purchased interest rate cap agreements	228,384	276,400
Equity contracts:		
Embedded written options on stock index deposits and notes payable	53,515	53,515
Purchased options used to manage exposure to the stock market on embedded stock index options	53,515	53,515
	$ 517,502	$ 1,696,293

The following table summarizes the fair value of derivative instruments and the location in the Statement of Financial Condition as of December 31, 2009 and 2008:

	Asset Derivatives			Liability Derivatives		
		As of December 31,			As of December 31,	
	Statement of Financial Condition Location	2009 Fair Value	2008 Fair Value	Statement of Financial Condition Location	2009 Fair Value	2008 Fair Value
	(In thousands)					
Economic undesignated hedges:						
Interest rate contracts:						
Interest rate swap	Other assets	$ 319	$ 5,649	Accounts payable and other liabilities	$ 5,068	$ 7,188

agreements used to hedge fixed-rate brokered CDs, notes payable and loans						
Written interest rate cap agreements	Other assets			Accounts payable and other liabilities	201	3
Purchased interest rate cap agreements	Other assets	4,423	764	Accounts payable and other liabilities		
Equity contracts:						
Embedded written options on stock index deposits	Other assets			Interest-bearing deposits	14	241
Embedded written options on stock index notes payable	Other assets			Notes payable	1,184	1,073
Purchased options used to manage exposure to the stock market on embedded stock index options	Other assets	1,194	1,597	Accounts payable and other liabilities		
		$ 5,936	$ 8,010		$ 6,467	$ 8,505

F-70

Table of Contents

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table summarizes the effect of derivative instruments on the Statement of Income for the years ended December 31, 2009, 2008 and 2007:

	Location of Gain or (Loss) Recognized in Income on Derivatives	Gain or (Loss) Year Ended December 31, 2009	2008	2007
		(In thousands)		
ECONOMIC UNDESIGNATED HEDGES:				
Interest rate contracts:				
Interest rate swap agreements used to hedge fixed-rate:				
Brokered CDs	Interest expense - Deposits	$ (5,236)	$ 63,132	$ 66,617
Notes payable	Interest expense - Notes payable and other borrowings	3	124	1,440
Loans	Interest income - Loans	2,023	(3,696)	(2,653)
Written and purchased interest rate cap agreements - mortgage-backed securities	Interest income - Investment securities	3,394	(4,283)	(3,546)
Written and purchased interest rate cap agreements - loans	Interest income - loans	102	(58)	(439)
Equity contracts:				
Embedded written and purchased options on stock index deposits	Interest expense - Deposits	(85)	(276)	209
Embedded written and purchased options on stock index notes payable	Interest expense - Notes payable and other borrowings	(202)	268	(71)
Total (loss) gain on derivatives		$ (1)	$ 55,211	$ 61,557

Derivative instruments, such as interest rate swaps, are subject to market risk. As is the case with investment securities, the market value of derivative instruments is largely a function of the financial market s expectations regarding the future direction of interest rates. Accordingly, current market values are not necessarily indicative of the future impact of derivative instruments on earnings. This will depend, for the most part, on the shape of the yield curve, the level of interest rates, as well as the expectations for rates in the future. The unrealized gains and losses in the fair value of derivatives that economically hedge certain callable brokered CDs and medium-term notes are partially offset by unrealized gains and losses on the valuation of such economically hedged liabilities measured at fair value. The Corporation includes the gain or loss on those economically hedged liabilities (brokered CDs and medium-term notes) in the same line item as the offsetting loss or gain on the related derivatives as set forth below:

	Year ended December 31,					
	2009			2008		
(In thousands)	**Loss on Derivatives**	**Gain (Loss) on liabilities measured at fair value**	**Net Gain (Loss)**	**Gain on Derivatives**	**(Loss) Gain on liabilities measured at fair value**	**Net Gain**
Interest expense Deposits	$(5,321)	$ 8,696	$ 3,375	$62,856	$ (54,199)	$8,657
Interest expense Notes payable and Other Borrowings	(199)	(3,221)	(3,420)	392	4,165	4,557

A summary of interest rate swaps as of December 31, 2009 and 2008 follows:

	As of December 31, 2009	As of December 31, 2008
	(Dollars in thousands)	
Pay fixed/receive floating :		
Notional amount	$79,567	$ 81,575
Weighted-average receive rate at period end	2.15%	3.21%
Weighted-average pay rate at period end	6.52%	6.75%
Floating rates range from 167 to 252 basis points over 3-month LIBOR		
Receive fixed/pay floating (generally used to economically hedge fixed-rate brokered CDs and notes payable):		
Notional amount	$	$1,103,244
Weighted-average receive rate at period end	0.00%	5.30%
Weighted-average pay rate at period end	0.00%	3.09%

