ARBIOS SYSTEMS INC
Form 8-K
August 06, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 8-K

Current Report
Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Date of Report (Date of earliest event reported): July 31, 2008

ARBIOS SYSTEMS, INC.
(Exact Name of Registrant as Specified in its Charter)

Delaware
(State or Other Jurisdiction of Incorporation)

000-32603	91-1955323
(Commission File Number)	(I.R.S. Employer Identification No.)

1050 Winter Street, Suite 1000 Waltham, Massachusetts	02451
(Address of Principal Executive Offices)	(Zip Code)

(781) 839-7292
(Registrant's Telephone Number, Including Area Code)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the Registrant under any of the following provisions (See General Instruction A.2 below):

¨ Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

¨ Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)

¨ Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))

¨ Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

ITEM 5.02 DEPARTURE OF DIRECTORS OR CERTAIN OFFICERS; ELECTION OF DIRECTORS; APPOINTMENT OF CERTAIN OFFICERS; COMPENSATORY ARRANGEMENTS OF CERTAIN OFFICERS

On August 5, 2008, Arbios Systems, Inc. (the "Company") announced that it was suspending its operations to focus its efforts on obtaining financing or consummating a strategic transaction. See, Item 8.01 below. In connection with the suspension of its operations, the Company on July 31, 2008 terminated the employment of Shawn Cain, President and Chief Executive Officer, Scott Hayashi, Chief Financial Officer, Jacek Rozga, MD, Ph.D., Chief Scientific Officer, and Susan Papalia, Vice President of Clinical Affairs. Upon the termination of their employments, each of the foregoing officers executed the Company's standard severance/termination agreement, and each of these officers received a severance payment in the following amount: Shawn Cain ($46,250, representing three month's salary), Scott Hayashi ($20,833, representing two month's salary), Jacek Rozga ($33,333, representing two month's salary), and Susan Papalia ($28,333, representing two month's salary).

Pursuant to a Consulting Agreement, dated August 1, 2008, Mr. Cain has agreed to continue to provide services to the Company as a part-time consultant for a period of 30 days at a rate of $5,000 per month. The Consulting agreement is renewable for consecutive 30-day periods upon joint agreement. Under the terms of the consulting agreement, Mr. Cain will act as the interim principal executive officer of the company.

Pursuant to a Consulting Agreement, dated August 1, 2008, Mr. Hayashi has agreed to continue to provide services to the Company as a part-time consultant for a period of 30 days at a rate of $5,000 per month. The Consulting agreement is renewable for consecutive 30-day periods upon joint agreement. Mr. Hayashi will act as the Company's interim Chief Financial Officer.

ITEM 8.01 OTHER EVENTS

On August 5, 2008, the Company issued a press release in which it announced that it would be focusing its day to day operations exclusively on obtaining financing or consummating a strategic transaction and, in connection therewith, that the Company's employees were released from employment in order to preserve the Company's remaining cash resources. A copy of the press release is attached to this Form 8-K as Exhibit 99.1 and is incorporated herein by reference.

ITEM 9.01 FINANCIAL STATEMENTS AND EXHIBITS

Exhibit No.	Exhibit
10.1	Consulting Agreement, dated August 1, 2008, between the Company and Shawn P. Cain.
10.2	Consulting Agreement, dated August 1, 2008, between the Company and Scott Hayashi.
99.1	Press Release dated August 5, 2008

SIGNATURES

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

ARBIOS SYSTEMS, INC.

Date: August 6, 2008	By:	/s/ SHAWN P. CAIN Shawn P. Cain, Interim President

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EXHIBIT INDEX

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99.1	Press Release dated August 5, 2008

468 61%

Finance leases	361,631	3%	280,571	2%	212,234	2%	159,696	2%	142,421	3%
Consumer loans	1,772,917	16%	1,733,569	14%	1,359,998	14%	1,160,829	16%	1,138,882	20%
Total	$11,263,980	100%	$12,685,929	100%	$9,697,994	100%	$7,041,055	100%	$5,635,023	100%

Table of Contents

Lending Activities

Total loans receivable decreased by $1.4 billion in 2006 when compared to 2005 due to the repayment by Doral and normal loan portfolio repayments partially offset by new originations. As shown in the table above, the 2006 loans portfolio was comprised of commercial (56%), residential real estate (25%), and consumer and finance leases (19%). Of the total loans of $11.3 billion for 2006, approximately 78% have credit risk concentration in Puerto Rico, 14% in the United States and 8% in the Virgin Islands.

First BanCorp relies primarily on its retail network of branches to originate residential and consumer loans. The Corporation supplements its residential mortgage originations with wholesale servicing release purchases from small mortgage bankers. For purpose of the following presentation, the Corporation excludes commercial loans to local financial institutions from loan production data because it believes this approach provides a better representation of the Corporation s commercial production capacity.

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

	For the year ended December 31,				
	2006	2005	2004	2003	2002
	(Dollars in thousands)				
Beginning balance	$ 12,537,930	$ 9,556,958	$ 6,914,677	$ 5,523,111	$ 4,215,903
Residential real estate loans originated and purchased	908,846	1,372,490	765,486	546,703	265,599
Construction loans originated and purchased	961,746	1,061,773	309,053	259,684	161,933
Commercial loans originated and purchased	2,031,629	2,258,558	1,014,946	924,712	581,301
Secured commercial loans disbursed to local financial institutions		681,407	2,228,056	1,258,782	726,250
Finance leases originated	177,390	145,808	116,200	67,332	54,750
Consumer loans originated and purchased	807,979	992,942	746,113	583,083	443,154
Total loans originated and purchased (1)	4,887,590	6,512,978	5,179,854	3,640,296	2,232,987
Sales and securitizations of loans	(167,381)	(118,527)	(180,818)	(228,824)	(80,446)
Repayments and prepayments	(6,022,633)	(3,803,804)	(2,263,043)	(1,938,301)	(753,524)
Other increases (decreases)(2)(3)	(129,822)	390,325	(93,712)	(81,605)	(91,809)
Net (decrease) increase	(1,432,246)	2,980,972	2,642,281	1,391,566	1,307,208
Ending balance	$ 11,105,684	$ 12,537,930	$ 9,556,958	$ 6,914,677	$ 5,523,111
Percentage (decrease) increase	-11.42%	31.19%	38.21%	25.20%	31.01%

(1)

Loan origination for 2002 includes $435 million acquired from JPMorgan Chase VI.

(2) Includes the change in the allowance for loan and lease losses and cancellation of loans due to the repossession of the collateral.

(3) For 2005, includes $470 million of loans acquired as part of the Ponce General acquisition.

Residential Real Estate Loans

Residential real estate loan production and purchases for the year ended December 31, 2006 decreased by $463.6 million, compared to the same period in 2005 and increased by $143.4 million, compared to the same period in 2004. The decrease in mortgage loan production for 2006 compared to 2005 was mainly attributable to higher rates, deteriorating economic conditions in Puerto Rico, competition from other financial institutions, and changes to the Corporation s and stricter underwriting standards. The Corporation decided to make certain adjustments to its underwriting standards designed to enhance the credit quality of its mortgage loan portfolio, in light of worsening macroeconomic conditions in Puerto Rico. The implementation of these standards contributed to the reduction in the Corporation s mortgage loan originations.

Residential real estate loans represent 19% of total loans originated and purchased for 2006, with the residential mortgage loans balance increasing by $425.7 million, from $2.3 billion in 2005 to $2.8 billion in 2006. The Corporation s strategy is to penetrate markets by providing customers with a variety of high quality mortgage products. The Corporation s residential mortgage loans originations continued to be driven by FirstMortgage, Inc., the mortgage loan origination subsidiary (FirstMortgage). The Corporation continued to commit substantial resources to this operation with the goal of becoming a

leading institution in the highly competitive residential mortgage loans market. The Corporation established FirstMortgage as a stand-alone subsidiary in 2003. As of December 31, 2006, FirstMortgage had a distribution network of 35 mortgage centers, including stand-alone centers and offices located within FirstBank Puerto Rico branches. FirstMortgage supplements its internal direct originations through its retail network with an indirect business strategy. The Corporation s Partners in Business, a division of FirstMortgage, partners with mortgage brokers in Puerto Rico to purchase ongoing mortgage loan production. FirstMortgage Realty Group, launched in 2005, focuses on building relationships with realtors by providing resources, office amenities and personnel, to assist real estate brokers in building their individual businesses and closing transactions. FirstMortgage multi-channel strategy has proven effective in capturing business.

Commercial and Construction Loans

In recent years, the Corporation has emphasized commercial lending activities and continues to penetrate this market. A substantial portion of this portfolio is collateralized by real estate. Total commercial loans originated and purchased amounted to $3.0 billion for 2006, an increase of $327.0 million when compared to originations during 2005, for total commercial loans of $8.3 billion at December 31, 2005. As a result of strong originations net of prepayments and maturities, the commercial loans balance, excluding secured commercial loans to local financial institutions, increased by $0.8 billion, from $4.6 billion as of December 31, 2005 to $5.4 billion as of December 31, 2006. The Corporation s subsidiary bank loan agency in Florida accounted for a substantial portion of the construction loans increase during 2005 and 2006. Loans disbursed by the agency for the years ended December 31, 2006 and 2005 amounted to $648.5 million and $746.9 million, respectively.

Although commercial loans involve greater credit risk because they are larger in size and more risk is concentrated in a single borrower, the Corporation has and continues to develop an effective credit risk management infrastructure that mitigates potential losses associated with commercial lending, including strong underwriting and loan review functions, sales of loan participations, and continuous monitoring of concentrations within portfolios.