F-71

Table of Contents

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The changes in notional amount of interest rate swaps outstanding during the years ended December 31, 2009 and 2008 follows:

		Notional Amount (In thousands)
Pay-fixed and receive-floating swaps:		
Balance as of December 31, 2007	**$**	**82,932**
Cancelled and matured contracts		(1,357)
New contracts		
Balance as of December 31, 2008		**81,575**
Cancelled and matured contracts		(2,008)
New contracts		
Balance as of December 31, 2009	**$**	**79,567**
Receive-fixed and pay floating swaps:		
Balance as of December 31, 2007	**$**	**4,161,541**
Cancelled and matured contracts		(3,426,519)
New contracts		368,222
Balance as of December 31, 2008		**1,103,244**
Cancelled and matured contracts		(1,103,244)
New contracts		
Balance as of December 31, 2009	**$**	

During the first half of 2009, all of the $1.1 billion of interest rate swaps that economically hedged brokered CDs that were outstanding as of December 31, 2008 were called by the counterparties, mainly due to lower levels of 3-month LIBOR. Following the cancellation of the interest rate swaps, the Corporation exercised its call option on the approximately $1.1 billion swapped-to-floating brokered CDs. The Corporation recorded a net loss of $3.5 million as a result of these transactions resulting from the reversal of the cumulative mark-to-market valuation of the swaps and the brokered CDs called.

As of December 31, 2009, the Corporation has not entered into any derivative instrument containing credit-risk-related contingent features.

Credit and Market Risk of Derivatives

The Corporation uses derivative instruments to manage interest rate risk. By using derivative instruments, the Corporation is exposed to credit and market risk. If the counterparty fails to perform, credit risk is equal to the extent of the Corporation s fair value gain in the derivative. When the fair value of a derivative instrument contract is positive, this generally indicates that the counterparty owes the Corporation and, therefore, creates a credit risk for the Corporation. When the fair value of a derivative instrument contract is negative, the Corporation owes the counterparty and, therefore, it has no credit risk. The Corporation minimizes the credit risk in derivative instruments by entering into transactions with reputable broker dealers (financial institutions) that are reviewed periodically by the Corporation s Management s Investment and Asset Liability Committee (MIALCO) and by the Board of Directors. The Corporation also maintains a policy of requiring that all derivative instrument contracts be governed by an

International Swaps and Derivatives Association Master Agreement, which includes a provision for netting; most of the Corporation s agreements with derivative counterparties include bilateral collateral arrangements. The bilateral collateral arrangement permits the counterparties to perform margin calls in the form of cash or securities in the event that the fair market value of the derivative favors either counterparty. The book value and aggregate market value of securities pledged as collateral for interest rate swaps as of December 31, 2008 was $52.5 million and $54.2 million, respectively (2008 $93.2 million and $91.7 million, respectively). The Corporation has a policy of diversifying derivatives counterparties to reduce the risk that any counterparty will default.

The Corporation has credit risk of $5.9 million (2008 $8.0 million) related to derivative instruments with positive fair values. The credit risk does not consider the value of any collateral and the effects of legally enforceable master netting agreements. There was a loss of approximately $1.4 million, related to a counterparty that failed to pay a scheduled net cash settlement in 2008 (refer to Note 31 for additional information). There were no credit losses associated with derivative instruments recognized in 2009 or 2007. As of December 31, 2009, the Corporation had a total net interest settlement payable of $0.3 million (2008 net interest settlement receivable of $4.1 million) related to the swap transactions. The net settlements receivable and net settlements payable on interest

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

rate swaps are included as part of Other Assets and Accounts payable and other liabilities , respectively, on the Consolidated Statements of Financial Condition.

Market risk is the adverse effect that a change in interest rates or implied volatility rates has on the value of a financial instrument. The Corporation manages the market risk associated with interest rate contracts by establishing and monitoring limits as to the types and degree of risk that may be undertaken.

The Corporation s derivative activities are monitored by the MIALCO as part of its risk-management oversight of the Corporation s treasury functions.

Note 33 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 December 31, 2009, 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.

Starting in the fourth quarter of 2009, the Corporation has realigned its reporting segments to better reflect how it views and manages its business. Two additional operating segments were created to evaluate the operations conducted by the Corporation, outside of Puerto Rico. Operations conducted in the United States and in the Virgin Islands are now individually evaluated as separate operating segments. This realignment in the segment reporting essentially reflects the effect of restructuring initiatives, including the merger of FirstBank Florida operations with and into FirstBank, and will allow the Corporation to better present the results from its growth focus. Prior to the third quarter of 2009, the operating segments were driven primarily by the Corporation s legal entities. FirstBank operations conducted in the Virgin Islands and through its loan production office in Miami, Florida were reflected in the Corporation s then four reportable segments (Commercial and Corporate Banking; Mortgage Banking; Consumer (Retail) Banking; Treasury and Investments) while the operations conducted by FirstBank Florida were reported as part of a category named Other . In the third quarter of 2009, as a result of the aforementioned merger, the operations of FirstBank Florida were reported as part of the four reportable segments. The change in the fourth quarter reflected a further realignment of the organizational structure as a result of management changes. Prior period amounts have been reclassified to conform to current period presentation. These changes did not have an impact on the previously reported consolidated results of the Corporation.

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 other products such as cash management and business management services. The Mortgage Banking segment s operations consist of the origination, sale and servicing of a variety of residential mortgage loans. The Mortgage Banking segment also acquires and sells mortgages in the secondary markets. In addition, the Mortgage Banking segment includes mortgage loans purchased from other local banks and mortgage bankers. The Consumer (Retail) Banking segment consists of the Corporation s consumer lending and deposit-taking activities conducted mainly through its branch network and loan centers. The Treasury and Investments segment is responsible for the Corporation s investment portfolio and treasury functions executed to manage and enhance liquidity. This segment lends funds to the Commercial and Corporate Banking, Mortgage Banking and Consumer (Retail) Banking segments to finance their lending activities and borrows from those segments. The Consumer (Retail) Banking segment also lends funds to other segments. The interest rates charged or credited by Treasury and Investments and the Consumer (Retail) Banking 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

Table of Contents

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

services. The Virgin Islands operations segment consists of all banking activities conducted by the Corporation in the U.S. and British Virgin Islands, including commercial and retail banking services and insurance activities.

The accounting policies of the segments are the same as those described in Note 1 Nature of Business and Summary of Significant Accounting Policies .

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

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

(In thousands)	Mortgage Banking	Consumer (Retail) Banking	Commercial and Corporate	Treasury and Investments	United States Operations	Virgin Islands Operations	Total
For the year ended December 31, 2009:							
Interest income	$ 156,729	$ 210,102	$ 239,399	$ 251,949	$ 67,936	$ 70,459	$ 996,574
Net (charge) credit for transfer of funds	(117,486)	205	(59,080)	176,361			
Interest expense		(60,661)		(342,161)	(65,360)	(9,350)	(477,532)
Net interest income	39,243	149,646	180,319	86,149	2,576	61,109	519,042
Provision for loan and lease losses	(29,717)	(62,457)	(273,822)		(188,651)	(25,211)	(579,858)
Non-interest income	8,497	32,003	5,695	84,369	1,460	10,240	142,264
Direct non-interest expenses	(32,314)	(98,263)	(41,948)	(7,416)	(37,704)	(45,364)	(263,009)
Segment (loss) income	$ (14,291)	$ 20,929	$ (129,756)	$ 163,102	$ (222,319)	$ 774	$ (181,561)
Average earnings assets	$ 2,654,504	$ 2,109,602	$ 5,974,950	$ 5,831,078	$ 1,449,878	$ 996,508	$ 19,016,520
For the year ended December 31, 2008:							
Interest income	$ 156,577	$ 225,474	$ 287,708	$ 288,063	$ 95,043	$ 74,032	$ 1,126,897
Net (charge) credit for transfer of	(119,257)	3,573	(175,454)	291,138			