The Corporation s commercial loans are primarily variable and adjustable rate loans. Commercial loan originations come from existing customers as well as through referrals and direct solicitations. The Corporation follows a strategy aimed to cater to customer needs in the commercial loans middle market segment by building strong relationships and offering financial solutions that meet customers unique needs. Starting in 2005, the Corporation expanded its distribution network and participation in the commercial loans middle market segment by focusing on customers with financing needs up to $5 million. The Corporation established 4 regional offices that provide coverage throughout Puerto Rico. The offices are staffed with sales, marketing and credit officers able to provide a high level of personalized service and prompt decision-making.

The Corporation has a significant lending concentration of $509.1 million in one mortgage originator in Puerto Rico, Doral Financial Corporation, as of December 31, 2006. The Corporation has outstanding $422.9 million with another mortgage originator in Puerto Rico, R&G Financial Corporation (R&G), for total loans to mortgage originators amounting to $932.0 million as of December 31, 2006. These commercial loans are secured by 10,307 individual mortgage loans on residential and commercial real estate with an average principal balance of $90,425 each. The mortgage originators have always paid the loans in accordance with their terms and conditions. In December 2005, the Corporation obtained a waiver from the Office of the Commissioner of Financial Institutions of the Commonwealth of Puerto Rico with respect to the statutory limit for individual borrowers (loan to one borrower limit). In May 2006, FirstBank Puerto Rico received a cash payment from Doral Financial Corporation of approximately $2.4 billion, substantially reducing the balance of the secured commercial loan to that institution. As part of the Consent Orders imposed on the Corporation and FirstBank by their regulators, the Corporation has continued working on the reduction of these exposures with both financial institutions.

In February 2007, the Corporation entered into a series of credit agreements with R&G relating to prior transactions originally treated as purchases of mortgages and pass-through trust certificates from R&G subsidiaries. First, R&G and First BanCorp entered into a credit agreement totaling $271 million to document as secured borrowings the loan transfers between the parties that previously had been accounted for incorrectly as sales. The terms of the agreement specified a 5-year term loans at an interest rate of 150 basis points over 90-day LIBOR, which adjusts quarterly. The loan has an overcollaterization ranging from 3% to 11% depending on the type of each

individual loan. In addition, R-G Premier Bank of Puerto Rico, R&G Financial Corporation s wholly owned Puerto Rico commercial bank subsidiary, repaid approximately $50 million of the commercial secured borrowing with the Corporation. Second, the Corporation and R-G Crown Bank, R&G s wholly owned Florida thrift subsidiary, agreed to restructure various agreements involving approximately $189 million of securities collateralized by loans that were originally sold through five grantor trusts. The modifications to the original agreements deleted or modified any previous conditions that precluded accounting for the transactions as purchases or sales. The agreements enabled First BanCorp to fulfill one of the remaining requirements of the Consent Orders.

Table of Contents

Consumer Loans

Consumer loan originations and purchases are principally driven through the Corporation s retail network. For the year ended December 31, 2006, consumer loan originations amounted to $808.0 million, a decrease of $185.0 million or 19% compared to the same period in 2005. The decrease in consumer loan origination was mainly attributable to lower volume of business due to the adverse economic conditions of Puerto Rico. Consumer loan originations were mainly driven by auto loan originations. Management finds the auto market attractive. The growth of this portfolio has been achieved through a strategy of providing outstanding service to selected auto dealers who provide the channel for the bulk of the Corporation s auto loan originations.

The above mentioned strategy is directly linked to our commercial lending activities as the Corporation maintains strong and stable auto floor plan relationships, which are the foundation of a successful auto loan generation operation. The Corporation will continue to strengthen the commercial relations with floor plan dealers, which directly benefit the Corporation s consumer lending operation.

Personal loans and, to a lesser extent, marine financing and a small credit card portfolio also contribute to interest income generated from consumer lending. Management plans to continue to be active in the consumer loan market applying the Corporation s strict underwriting standards.

Finance Leases

Finance leases originations, which are mostly composed of loans to individuals to finance the acquisition of motor vehicles, increased by $31.6 million or 22% to $177.4 million during 2006 compared to 2005. As a result, portfolio balances increased by $81.1 million in 2006. These leases typically have five-year terms and are collateralized by a security interest in the underlying assets. The Corporation s credit risk exposure for this portfolio is similar to the credit exposure of an auto loan portfolio.

Investment Activities

The Corporation s investment portfolio as of December 31, 2006 amounted to $5.5 billion, a decrease of $1.2 billion when compared with the investment portfolio of $6.7 billion as of December 31, 2005. The decrease in investment securities resulted mainly from prepayments and maturities received from the Corporation s investment portfolio, mainly mortgage-backed and the Corporation s decision to de-leverage its balance sheet. The Corporation s decision to de-leverage its balance sheet was influenced, among other things, by the flat to inverted yield curve. As a result, the Corporation decided to repay higher rate maturing liabilities, in particular brokered CDs, rather than investing the proceeds at an effective interest rate lower than the Corporation s cost of funds.

Total purchases of investment securities, excluding those invested on a short-term basis (money market investments) during 2006 amounted to approximately $672.9 million and were composed mainly of mortgage-backed securities in the amount of $233.2 million with a weighted average coupon of 5.70% and government agency securities and U.S. Treasury securities in the amount of $437.2 million with a weighted average coupon of 4.86%.

The following table presents the carrying value of investments as of December 31, 2006 and 2005:

	2006	2005
	(Dollars in thousands)	
Money market investments	$ 456,470	$ 1,224,791
Investment securities held-to-maturity:		
U.S. Government and agencies obligations	2,258,040	2,190,714
Puerto Rico Government obligations	31,716	14,163
Mortgage-backed securities	1,055,375	1,233,711
Corporate bonds	2,000	
	3,347,131	3,438,588
Investment securities available-for-sale:		
U.S. Government and agencies obligations	403,592	389,650
Puerto Rico Government obligations	25,302	25,006
Mortgage-backed securities	1,253,853	1,478,720
Corporate bonds	4,961	25,381
Equity securities	12,715	29,421
	1,700,423	1,948,178
Other equity securities	40,159	42,368
Total investments	$ 5,544,183	$ 6,653,925

Mortgage-backed securities as of December 31, 2006 and 2005, consist of:

	2006	2005
	(Dollars in thousands)	
Held-to-maturity:		
FHLMC certificates	$ 15,438	$ 20,211
FNMA certificates	1,039,937	1,213,500
	1,055,375	1,233,711
Available-for-sale:		
FHLMC certificates	7,575	9,962
GNMA certificates	374,368	438,881
FNMA certificates	871,540	1,029,474
Mortgage pass-through certificates	370	403
	1,253,853	1,478,720
Total mortgage-backed securities	$ 2,309,228	$ 2,712,431

The carrying amounts of investment securities classified as available-for-sale and held-to-maturity as of December 31, 2006 by contractual maturity (excluding mortgage-backed securities and money market investments) are shown below:

	Carrying amount	**Weighted average yield %**
	(Dollars in thousands)	
U.S. Government and agencies obligations		
Due within one year	$ 183,097	5.01
Due after five years through ten years	390,728	4.31
Due after ten years	2,087,807	5.83
	2,661,632	5.55
Puerto Rico Government obligations		
Due after one year through five years	4,761	6.18
Due after five years through ten years	31,961	5.37
Due after ten years	20,296	5.60
	57,018	5.52
Corporate bonds		
Due after five years through ten years	1,217	7.70
Due after ten years	5,744	7.21
	6,961	7.30
Total	2,725,611	
Mortgage-backed securities	2,309,228	
Equity securities	12,715	
Total investment securities available-for-sale and held-to-maturity	$ 5,047,554	

Table of Contents

Total proceeds from the sale of securities during the year ended December 31, 2006 amounted to $232.5 million (2005 $252.7 million).

In 2006, the Corporation realized gross gains of $7.3 million (2005 $21.4 million, 2004 $12.2 million), and realized gross losses of $0.2 million (2005 $0.7 million, 2004 $0).

During the year ended December 31, 2006, the Corporation recognized through earnings approximately $15.3 million (2005 $8.4 million, 2004 $2.7 million) of losses in the investment securities available-for-sale portfolio that management considered to be other-than-temporarily impaired. The impairment losses were related to equity securities.

Net interest income of future periods may be affected by the acceleration in prepayments of mortgage-backed securities. Acceleration in the prepayments of mortgage-backed securities would lower yields on these securities, as the amortization of premiums paid upon acquisition of these securities would accelerate. Also, net interest income in future periods might be affected given substantial investments in callable securities. The book value of the callable securities, mainly agency securities, amounted to $2.1 billion as of December 31, 2006. Lower reinvestment rates and a time lag between calls, prepayments and/or the maturity of investments and actual reinvestment of proceeds into new investments, might also affect net interest income. Increases in short-term interest rates may reduce net interest income; when rates rise the Corporation must pay more in interest on its liabilities while the interest earned on its assets, including investments, does not rise as quickly. These risks are directly linked to future period s market interest rate fluctuations. Refer to the Risk Management Interest Rate Risk Management section of this Management s Discussion and Analysis for further analysis of the effects of changing interest rates on the Corporation s net interest income and for the interest rate risk management strategies followed by the Corporation.

Investment Securities and Loans Receivable Maturities

The following table presents the maturities or repricing of the loan and investment portfolio as of December 31, 2006:

(Dollars in thousands)

		2-5 Years		Over 5 Years		
	One Year or Less	Fixed Interest Rates	Variable Interest Rates	Fixed Interest Rates	Variable Interest Rates	Total
Money market investments	$ 456,470	$	$	$	$	$ 456,470
Mortgage-backed securities	107,098	560,461		1,641,669		2,309,228
Other securities	223,796	50,537		2,504,152		2,778,485
Total Investments	787,364	610,998		4,145,821		5,544,183
Loans						
Residential real estate	388,867	336,613		2,047,150		2,772,630
Commercial and commercial real estate	3,631,181	249,561	364,208	538,380	61,864	4,845,194
Construction	1,448,925	26,413		36,270		1,511,608
Finance leases	87,179	274,452				361,631
Consumer	638,646	1,101,851		32,420		1,772,917
Total loans	6,194,798	1,988,890	364,208	2,654,220	61,864	11,263,980
Total earning assets	$ 6,982,162	$ 2,599,888	$ 364,208	$ 6,800,041	$ 61,864	$ 16,808,163

(1) Equity securities available-for-sale and other equity securities were included under the one year or less category .