funds							
Interest expense		(63,001)		(455,802)	(66,204)	(14,009)	(599,016)
Net interest income	37,320	166,046	112,254	123,399	28,839	60,023	527,881
Provision for loan and lease losses	(8,997)	(80,506)	(35,504)		(53,406)	(12,535)	(190,948)
Non-interest income (loss)	2,667	35,531	4,591	25,577	(3,570)	9,847	74,643
Direct non-interest expenses	(22,703)	(99,232)	(24,467)	(6,713)	(34,236)	(48,105)	(235,456)
Segment income (loss)	$ 8,287	$ 21,839	$ 56,874	$ 142,263	$ (62,373)	$ 9,230	$ 176,120
Average earnings assets	$ 2,492,566	$ 2,185,888	$ 5,086,787	$ 5,583,181	$ 1,515,418	$ 942,052	$ 17,805,892
For the year ended December 31, 2007:							
Interest income	$ 133,068	$ 238,874	$ 335,625	$ 284,155	$ 121,897	$ 75,628	$ 1,189,247
Net (charge) credit for transfer of funds	(105,459)	(794)	(230,777)	370,451	(33,421)		
Interest expense		(63,807)		(608,119)	(49,734)	(16,571)	(738,231)
Net interest income	27,609	174,273	104,848	46,487	38,742	59,057	451,016
Provision for loan and lease losses	(1,643)	(73,799)	(12,465)		(30,174)	(2,529)	(120,610)
Non-interest income (loss)	2,124	32,529	3,737	(2,161)	1,167	12,188	49,584
Net gain on partial extinguishment and recharacterization of secured commercial loans to a local financial institution			2,497				2,497
Direct non-interest expenses	(20,890)	(95,169)	(20,056)	(7,842)	(21,848)	(42,407)	(208,212)
Segment income (loss)	$ 7,200	$ 37,834	$ 78,561	$ 36,484	$ (12,113)	$ 26,309	$ 174,275

Average earnings assets	$ 2,140,647	$ 2,207,447	$ 4,363,149	$ 5,400,648	$ 1,561,029	$ 895,434	$ 16,568,354

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

	Year Ended December 31,		
	2009	2008	2007
		(In thousands)	
Net (loss) income:			
Total (loss) income for segments and other	$ (181,561)	$ 176,120	$ 174,275
Other Income			15,075
Other operating expenses	(89,092)	(97,915)	(99,631)
Income before income taxes	(270,653)	78,205	89,719
Income tax (expense) benefit	(4,534)	31,732	(21,583)
Total consolidated net (loss) income	$ (275,187)	$ 109,937	$ 68,136
Average assets:			
Total average earning assets for segments	$ 19,016,520	$ 17,805,892	$ 16,568,354
Average non-earning assets	790,702	702,064	645,853
Total consolidated average assets	$ 19,807,222	$ 18,507,956	$ 17,214,207

The following table presents revenues and selected balance sheet data by geography based on the location in which the transaction is originated:

	2009	2008	2007
		(In thousands)	
Revenues:			
Puerto Rico[1]	$ 988,743	$ 1,026,188	$ 1,045,523
United States	69,396	91,473	123,064
Virgin Islands	80,699	83,879	87,816
Total consolidated revenues	$ 1,138,838	$ 1,201,540	$ 1,256,403
Selected Balance Sheet Information:			
Total assets:			
Puerto Rico	$ 16,843,767	$ 16,824,168	$ 14,633,217
United States	1,716,694	1,619,280	1,540,808
Virgin Islands	1,067,987	1,047,820	1,012,906
Loans:			
Puerto Rico	$ 11,614,866	$ 10,601,488	$ 9,413,118
United States	1,275,869	1,484,011	1,448,613
Virgin Islands	1,058,491	1,002,793	938,015

Deposits:			
Puerto Rico	$ 10,497,646	$ 10,746,688	$ 8,776,874
United States	1,252,977	1,243,754	1,239,913
Virgin Islands	918,424	1,066,988	1,017,734

(1) For 2007, Revenues of Puerto Rico operations include $15.1 million related to reimbursement of expenses, mainly from insurance carriers, related to a class action lawsuit settled in 2007.

Table of Contents

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 34 Litigations

As of December 31, 2009, First BanCorp and its subsidiaries were defendants in various legal proceedings arising in the ordinary course of business. Management believes that the final disposition of these matters will not have a material adverse effect on the Corporation s financial position or results of operations.

Note 35 First BanCorp (Holding Company Only) Financial Information

The following condensed financial information presents the financial position of the Holding Company only as of December 31, 2009 and 2008, and the results of its operations and cash flows for the years ended on December 31, 2009, 2008 and 2007.