(2) Non-accruing loans were included under the one year or less category .

66

Table of Contents

Sources of Funds

The Corporation s principal funding sources are branch-based deposits, brokered CDs, institutional deposits, federal funds purchased, securities sold under agreements to repurchase, notes payable and FHLB advances.

As of December 31, 2006, total liabilities amounted to $16.2 billion, a decrease of $2.5 billion as compared to $18.7 billion as of December 31, 2005. The decrease in total liabilities was mainly due to a $1.5 billion decrease in total deposits, primarily brokered CDs and a decrease of $1.1 billion in federal funds purchased and securities sold under agreements to repurchase. During the second half of 2006, the Corporation s brokered CDs decreased significantly due to the Corporation s decision to pay down higher rate maturing short-term brokered CDs with available funds received from Doral s payment of $2.4 billion in May 2006. The Corporation s decision to pay down maturing brokered CDs was influenced, among other things, by the flat to inverted yield curve. The Corporation decided to repay higher rate maturing liabilities, in particular brokered CDs, rather than investing the proceeds at an effective interest rate lower than the Corporation s cost of funds.

The Corporation maintains unsecured uncommitted lines of credit with other banks. As of December 31, 2006, the Corporation s total unused lines of credit with these banks amounted to $255 million. As of December 31, 2006, the Corporation had an available line of credit with the FHLB, guaranteed with excess collateral pledged to the FHLB in the amount of $687.7 million.

Deposits

Total deposits amounted to $11.0 billion as of December 31, 2006, as compared to $12.5 billion and $7.9 billion as of December 31, 2005 and 2004, respectively.

The following table presents the composition of total deposits:

	Weighted average rates as of December 31, 2006		**December 31,**	
		2006	**2005**	**2004**
		(Dollars in thousands)		
Savings accounts	1.49%	$ 984,332	$ 1,034,047	$ 1,077,002
Interest-bearing checking accounts	2.07%	433,278	375,305	385,078
Certificates of deposit	5.56%	8,795,692	10,243,394	5,750,660
Interest-bearing deposits	4.92%	10,213,302	11,652,746	7,212,740
Non-interest-bearing deposits		790,985	811,006	699,582
Total		$ 11,004,287	$ 12,463,752	$ 7,912,322
Interest-bearing deposits:				
Average balance outstanding		$ 11,873,608	$ 9,855,761	$ 6,403,252
Non-interest-bearing deposits:				
Average balance outstanding		$ 771,343	$ 791,815	$ 645,512
Weighted average rate during the period on interest-bearing deposits(1)		4.63%	3.29%	2.08%

(1) Excludes changes in the fair value of interest rate

swaps and basis
adjustment on
fair value
hedges.

Total deposits are composed of branch-based deposits, brokered CDs and, to a lesser extent, institutional deposits. Institutional deposits include, among others, certificates issued to agencies of the Government of Puerto Rico and to Government agencies in the Virgin Islands.

Total deposits decreased by $1.5 billion as of December 31, 2006 when compared to December 31, 2005 mainly due to a decrease in brokered CDs. Brokered CDs, which are certificates sold through brokers, amounted to $7.1 billion as of December 31, 2006 compared to $8.6 billion as of December 31, 2005. The total U.S. market for this source of funding approximates $520 billion. The use of brokered CDs has been particularly important to the growth of the Corporation. The Corporation encounters intense competition in attracting and retaining deposits in Puerto Rico, as financial institutions are at a competitive disadvantage since the income generated on other investment products available to investors in Puerto Rico is taxed at lower rates than tax rates for income generated on deposit products. The brokered CDs market is a very competitive and liquid market in which the Corporation has been able to obtain substantial amounts of funding in short periods of time. This strategy enhanced the Corporation s liquidity position, since the brokered CDs are unsecured and can be obtained at substantially longer maturities than other regular retail deposits. Also, the Corporation has the ability to convert the fixed-rate brokered CDs to short-term adjustable rate liabilities using interest rate swap agreements. For the year ended December 31, 2006, the Corporation issued $4.9 billion in brokered CDs (including rollover of short-term brokered CDs) compared to $8.0

67

billion for the year ended December 31, 2005. Refer to the Risk Management Interest Rate Risk Management section of this Management s Discussion and Analysis for further discussion on interest rate risk management strategies followed by the Corporation.

As of December 31, 2006, 63% of the value of retail brokered CDs held by the Corporation were long-term fixed callable certificates, in which the Corporation retains the option to cancel the certificates before maturity. As of December 31, 2006, the average remaining maturity of long-term callable brokered CDs approximated 10.60 years (2005 11.60 years) and of short-term fixed brokered certificates of deposits approximated 0.45 years (2005 0.39 years). When using interest rate swaps, the Corporation mainly hedges those brokered CDs with long-term maturities.

During the second half of 2006, the Corporation s brokered CDs decreased significantly due to the Corporation s decision to pay down higher rate maturing short-term brokered CDs with available funds received from Doral s payment of $2.4 billion in May 2006. This strategy significantly reduced the negative carry attributed to such repayment.

The following table presents a maturity summary of certificates of deposit with balances of $100,000 or more as of December 31, 2006:

		(Dollars in thousands)
Three months or less	$	1,867,353
Over three months to six months		797,053
Over six months to one year		486,722
Over one year		4,817,318
Total	$	7,968,446

Borrowings

As of December 31, 2006, total borrowings amounted to $4.7 billion as compared to $5.8 billion and $6.3 billion as of December 31, 2005 and 2004, respectively.

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

	Weighted average rates as of December 31, 2006	December 31, 2006	2005	2004
		(Dollars in thousands)		
Federal funds purchased and securities sold under agreements to repurchase	4.87%	$ 3,687,724	$ 4,833,882	$ 4,165,361
Advances from FHLB	5.37%	560,000	506,000	1,598,000
Notes payable	5.76%	182,828	178,693	178,240
Other borrowings	7.98%	231,719	231,622	276,692
Subordinated notes				82,280
Total	5.12%	$ 4,662,271	$ 5,750,197	$ 6,300,573
Weighted average rate during the period		4.99%	4.08%	3.26%

The Corporation uses federal funds purchased, repurchase agreements, advances from the Federal Home Loan Bank (FHLB), notes payable and other borrowings, such as trust preferred securities, as additional funding sources.

The growth of the Corporation s investment portfolio is substantially funded with repurchase agreements. One of the Corporation s strategies is the use of structured repurchase agreements. Under these agreements, the Corporation attempts to reduce exposure to interest rate risk by lengthening the final maturities of its liabilities while keeping funding cost low. As of December 31, 2006, the outstanding balance of structured repurchase agreements was $1.4 billion.

FirstBank 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, 2006, the outstanding balance of FHLB advances was $560.0 million.

During 2004, the Corporation undertook several financing transactions to diversify its funding sources. FirstBank, the Corporation s bank subsidiary, issued notes payable that as of December 31, 2006 had an outstanding balance of $182.8 million.

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 (which 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 composition and estimated weighted average interest rates of interest-bearing liabilities as of December 31, 2006, were as follows:

		Amount (Dollars in thousands)	**Weighted Average Rate**
Interest-bearing deposits	$	10,213,302	4.92%
Borrowed funds		4,662,271	5.12%
	$	14,875,573	4.98%

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 our credit, market or liquidity risks, (3) diversify our funding sources or (4) optimize capital.

As a provider of financial services, the Corporation routinely enters into agreements 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 agreements 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, 2006, commitments to extend credit and commercial and financial standby letters of credit amounted to approximately $2.0 billion and $97.3 million, respectively. Commitments to extend credit are agreements to lend to customers as long as the conditions established in the contract are met. Generally, the Corporation does not enter into interest rate lock agreements with borrowers.

Contractual Obligations and Commitments

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

credit:

	Contractual Obligations and Commitments (Dollars in thousands)				
	Total	Less than 1 year	1-3 years	3-5 years	After 5 years
Contractual obligations:					
Certificates of deposit	$ 8,795,692	$ 3,762,400	$ 949,313	$ 446,066	$ 3,637,913
Federal funds purchased and securities sold under agreements to repurchase	3,687,724	2,600,224		487,500	600,000
Advances from FHLB	560,000	20,000	516,000	24,000	
Notes payable	182,828			8,132	174,696
Other borrowings	231,719				231,719
Operating leases	54,181	8,974	13,847	8,575	22,785
Other contractual obligations	6,171	1,743	2,916	1,402	110
Total contractual obligations	$ 13,518,315	$ 6,393,341	$ 1,482,076	$ 975,675	$ 4,667,223
Commitments to sell mortgage loans	$ 55,238	$ 55,238			
Standby letters of credit	$ 97,319	$ 97,319			
Commitments to extend credit:					
Lines of credit	$ 1,403,576	$ 1,403,576			
Letters of credit	40,915	40,915			
Commitments to originate loans	539,267	539,267			
Total commercial commitments	$ 1,983,758	$ 1,983,758			

Included in the above table are the Corporation s obligations and commitments to make future payments under contracts, such as debt and lease agreements, and under other commitments to purchase and sell loans 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 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 credit cards and personal lines of credit, the Corporation can at any time and without cause, cancel the unused credit facility.

Capital

The Corporation s capital amounted to $1.2 billion as of December 31, 2006 and 2005. As of December 31, 2006, total capital increased by $31.7 million compared to balances as of December 31, 2005. The change in capital for 2006 is composed of increases in earnings of $84.6 million, the issuance of 2,379,000 shares of common stock through the exercise of stock options with proceeds of $19.8 million and $5.4 million of stock-based compensation recognized offset in part by cash dividends of $63.6 million and by a negative non-cash valuation of securities available-for-sale of $14.5 million.

As of December 31, 2006, First BanCorp, FirstBank and FirstBank Florida were in compliance with regulatory capital requirements that were applicable to them as a financial holding company, a state non-member bank and a thrift, 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, FirstBank and FirstBank Florida s

regulatory capital ratios as of December 31, 2006, based on existing Federal Reserve, FDIC, and OTS guidelines.

		First BanCorp Banking Subsidiary		
	First BanCorp	**FirstBank**	**FirstBank Florida**	**Well-Capitalized Minimum**
Total capital (Total capital to risk-weighted assets)	12.46%	12.25%	11.35%	10.00%
Tier 1 capital ratio (Tier 1 capital to risk-weighted assets)	11.27%	11.02%	10.96%	6.00%
Leverage ratio	7.97%	7.76%	8.10%	5.00%

As of December 31, 2006, FirstBank and FirstBank Florida were considered a well-capitalized bank for purposes of the prompt corrective action regulations adopted by the FDIC. To be considered a well-capitalized institution under the FDIC s regulations, an institution must maintain a Leverage Ratio of at least 5%, a Tier 1 Capital Ratio of at least 6% and a Total Capital Ratio of at least 10%, and not be subject to any written agreement or directive to meet a specific capital ratio.

70

Table of Contents

On March 17, 2006, First BanCorp and its banking subsidiary FirstBank entered into Consent Orders with the Board of Governors of the Federal Reserve System, the FDIC and the Office of the Commissioner relating to mortgage-related transactions with Doral Financial Corporation and R&G Financial Corporation. For a detailed description of these orders, please refer to Part I, Item 3. Legal Proceedings, in this Form 10-K.

During the first quarter of 2007, the Corporation reached an agreement in principle to settle all claims with the lead plaintiffs in a shareholder class action originally filed in 2005. Under the terms of the settlement, which is subject to notice being provided to the class and final approval by the United States District Court for the District of Puerto Rico, First BanCorp will pay the plaintiffs $74.25 million. Based on available evidence, the Corporation had accrued $74.25 million in its consolidated financial statements for the year ended December 31, 2005 in connection with a potential settlement.

During the first quarter of 2007, the Corporation agreed to issue approximately 9.250 million shares of its common stock to The Bank of Nova Scotia (Scotiabank), through a private placement offering, valuing the stock at $10.25 per share for a total purchase price of approximately $94.8 million. The valuation reflects a premium of approximately 5% over the volume weighted-average closing share price over the 30 trading day period ending January 30, 2007. After the investment, Scotiabank will hold 10% of First BanCorp s outstanding common shares. The issuance of common stock to Scotiabank is subject to regulatory approval.

Effective January 1, 2007, the Corporation early adopted SFAS 159. The adoption of SFAS 159 for the Corporation s brokered CDs and medium-term notes that are hedged with interest rate swaps resulted in increases to the Corporation s regulatory capital ratio of approximately 125 basis points.

Dividends

In 2006, 2005 and 2004 the Corporation declared four quarterly cash dividends of $0.07, $0.07 and $0.06 per common share outstanding, respectively, for an annual dividend of $0.28, $0.28 and $0.24, respectively. Total cash dividends paid on common shares amounted to $23.3 million for 2006 (or a 53% dividend payout ratio), $22.6 million for 2005 (or a 30% dividend payout ratio) and $19.3 million for 2004 (or a 14% dividend payout ratio). Dividends declared on preferred stock amounted to $40.3 million in 2006, 2005 and 2004.

RISK MANAGEMENT

Background

As part of the Corporation s restatement efforts (refer to the Corporation s amended 2004 Annual Report on Form 10K), during the first quarter of 2006, the Board reviewed the Corporation s risk management program with the assistance of outside consultants and counsel. This effort resulted in the realignment of the Corporation s risk management functions and the adoption of an enterprise-wide risk management process. The Board appointed a senior management officer as Chief Risk Officer (CRO) and appointed this officer to the Risk Management Council (RMC) with reporting responsibilities to the CEO and the Audit Committee. In addition, the Board established an Asset/Liability Risk Committee of the Board, with oversight responsibilities for risk management, including asset quality, portfolio performance, interest rate and market sensitivity, and portfolio diversification. In addition, the Asset/Liability Risk Committee has authority to examine the Corporation s assets and liabilities, such as its brokered CDs, to facilitate appropriate oversight by the Board. Finally, management is required to bring to the attention of the Asset/Liability Risk Committee new forms of transactions or variants of forms of transactions that the Asset/Liability Risk Committee has not yet reviewed to enable the Asset/Liability Risk Committee to fully evaluate the consequences of such transactions to the Corporation. In addition, management is required to bring to the attention of the Audit Committee new forms of transactions or variants of forms of transactions for which the Corporation has not determined the appropriate accounting treatment to enable the Audit Committee to fully evaluate the accounting treatment of such transactions.

During 2006, management continued to refine and enhance its risk management policies, processes and procedures to maintain effective risk management and governance, including identifying, measuring, monitoring, controlling, mitigating and reporting of all material risks.

Table of Contents

General

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

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

Risk Definition

Interest Rate Risk

Interest rate risk is the risk to earnings or capital arising from adverse movements in interest rates.

Market Risk

Market risk is the risk to earnings or capital arising from adverse movements in market rates or prices, such as interest rates or equity prices. The Corporation evaluates market risk together with interest rate risk, refer to Interest Rate Risk Management section below for further details.

Credit Risk

Credit risk is the risk to earnings or capital arising from a borrower s or a counterparty s failure to meet the terms of a contract with the Corporation or otherwise to perform as agreed. Refer to Credit Risk Management section below for further details.

Liquidity Risk

Liquidity risk is the risk to earnings or capital arising from the possibility that the Corporation will not have sufficient cash to meet the short term liquidity demands such as from deposit redemptions or loan commitments. Refer to Liquidity Risk Management section below for further details.

Operational Risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. This risk is inherent across all functions, products and services of the Corporation.

Legal and Compliance Risk

Legal and compliance risk is the risk of negative impact to business activities, earnings or capital, regulatory relationships or reputation as a result of failure to adhere to or comply with regulations, laws, industry codes or rules, regulatory expectations or ethical standards.

Reputation Risk

Reputation risk is the risk to earnings and capital arising from adverse impact to the Corporation s market value, capital or earnings arising from negative public opinion, whether true or not. This risk affects the Corporation s ability to establish new relationships or services, or to continue servicing existing relationships.

Contingency Risk

Contingency risk is the risk to earnings and capital associated with the Corporation s preparedness for the occurrence of an unforeseen event.

Risk Governance

The following discussion highlights the roles and responsibilities of the key participants in the Corporation s risk management framework:

Board of Directors

The Board of Directors provides oversight and establishes the objectives and limits of the Corporation s risk management activities. The Asset/Liability Risk Committee and the Audit Committee assist the Board of Directors in executing this responsibility.

Asset/Liability Risk Committee

The Asset/Liability Risk Committee of the Corporation is appointed by the Board of Directors to assist the Board of Directors in its

oversight of risk management, including asset quality, portfolio performance, interest rate and market sensitivity, and portfolio diversification. In addition, the Asset/Liability Risk Committee has the authority to examine the Corporation s assets and liabilities. In so doing, the Committee s primary general functions involve:

The establishment of a process to enable the recognition, assessment, and management of risks that could affect the Corporation s assets and liabilities;

The identification of the Corporation s risk tolerance levels relating to its assets and liabilities;

The evaluation of the adequacy and effectiveness of the Corporation s risk management process relating to the Corporation s assets and liabilities, including management s role in that process;

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

The approval of loans and other business matters following the lending authorities approved by the Board.

Audit Committee

The Audit Committee of First BanCorp is appointed by the Board of Directors to assist the Board of Directors in its oversight of risk management processes related to compliance, operations, the Corporation s internal audit function, and the Corporation s external financial reporting and internal control over financial reporting process. In performing this function, the Audit Committee is assisted by the CRO, the RMC, and other members of senior management.

Risk Management Council

The RMC is responsible for supporting the CRO in measuring and managing the Corporation s aggregate risk profile. The RMC executes management s oversight role regarding risk management. This committee is designed to ensure that the appropriate authorities, resources, responsibilities and reporting are in place to support an effective risk management program. The RMC Council consists of various senior executives throughout the Corporation and meets on a monthly basis. The RMC is responsible for ensuring that the Corporation s overall risk profile is consistent with the Corporation s objectives and risk tolerance levels. The RMC is also responsible for ensuring that there are appropriate and effective risk management processes to identify, measure and manage risks on an aggregate basis.

Other Management Committees

As part of its governance framework, the Corporation has various 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 oversees interest rate and market risk, liquidity management and other related matters. Refer to Interest Rate Risk Management discussion 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 Bank Secrecy Act.

(4) Credit Committees (Delinquency and Credit Management Committee) oversee and establish standards for credit risk management process 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 reviews of (1) past due loans, (2) overdrafts, (3) non-accrual loans, (4) OREO assets, and (5) the bank s watch list and non-performing loans.

Executive 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 and Chief Operating Officer responsible for the overall risk governance structure.

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

(3) Chief Credit Officer manages 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.

(5) Chief Accounting Officer responsible for the development and implementation of the Corporation s accounting policies and practices and to review and monitor critical accounts and transactions to ensure that they are managed in accordance with generally accepted accounting principles in the United States and applicable regulatory requirements.

Other Officers

In addition to the centralized Enterprise Risk Management function, certain line of businesses and corporate functions have its own Risk Managers and support staff. The Risk Managers, while reporting directly to their respective line of business or

function, facilitate communications with the Corporation s risk functions and works in partnership with the CRO to ensure alignment with sound risk management practices and expedite the implementation of the enterprise risk management framework and policies.