Statements of Financial Condition

	As of December 31,	
	2009	**2008**
	(In thousands)	
Assets		
Cash and due from banks	$ 55,423	$ 58,075
Money market investments	300	300
Investment securities available for sale, at market:		
Equity investments	303	669
Other investment securities	1,550	1,550
Investment in First Bank Puerto Rico, at equity	1,754,217	1,574,940
Investment in First Bank Insurance Agency, at equity	6,709	5,640
Investment in Ponce General Corporation, at equity		123,367
Investment in PR Finance, at equity	3,036	2,789
Investment in FBP Statutory Trust I	3,093	3,093
Investment in FBP Statutory Trust II	3,866	3,866
Other assets	3,194	6,596
Total assets	$ 1,831,691	$ 1,780,885
Liabilities & Stockholders Equity		
Liabilities:		
Other borrowings	$ 231,959	$ 231,914
Accounts payable and other liabilities	669	854
Total liabilities	232,628	232,768
Stockholders equity	1,599,063	1,548,117
Total liabilities and stockholders equity	$ 1,831,691	$ 1,780,885

Table of Contents

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
Statements of (Loss) Income

	Year Ended December 31,		
	2009	2008	2007
	(In thousands)		
Income:			
Interest income on investment securities	$	$ 727	$ 3,029
Interest income on other investments	38	1,144	1,289
Interest income on loans			631
Dividend from First Bank Puerto Rico	46,562	81,852	79,135
Dividend from other subsidiaries	1,000	4,000	1,000
Other income	496	408	565
	48,096	88,131	85,649
Expense:			
Notes payable and other borrowings	8,315	13,947	18,942
Interest on funding to subsidiaries		550	3,319
(Recovery) provision for loan losses		(1,398)	1,300
Other operating expenses	2,698	1,961	2,844
	11,013	15,060	26,405
Net loss on investments and impairments	(388)	(1,824)	(6,643)
Net loss on partial extinguishment and recharacterization of secured commercial loans to a local financial institution			(1,207)
Income before income taxes and equity in undistributed (losses) earnings of subsidiaries	36,695	71,247	51,394
Income tax provision	(6)	(543)	(1,714)
Equity in undistributed (losses) earnings of subsidiaries	(311,876)	39,233	18,456
Net (loss) income	(275,187)	109,937	68,136
Other comprehensive (loss) income, net of tax	(30,896)	82,653	4,903
Comprehensive (loss) income	$ (306,083)	$ 192,590	$ 73,039

FIRST BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
Statements of Cash Flows

	Year Ended December 31,		
	2009	2008	2007
		(In thousands)	
Cash flows from operating activities:			
Net (loss) income	$ (275,187)	$ 109,937	$ 68,136
Adjustments to reconcile net (loss) income to net cash provided by operating activities:			
(Recovery) provision for loan losses		(1,398)	1,300
Deferred income tax provision	3	543	1,714
Stock-based compensation recognized	71	7	
Equity in undistributed losses (earnings) of subsidiaries	311,876	(39,233)	(18,456)
Net loss on sale of investment securities			733
Loss on impairment of investment securities	388	1,824	5,910
Net loss on partial extinguishment and recharacterization of secured commercial loans to a local financial institution			1,207
Accretion of discount on investment securities		(33)	(197)
Net decrease (increase) in other assets	3,399	(3,542)	52,515
Net (decrease) increase in other liabilities	(144)	245	(72,639)
Total adjustments	315,593	(41,587)	(27,913)
Net cash provided by operating activities	40,406	68,350	40,223
Cash flows from investing activities:			
Capital contribution to subsidiaries	(400,000)	(37,786)	
Principal collected on loans		3,995	1,622
Purchases of securities available for sale			
Sales, principal repayments and maturity of available-for-sale and held-to-maturity securities		1,582	11,403
Other investing activities			437
Net cash (used in) provided by investing activities	(400,000)	(32,209)	13,462
Cash flows from financing activities:			
Proceeds from purchased funds and other short-term borrowings			
Repayments of purchased funds and other short-term borrowings		(1,450)	(5,800)
Issuance of common stock			91,924
Exercise of stock options		53	
Issuance of preferred stock	400,000		

Cash dividends paid	(43,066)	(66,181)	(64,881)
Other financing activities	8		
Net cash provided by (used in) financing activities	356,942	(67,578)	21,243
Net (decrease) increase in cash and cash equivalents	(2,652)	(31,437)	74,928
Cash and cash equivalents at the beginning of the year	58,375	89,812	14,884
Cash and cash equivalents at the end of the year	$ 55,723	$ 58,375	$ 89,812
Cash and cash equivalents include:			
Cash and due form banks	55,423	58,075	43,519
Money market investments	300	300	46,293
	$ 55,723	$ 58,375	$ 89,812

F-78