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

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

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. The Management s Investment and Asset Liability Committee of FirstBank (MIALCO) oversees interest rate risk, liquidity management and other related matters. The MIALCO, which reports to the Investment Sub-committee of the Board of Directors Asset/Liability Risk Committee, is composed of senior management officers, including the Chief Executive Officer, the Chief Financial Officer, the Chief Operating Officer, the Risk Manager of the Treasury and Investment Department, the Economist and the Treasurer.

Committee meetings focus on, among other things, current and expected conditions in world financial markets, competition and prevailing rates in the local deposit market, liquidity, unrealized gains and losses in securities, recent or proposed changes to the investment portfolio, alternative funding sources and their 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. On a quarterly basis, the MIALCO performs a comprehensive asset/liability review, examining interest rate risk as described below together with other issues such as liquidity and capital.

The Corporation uses scenario analysis to measure the effects of changes in interest rates on net interest income. These simulations are carried out over a one-year and a two-year time horizon, assuming gradual upward and downward interest rate movements of 200 basis points. Simulations are carried out in two ways:

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

(2) using a growing balance sheet based on recent growth patterns and strategies.

The balance sheet is divided into groups of assets and liabilities in order to simplify the projections. As interest rates rise or fall, these simulations incorporate expected future lending rates, current and expected future funding sources and cost, the possible exercise of options, changes in prepayment rates, and other factors which may be important in projecting the future growth of net interest income. These projections are carried out for First BanCorp on a fully consolidated basis.

The Corporation uses asset-liability management software 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 of the balance sheet on the date of the simulations. Interest rates used for the simulations also correspond to actual rates at the start of the projection period.

These simulations are highly complex, and they use many simplifying assumptions that are intended to reflect the general behavior of the Corporation over the period in question. There can be no assurance 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.

The following table presents the results of the simulations as of December 31, 2006 and 2005:

(Dollars in millions)

	December 31, 2006 Net Interest Income Risk (projected for 2007)				December 31, 2005 Net Interest Income Risk (projected for 2006)			
	Static Simulation		Growing Balance Sheet		Static Simulation		Growing Balance Sheet	
	$ Change	% Change	$ Change	% Change	$ Change	% Change	$ Change	% Change
+200 bps ramp	($34.6)	(6.86%)	($36.9)	(7.1%)	($25.9)	(4.7%)	($21.4)	(3.8%)

-200 bps ramp	50.7	10.1%	20.4	3.9%	7.2	1.3%	0.4	0.1%

The increase in net interest income risk from 2005 to 2006 was primarily due to an increase in the proportion of fixed

74

interest rate securities and loans. As of the December 31, 2006 the ratio of fixed interest rate securities and loans to total securities and loans was 66% compared to 58% as of December 31, 2005. The increase was primarily due to the growth of the Corporation s fixed-rate loans portfolio, mainly residential real estate loans and the substantial repayment of a floating rate commercial loan from a local financial institution. This increase was not offset by a proportional increase in the Corporation s fixed-rate liabilities.

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 Corporation s asset liability management program includes the use of derivatives instruments, which have worked effectively to date, and that management believes will continue to be effective in the future.

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

Interest rate swaps Under interest rate swap agreements, the Corporation agrees with other parties to exchange, at specified intervals, the difference between fixed-rate and floating-rate interest rate amounts calculated by reference to an agreed notional principal amount. Since a substantial portion of the Corporation s loans, mainly commercial loans, yield variable rates, the interest rate swaps are utilized to convert fixed-rate brokered certificates of deposit (liabilities), mainly those with long-term maturities, to a variable rate to better match the variable rate nature of these loans.

Interest rate cap agreements In order to hedge risk inherent on certain commercial loans to other financial institutions, as the yield is a variable rate limited to the weighted-average coupon of the referenced residential mortgage collateral, less a contractual servicing fee, the Corporation enters into referenced interest rate cap agreements that provide protection against rising interest rates. In managing this risk, the Corporation determines the need for derivatives, including cap agreements, based on different rising interest rate scenario projections and the weighted-average coupon of the referenced residential mortgage loan pools.

Structured repurchase agreements The Corporation uses structured repurchase agreements, with embedded call options, with the intention of reducing 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 repurchase agreements with embedded cap corridors; these instruments also provide protection for a rising rate scenario.

The following table summarizes the notional amount of all derivative instruments as of December 31, 2006 and 2005:

	Notional Amount December 31,	
	2006	**2005**
	(Dollars in thousands)	
Interest rate swap agreements:		
Pay fixed versus receive floating	$ 80,720	$ 109,320
Receive fixed versus pay floating	4,802,370	5,751,128
Embedded written options	13,515	13,515
Purchased options	13,515	13,515
Written interest rate cap agreements	125,200	150,200
Purchased interest rate cap agreements	330,607	386,750
	$ 5,365,927	$ 6,424,428

The following table summarizes the notional amount of all derivatives by the Corporation s designation as of December 31, 2006 and 2005:

Table of Contents

	Notional Amount December 31,	
	2006	**2005**
	(Dollars in thousands)	
Designated hedges:		
Fair value hedge:		
Interest rate swaps used to hedge fixed rate certificates of deposit	$ 4,381,175	$
Interest rate swaps used to hedge fixed and step rate notes payable	165,442	
Total fair value hedges	$ 4,546,617	$
Economic undesignated hedges:		
Interest rate swaps used to hedge fixed rate certificates of deposit and loans	$ 336,473	$ 5,860,448
Embedded options on stock index deposits	13,515	13,515
Purchased options used to manage exposure to the stock market on embedded stock index options	13,515	13,515
Written interest rate cap agreements	125,200	150,200
Purchased interest rate cap agreements	330,607	386,750
Total derivatives not designated as hedge	$ 819,310	$ 6,424,428
Total	$ 5,365,927	$ 6,424,428

The majority of the Corporation s derivatives represent interest rate swaps used mainly to convert long-term fixed-rate brokered CDs to a variable rate. A summary of these interest rate swaps as of December 31, 2006 and 2005 follows:

	December 31,	
	2006	**2005**
	(Dollars in thousands)	
Pay fixed/receive floating:		
Notional amount	$ 80,720	$ 109,320
Weighted average receive rate at year end	7.38%	6.41%
Weighted average pay rate at year end	6.37%	6.60%
Floating rates range from 175 to 252 basis points over LIBOR rate		

	December 31,	
	2006	**2005**
	(Dollars in thousands)	
Receive fixed/pay floating:		
Notional amount	$ 4,802,370	$ 5,751,128
Weighted average receive rate at year end	5.16%	4.90%
Weighted average pay rate at year end	5.42%	4.37%
Floating rates range from minus 5 basis points to 20 basis points over LIBOR rate		

The changes in notional amount of interest rate swaps outstanding during the years ended December 31, 2006 and 2005 follows:

Table of Contents

		Notional amount (Dollars in thousands)
Pay-fixed and receive-floating swaps:		
Balance at December 31, 2004	$	**113,165**
Canceled and matured contracts		(44,565)
New contracts		40,720
Balance at December 31, 2005		**109,320**
Canceled and matured contracts		(28,600)
New contracts		
Balance at December 31, 2006	$	**80,720**
Receive-fixed and pay floating swaps:		
Balance at December 31, 2004	$	**4,118,615**
Canceled and matured contracts		(549,302)
New contracts		2,181,815
Balance at December 31, 2005		**5,751,128**
Canceled and matured contracts		(948,758)
New contracts		
Balance at December 31, 2006	$	**4,802,370**

The cumulative valuation of interest rate swaps as of December 31, 2006 and 2005 was unrealized losses of $137.1 million and $153.1 million, respectively. Prior to April 2006, none of these instruments were qualified for hedge accounting. Effective April 2006, the Corporation designated the majority of interest rate swap instruments (98% of the interest rate swaps outstanding) under the long-haul method of hedge accounting to hedge the changes in fair value of callable brokered certificates of deposit and callable medium-term notes. Since the adoption of the long-haul method, the fair value adjustment to the effective portion of the hedged liabilities is recorded as an adjustment to income that offsets or partially offsets the fair value adjustment of the related interest rate swaps.

Effective January 1, 2007, the Corporation decided to early adopt SFAS 159 for the callable brokered CDs and a portion of the callable fixed medium-term notes that were hedged with interest rate swaps. One of the main considerations in determining to early adopt SFAS 159 for these instruments is to eliminate the operational procedures required by the long-haul method of accounting in terms of documentation, effectiveness assessment, and manual procedures followed by the Corporation to fulfill the requirements specified by SFAS 133.

Upon adoption of SFAS 159, First BanCorp selected the fair value measurement for approximately $4.4 billion, or 63%, of the brokered CDs portfolio and approximately $29 million, or 16%, of the medium-term notes portfolio. The CDs and a portion of the notes chosen for the fair value measurement option are the ones hedged as of January 1, 2007 by callable interest rate swaps with the same terms and conditions.

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

(Dollars in thousands)	**December 31, 2006**

Fair value of contracts outstanding at the beginning of the year	$	(142,347)
Contracts realized or otherwise settled during the year		4,608
Changes in fair value during the year		10,961
Fair value of contracts outstanding at the end of the year	$	(126,778)

77

Table of Contents

Source of Fair Value
(Dollars in thousands)

	Payments Due by Period				
As of December 31, 2006	Maturity Less Than One Year	Maturity 1-3 Years	Maturity 3-5 Years	Maturity In Excess of 5 Years	Total Fair Value
Prices provided by external sources	$(595)	$(4,670)	$(6,491)	$(115,022)	$(126,778)

The use of derivatives involves market and credit risk. The market risk of derivatives arises principally from the potential for changes in the value of derivatives contracts based on changes in interest rates.

The credit risk of derivatives arises from the potential of a 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. 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.

Derivative Counterparty Credit Exposure
(Dollars in thousands)

	December 31, 2006				
Rating (1)	**Number of Counterparties(2)**	**Notional**	**Total Exposure at Fair Value(3)**	**Negative Fair Values**	**Total Fair Value**
AA+	1	$ 240,772	$	$ (6,553)	$ (6,553)
AA-	7	3,088,244	3,082	(87,046)	(83,964)
A+	4	1,690,069	2,843	(44,637)	(41,794)
BBB-	1	205,407	9,088		9,088
Subtotal	13	$ 5,224,492	$ 15,013	$ (138,236)	$ (123,223)
Other derivatives:					
Caps (4)		125,200		(390)	(390)
Equity-indexed options (4)		13,515		(4,347)	(4,347)
Loans (4)		2,720		(18)	(18)
Warrants		N/A	1,200		1,200
		$ 5,365,927	$ 16,213	$ (142,991)	$ (126,778)

(Dollars in thousands)

	December 31, 2005				
Rating (1)	**Number of Counterparties(2)**	**Notional**	**Total Exposure at Fair Value(3)**	**Negative Fair Values**	**Total Fair Value**
AA+	1	$ 241,505	$	$ (5,646)	$ (5,646)
AA-	4	2,356,778		(72,440)	(72,440)

A+	6	3,342,410	3,406	(74,003)	(70,597)
A	1	80,750	1,580	(2,069)	(489)
BBB-	1	236,550	9,560		9,560
Subtotal	13	$ 6,257,993	$ 14,546	$ (154,158)	$ (139,612)
Other derivatives:					
Caps (4)		150,200		(866)	(866)
Equity-indexed options (4)		13,515		(3,098)	(3,098)
Loans (4)		2,720	29		29
Warrants		N/A	1,200		1,200
		$ 6,424,428	$ 15,775	$ (158,122)	$ (142,347)

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

(2) Based on legal entities. Affiliated legal entities are reported separately.

Table of Contents

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

(4) These derivatives represent transactions sold to local companies or institutions for which a credit rating is not readily available. The credit exposure is mitigated because a transaction with the same terms and conditions was bought with a rated counterparty.

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 a counterparty s default on its contractual obligations. To manage this credit risk, the Corporation deals with counterparties of good credit standing, enters into master netting agreements whenever possible and, when appropriate, obtains collateral. For further details and information on the Corporation s derivative credit risk exposure, refer to Interest Rate Risk Management section above. The Corporation manages its credit risk through credit policy, underwriting, and quality control. The Corporation also employs proactive collection and loss mitigation efforts.

The Corporation may also encounter risk of default in relation to its securities portfolio. The securities held by the Corporation are principally mortgage-backed securities, U.S. Treasury and agency securities. Thus, a substantial portion of these instruments are guaranteed by mortgages, a U.S. government-sponsored entity or the full faith and credit of the U.S. government and are deemed to be of the highest credit quality.

Management s Credit Committee, comprised of the Corporation s Chief Credit Risk Officer and other senior executives, has 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 provision for loan and lease losses is charged to earnings to maintain the allowance for loan and lease losses at a level that the Corporation considers adequate to absorb probable losses inherent in the portfolio. The Corporation establishes the allowance for loan and lease losses based on its asset classification report to cover the total amount of

any assets classified as a loss, the probable loss exposure of other classified assets, and the estimated losses of assets not classified. The adequacy of the allowance for loan and lease losses is also based upon a number of additional factors including historical loan loss experience, current economic conditions, the fair value of the underlying collateral, the financial condition of the borrowers, and, as such, includes amounts based on judgments and estimates made by the Corporation. Although management believes that the allowance for loan and lease losses is adequate, factors beyond the Corporation s control, including factors affecting the Puerto Rico, Florida (USA), United States Virgin Islands or British Virgin Islands economies may contribute to delinquencies and defaults, thus necessitating additional reserves.

For small, homogeneous type of loans including residential mortgage loans, auto loans, consumer loans, finance lease loans, and commercial and construction loans under $1.0 million, the Corporation evaluates a specific allowance based on average historical loss experience for each corresponding type of loans. The methodology of accounting for all probable losses is made in accordance with the guidance provided by Statement of Accounting Standards (SFAS) No. 5, Accounting for Contingencies.

Commercial and construction loans over $1.0 million amount are individually evaluated on a quarterly basis for impairment following the provision of SFAS No. 114, Accounting by Creditors of a Loan. A loan is impaired when based on current information and events; it is probable that the Corporation will be unable to collect all amounts due according to the contractual terms of the loan agreement. The impairment loss, if any, on each individual loan identified as impaired is measured based on the present value of expected cash flows discounted at the loan s effective interest rate, except as a practical expedient, impairment may be measured based on the loan s observable market price, or the fair value of the collateral, if the loan is collateral dependent.

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,	2006	2005	2004	2003	2002
(Dollars in thousands)					
Allowance for loan losses, beginning of year	$ 147,999	$ 141,036	$ 126,378	$ 111,911	$ 91,060
Provision for loan losses	74,991	50,644	52,799	55,916	62,302
Loans charged-off:					
Residential real estate	(997)	(945)	(254)	(475)	(555)
Commercial and Construction	(6,036)	(8,558)	(6,190)	(6,488)	(4,643)
Finance leases	(5,721)	(2,748)	(2,894)	(2,424)	(2,532)
Consumer	(64,455)	(39,669)	(34,704)	(38,745)	(41,261)
Recoveries	12,515	6,876	5,901	6,683	7,540
Net charge-offs	(64,694)	(45,044)	(38,141)	(41,449)	(41,451)
Other adjustments (1)		1,363			
Allowance for loan losses, end of year	$ 158,296	$ 147,999	$ 141,036	$ 126,378	$ 111,911
Allowance for loan losses to year end total loans	1.41%	1.17%	1.49%	1.80%	1.99%
Net charge offs to average loans outstanding during the period	0.55%	0.39%	0.48%	0.66%	0.87%
Provision for loan and lease losses to net charge-offs during the period	1.16x	1.12x	1.38x	1.35x	1.50x

(1) Represents allowance for loan losses from the acquisition of Unibank.

First BanCorp s allowance for loan and lease losses was $158.3 million as of December 31, 2006, compared to $148.0 million as of December 31, 2005 and $141.0 million as of December 31, 2004. First BanCorp s ratio of the allowance for loan and lease losses to period end total loans was 1.41% as of December 31, 2006, compared to 1.17% as of December 31, 2005 and 1.49% as of December 31, 2004.

The provision for loan losses totaled 116% of net charge-offs for the year ended December 31, 2006, compared with 112% of net charge-offs for the same period in 2005 and 138% for the same period in 2004. Net charge-offs for 2006 increased by $19.7 million compared to the 2005. The increase in net charge-offs during 2006 was mainly composed of higher charge-offs in consumer loans of $24.8 million offset in part by higher recoveries from previously written-off accounts of $5.6 million. The increase in charge-offs in consumer loans was impacted by the fiscal and economic situation of Puerto Rico. According to the Puerto Rico Planning Board, Puerto Rico is in a midst of a recession. The latest GNP forecast by the Puerto Rico Planning Board expects a 1.4% reduction in fiscal year 2007 compared to fiscal year 2006. The slowdown in activity is the result of, among other things, higher utilities prices, higher taxes, government budgetary imbalances, the upward trend in short-term interest rates and the flattening of the yield curve, and higher levels of oil prices.

The increase of $6.9 million in net charge-offs in the 2005 year, compared with the previous year, was mainly composed of $5.0 million of higher charge-offs in consumer loans, primarily auto loans, given higher delinquencies

during 2005, and $2.4 million of higher charge-offs in commercial loans, including construction loans. Recoveries made from previously written-off accounts increased by $1.0 million in 2005 compared to 2004.

Non-performing Assets

Total non-performing assets are the sum of non-accruing loans, foreclosed real estate, other repossessed properties and non-accruing investment securities. Non-accruing loans and investments are loans and investments as to which interest is no longer being recognized. When loans and investments fall into non-accruing status, all previously accrued and uncollected interest is charged against interest income.

Table of Contents

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 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. 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).

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 carrying amount.

Past Due Loans

Past due loans are accruing commercial loans which are contractually delinquent 90 days or more. Past due commercial loans are current as to interest but delinquent in the payment of principal.

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

December 31,	2006	2005	2004	2003	2002
			(Dollars in thousands)		
Non-accruing loans:					
Residential real estate	$ 114,828	$ 54,777	$ 31,577	$ 26,327	$ 23,018
Commercial, commercial real estate and construction	82,713	35,814	32,454	38,304	47,705
Finance leases	8,045	3,272	2,212	3,181	2,049
Consumer	46,501	40,459	25,422	17,713	18,993
	252,087	134,322	91,665	85,525	91,765
Other real estate owned	2,870	5,019	9,256	4,617	2,938
Other repossessed property	12,103	9,631	7,291	6,879	6,222
Investment securities				3,750	3,750
Total non-performing assets	$ 267,060	$ 148,972	$ 108,212	$ 100,771	$ 104,675
Past due loans	$ 31,645	$ 27,501	$ 18,359	$ 23,493	$ 24,435
Non-performing assets to total assets	1.54%	0.75%	0.69%	0.79%	1.09%
Non-accruing loans to total loans	2.24%	1.06%	0.95%	1.21%	1.63%
Allowance for loan and lease losses	$ 158,296	$ 147,999	$ 141,036	$ 126,378	$ 111,911
Allowance to total non-accruing loans	62.79%	110.18%	153.86%	147.77%	121.95%
Allowance to total non-accruing loans excluding residential real estate loans	115.33%	186.06%	234.72%	213.48%	162.79%

Due to macroeconomic conditions in Puerto Rico, increased delinquencies, and the overall growth of the Corporation s loans portfolio, total non-performing assets increased to $267.1 million as of December 31, 2006 from $149.0 million as of December 31, 2005 and from $108.2 million as of December 31, 2004.

As a result of the increase in delinquencies, the Corporation s non-performing loans to total loans ratio as of December 31, 2006 increased by 118 basis points compared to the ratio as of December 31, 2005, from 1.06% to 2.24%. The increase in non-performing loans was mainly due to an increase of $60.1 million in the residential real estate portfolio and $46.9 million in commercial portfolio, including construction and commercial real estate. Historically, the Corporation has experienced the lowest rates of losses for these portfolios. As a consequence, the provision and allowance for loan and lease losses did not increase proportionately with the increase in non-performing loans. As of December 31, 2006, the Corporation s ratio allowance for loan and lease losses to non-performing loans decreased by 47 basis points compared to the ratio as of December 31, 2005, from 110% to 63%. Excluding mortgage loans, the ratio of allowance for loan and lease losses to non-performing loans decreased by 71 basis points from 186% as of December 31, 2005 to 115% as of December 31, 2006.

The increase in consumer non-performing loans mainly relates to increases in the Corporation auto and personal unsecured portfolios.

Liquidity Risk

Liquidity refers to the level of cash and eligible loans and investments to meet loan and investment commitments, potential deposit outflows and debt repayments. MIALCO, using measures of liquidity developed by management, which involves the use of several assumptions, reviews the Corporation s liquidity position on a weekly basis.

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 as it protects the Corporation s liquidity from market disruptions. The principal sources of short-term funds are deposits, securities sold under agreements to repurchase, and lines of credit with the FHLB and other unsecured lines established with financial institutions. MIALCO reviews credit availability on a regular basis. In the past, the Corporation has securitized and sold auto and mortgage loans as supplementary sources of funding. Commercial paper has also provided additional funding as well as long-term funding through the issuance of notes and long-term brokered certificates of deposit. The cost of these different alternatives, among other things, is taken into consideration. The Corporation s principal uses of funds are the origination of loans and the repayment of maturing deposit accounts and borrowings.

Over the last three years, the Corporation has committed substantial resources to its mortgage banking subsidiary, FirstMortgage Inc., with the goal of becoming a leading institution in the highly competitive residential mortgage loans market.

Table of Contents

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 25% at December 31, 2006. 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 it allows the Corporation to derive, if needed, liquidity from the sale of mortgage loans in the secondary market. The U.S. (including Puerto Rico) secondary mortgage market is the most liquid in the world in large part because of the sale or guarantee programs maintained by FHA, VA, HUD, FNMA and FHLMC.

A large portion of the Corporation s funding is retail brokered CDs issued by the Bank subsidiary. In the event that the Corporation s Bank subsidiary falls under the ratios of a well-capitalized institution, it faces the risk of not being able to replace this source of funding. The Bank currently complies with the minimum requirements of ratios for a well-capitalized institution and does not foresee falling below required levels to issue brokered deposits. In addition, the average term to maturity of the retail brokered CDs was approximately 7 years as of December 31, 2006. Approximately 63% of the value of these certificates are callable at the Bank s option.

Certificates of deposit with denominations of $100,000 or higher amounted to $8.0 billion as of December 31, 2006 of which $7.0 billion were brokered CDs.

The following table presents a maturity summary of brokered CDs with denominations of $100,000 or higher as of December 31, 2006:

		Total (Dollars in thousands)
Less than one year	$	2,345,814
Over one year to five years		1,054,414
Over five years to ten years		1,088,178
Over ten years		2,548,571
Total	$	7,036,977

The Corporation s liquidity plan contemplates alternative sources of funding that could provide significant amounts of funding at a reasonable cost. The alternative sources of funding include, among others, sales of commercial loan participations, and the securitization of auto loans and commercial paper.

Operational Risk

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

Legal and regulatory 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 it 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. In 2006 as part of the implementation of the enterprise risk management framework, the Corporation revised and implemented a new corporate compliance function, headed by a newly

designated Compliance Director. The Corporation s Compliance Director reports to the Chief Risk Officer and is responsible for the oversight of regulatory compliance and implementation an enterprise-wide compliance risk assessment process. The Compliance Officers roles were also established in each major business areas with a direct reporting relationship 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 accounting principles generally accepted in the United States of America, 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 entrance into new markets through FirstBank Florida.

The Corporation has a significant lending concentration of $509.1 million in one mortgage originator in Puerto Rico as of December 31, 2006. The Corporation has outstanding $422.9 million with another mortgage originator in Puerto Rico for total loans granted to mortgage originators amounting to $932.0 million as of December 31, 2006. These commercial loans are secured by 10,307 individual mortgage loans on residential and commercial real estate with an average principal balance of $90,425 each. The mortgage originators have always paid the loans in accordance with their terms and conditions. On December 6, 2005, the Corporation obtained a waiver from the Office of the Commissioner of Financial Institutions of the Commonwealth of Puerto Rico with respect to the statutory limit for individual borrowers (loan to one borrower limit). Of the total loans of $11.1 billion for 2006, approximately 78% have credit risk concentration in Puerto Rico, 14% in the United States and 8% in the Virgin Islands.

Selected Quarterly Financial Data

Financial data showing results of the 2006 and 2005 quarters is presented below. In the opinion of management, all adjustments necessary for a fair presentation have been included. This financial data has not been reviewed by the Corporation s independent registered public accounting firm.

Table of Contents

	2006			
	March 31	June 30	September 30	December 31
	(Dollars in thousands, except for per share results)			
Interest income	$327,705	$344,443	$317,712	$298,953
Net interest income	72,819	126,238	122,702	121,935
Provision for loan losses	19,376	9,354	20,560	25,701
Net income	3,863	31,803	26,682	22,286
Earnings per common share-basic	$ (0.08)	$ 0.26	$ 0.20	$ 0.16
Earnings per common share-diluted	$ (0.08)	$ 0.26	$ 0.20	$ 0.15

	2005			
	March 31(1)	June 30	September 30	December 31
	(Dollars in thousands, except for per share results)			
Interest income	$212,377	$249,157	$292,263	$313,793
Net interest income	65,276	193,071	66,743	107,229
Provision for loan losses	10,954	11,075	12,861	15,754
Net income (loss)	25,215	97,406	17,305	(25,322)
Earnings per common share-basic	$ 0.19	$ 1.08	$ 0.09	$ (0.44)
Earnings per common share-diluted	$ 0.18	$ 1.05	$ 0.09	$ (0.42)

(1) The March 31, 2005 financial information has been restated from the previously filed Form 10-Q.

Net interest income includes the effect of changes in the valuation of derivative, hedged instruments and basis adjustment accretion or amortization.

Market Prices and Stock Data

The Corporation s common stock is traded in the New York Stock Exchange (NYSE) under the symbol FBP. As of December 31, 2006, there were 566 holders of record of the Corporation s common stock.

The following table sets forth the high and low prices of the Corporation s common stock for the periods indicated as reported by the NYSE. This table reflects the effect of the June 2005 two-for-one stock split on the Corporation s outstanding shares of common stock as of June 15, 2005.

Quarter ended	High	Low	Last
2006:			
December	$10.79	$ 9.39	$ 9.53
September	11.15	8.66	11.06
June	12.22	8.90	9.30
March	13.15	12.20	12.36
2005:			
December	$15.56	$10.61	$12.41
September	26.07	16.50	16.92

June	21.31	17.31	20.08
March	32.26	20.78	21.13
2004:			
December	$32.43	$23.65	$31.76
September	24.93	19.81	24.15
June	21.34	17.57	20.38
March	21.66	19.50	20.80

85

Table of Contents

Changes in Internal Controls over Financial Reporting

Refer to Item 9A.

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.

Table of Contents

Item 9A. Controls and Procedures

Restatement of Consolidated Financial Statements

In coming to the conclusion that the Corporation s disclosure controls and procedures and internal control over financial reporting were effective as of December 31, 2006, management considered, among other things, the control deficiencies related to the accounting for the cash flows resulting mainly from the treatment of discounts and related accretion activity on zero coupon bonds, from the disposition of repossessed assets, and purchases and principal repayments and maturities on securities, which resulted in the need to restate the Corporation s previously issued Consolidated Statements of Cash Flows for 2005 and 2004 as discussed in Note 1 to the consolidated financial statements. Management concluded that the Corporation s controls over the accounting for cash flows operated effectively as of December 31, 2006 and that it was the effective operation of those controls that resulted in the restatement referred to above.

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, 2006, the Corporation s disclosure controls and procedures were effective to ensure that 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.

Our management s assessment of the effectiveness of our internal control over financial reporting as of July 5, 2007 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report as set forth in Item 8.

Remediation of Prior Year Material Weaknesses in Internal Control Over Financial Reporting

During the 2006, First BanCorp completed the implementation of remediation steps to address the material weaknesses identified during the assessment of the effectiveness of internal control over financial reporting for the year 2005. As of December 31, 2005, in the Corporation s assessment of the effectiveness of its internal control over financial reporting, First BanCorp s management identified material weaknesses in the internal control over financial reporting relating to:

1. *Ineffective Control Environment.* The Corporation did not maintain an effective control environment. Specifically the Corporation did not maintain effective controls with respect to the review, supervision and monitoring of its accounting operations, including with respect to the accounting of purchases in bulk of mortgage loans and pass-through trust certificates (the mortgage-related transactions).

2. *Ineffective controls over the documentation and communication of relevant terms of certain mortgage loans bulk purchase transactions.* The Corporation did not maintain effective controls over the documentation and communication of all of the relevant terms and conditions of certain mortgage loans bulk purchase transactions, including the existence of oral and emails agreements and extended recourse.

3. *Ineffective controls over communications to the Audit Committee.* The Corporation did not maintain effective controls to ensure that management provided the Audit Committee complete information

regarding certain mortgage-related transactions in an organized manner so as to enable the Audit Committee to properly oversee those transactions and their associated external financial reporting.

4. *Ineffective controls over communications to the Corporation s independent registered public accounting firm.* The Corporation did not maintain effective controls to ensure complete and adequate communication to the Corporation s registered public accounting firm.

5. *Ineffective anti-fraud controls and procedures.* The Corporation did not maintain effective anti-fraud controls and procedures to ensure the effective assignment of authority and monitoring of its external financial reporting process.

6. *Insufficient accounting resources and expertise.* The Corporation did not maintain a sufficient complement of accounting and financial personnel with sufficient knowledge, experience, and training to meet the Corporation s external financial reporting responsibilities.

7. *Ineffective controls over the accounting for mortgage-related transactions.* The Corporation did not maintain effective controls over the accounting for its mortgage-related transactions with certain counterparties. Specifically, the Corporation did not have effective controls in place to ensure the identification of recourse provisions that precluded the recognition of such transactions as purchases of loans or collaterized mortgage securities in written agreements relating to the mortgage-related transactions.

8. *Ineffective controls over the accounting for derivative financial instruments.* The Corporation did not maintain effective controls over the accounting of its derivative financial instruments. Specifically, the Corporation s internal controls were not properly designed to identify derivatives embedded within its mortgage purchases and other loan contracts. Additionally, the Corporation did not maintain effective controls over the identification and valuation of hedge ineffectiveness as required by generally accepted accounting principles.

9. *Ineffective controls over the valuation of premiums and discounts on mortgage-backed securities*. The Corporation did not maintain effective controls over the valuation of premiums and discounts on mortgage-backed securities. Specifically, the Corporation amortized premium and discounts on mortgage-backed securities using a straight-line pro rata method rather than the effective interest method, as required by generally accepted accounting principles.

These material weaknesses are discussed in greater detail in our Annual Report on Form 10-K for the year ended December 31, 2005.

As previously mentioned, during the year ended December 31, 2006, First BanCorp completed the implementation of the following remediation steps to address the material weakness as of December 31, 2005:

1. First BanCorp has significantly improved its control environment including the documentation and communication of relevant terms of certain mortgage loan bulk purchase transactions, communication to the Audit Committee and to the Corporation s independent registered public accounting firm, and anti-fraud controls and procedures by implementing enhanced procedures and controls including the following:

Changes in Management and Clarification of the Role, Responsibilities and Authority of Management. The former CEO and former CFO resigned from the Corporation upon the request of the Board pursuant to a recommendation to this effect by the Audit Committee. Also, the Board appointed a new CEO and a new CFO and created the new position of COO, to which an executive of the Corporation was appointed. In addition, the Board appointed a new General Counsel, who reports to the CEO. The roles, responsibilities and authority of the persons in each of these positions have been clarified to better inhibit any override of the Corporation s internal control over financial reporting. In addition, in 2006 the Corporation implemented detection controls to

improve the identification and response to any instances of undue control by an unauthorized person of the financial reporting process.

Risk Management Program and Enhancement of the Communication of Information to the Audit Committee. During the first quarter of 2006, the Board reviewed the Corporation s risk management program with the assistance of outside consultants and legal counsel. This effort has resulted in a realignment of risk management functions and the adoption of an enterprise-wide risk management process. The Board appointed a senior management officer as Chief Risk Officer and appointed this officer to the Risk Management Council with reporting responsibilities to the CEO and the Audit Committee. In addition, the Board formed an Asset/Liability Risk Committee which is responsible for the oversight of risk management, including asset quality, portfolio performance, interest rate and market sensitivity, and portfolio diversification. In addition, the Asset/Liability Risk Committee has the authority to examine the Corporation s investment activities and liabilities, such as its brokered CDs, to facilitate appropriate oversight by the Board. Finally, management is required to bring to the attention of the Asset/Liability Risk Committee new forms of transactions or variants of forms of transactions that the Committee has not yet reviewed to enable the Committee to fully evaluate the consequences of such transactions to the Corporation. In addition, management is required to bring to the attention of the Audit Committee significant new forms of transactions or variants of forms of transactions for which the Corporation has not determined the appropriate accounting treatment to enable the Audit Committee to fully evaluate the accounting treatment of such transactions. The enhancements of the risk management program are expected to result in a control environment that ensures the discussion and analysis of the legal and accounting implications of new forms of transactions or variants of transactions that may have a significant impact on the Corporation s financial condition or on the accuracy and completeness of the financial reporting process.

Transaction Documentation. In August 2006, the Corporation adopted a specific policy that requires that all transactions be completely and fully documented, thereby prohibiting any oral or undisclosed side agreements, and that such documentation be contemporaneously prepared and executed and centrally maintained and organized.

Board Membership Changes. The Board appointed the new CEO and new COO to the Board. In addition, in November 2005, the Board elected Fernando Rodríguez-Amaro as a new independent director to serve as an additional audit committee financial expert, and thereafter appointed him Chairman of the Audit Committee as of January 1, 2006. Also, in the first quarter of 2006, the Board appointed Jose Menéndez Cortada as the Lead Independent Director of the Board.

Corporate Governance Review. During the first quarter of 2006, with the assistance of outside consultants and outside counsel, the Corporate Governance Committee of the Board re-evaluated the Corporation s corporate governance policies and made recommendations to the full Board for changes. This changes were implemented and are expected to result in a continued and clearer understanding of the responsibilities and duties of the Board and its committees and in an alignment of those responsibilities with the industry s best practices.

Ethical training of employees and directors. In 2006, the Corporation designed and offered enhanced corporate compliance seminars to every employee and director of the Corporation. Through the corporate compliance training program, the Corporation is emphasizing the importance of compliance with the Corporation s policies and procedures and control systems, including the new policy regarding full and complete

Table of Contents

documentation of agreements and prohibiting oral and side agreements, the Corporation s Code of Ethics and Code of Conduct, the Corporation s various legal compliance programs, and the availability of mechanisms to report possible unethical behavior, such as the Audit Committee s whistleblower hotline.

Procedures Relating to Concerns About Senior Management s Conduct. During 2006, the Board and the Audit Committee revised their respective procedures to emphasize more clearly the requirement that the Board or the Audit Committee be notified whenever any concerns arise regarding the conduct of senior management, including allegations of possible fraud, self-dealing or any other inappropriate conduct. In addition, when the Corporation appointed a new General Counsel, it specified that the General Counsel will report to the CEO in contrast to the former General Counsel who reported to the former CFO.

2. Accounting for Mortgage-Related Transactions. During the first semester of 2006, the Corporation implemented controls that specify that the terms of any recourse provisions or retained servicing arrangements must be reviewed by the General Counsel before they are included in purchase agreements. In addition, the Board reviewed the Corporation s risk management program, enhanced the communication to the Audit Committee and adopted a specific policy for transactions documentation as further described in item 1 above.

3. Accounting for derivative financial instruments. With respect to the identification of derivatives, the Corporation implemented the following changes:

the Corporation has created the Investment and Derivative Risk Manager position, which is responsible for the evaluation of complex transactions, such as derivatives, implementation of policies and procedures and monitoring of external consultants analysis/computations.

With respect to the measurement of hedge effectiveness, the Corporation revised its accounting policies to state that the receipt of an upfront payment from an interest rate swap counterparty precludes the use of the short-cut method of accounting under SFAS 133.

4. Accounting for the amortization of premiums and discounts on mortgage-backed securities. During the first semester of 2006, management adjusted the balances to reflect the use of the effective interest method. In addition, the Corporation reviewed the accounting policy to require the use of the interest method for the amortization of premiums and discounts on mortgage-backed securities. As a result of such review, effective January 1, 2006 the Corporation implemented the interest method for the amortization of premiums and discounts on mortgage-backed securities.

5. Overall Accounting Resources and Expertise. The Corporation has recruited additional staff to strengthen its accounting, internal control, financial reporting, legal, and internal audit functions. Further, the Corporation has appointed a senior management executive as the Chief Accounting Officer with primary responsibility for the development and implementation of the Corporation s accounting policies and practices and to review and monitor critical accounts and transactions to ensure that they are managed in accordance with such policies and practices, generally accepted accounting principles in the United States and applicable regulatory requirements.

Table of Contents

Other Enhancements to Internal Control Over Financial Reporting

The following describes other enhancements that were undertaken by First BanCorp during 2006, in addition to the measures described above, to address the material weaknesses in the Corporation s internal control over financial reporting:

1. The Corporation created the position of Corporate Controller that reports directly to the CFO. The Corporate Controller oversees the corporate financial records of the Corporation. The controllers of the Corporation s subsidiaries now report directly to the Corporate Controller.

2. The Corporation segregated the investment accounting department from the treasury department. The investment accounting department reports now directly to the Corporate Controller.

3. The Corporation created the corporate reporting department reporting directly to the Chief Accounting Officer. The corporate reporting department has the responsibility of SEC filings and financial reporting to the Corporation s Board of Directors.

As of December 31, 2006, the Corporation completed the implementation of its remediation plan, evaluated and tested the effectiveness of the controls as of December 31, 2006, and determined that the material weaknesses described above have been remediated.

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, 2006 that have materially affected, or are reasonably likely to materially affect, the Corporation s internal control over financial reporting.

Table of Contents

PART III

Item 10. Directors and Executive Officers of the Registrant and Corporate Governance

DIRECTORS

The current directors of the Corporation are listed below. They have provided the following information about their principal, occupation, business experience and other matters.

Luis M. Beauchamp, 64

Chairman, President and Chief Executive Officer

Chairman from January 2006 to present. President and Chief Executive Officer from October 2005 to present. Senior Executive Vice President, Wholesale Banking, from March 1997 to October 2005. Executive Vice President, Chief Lending Officer from 1990 to March 1997. General Manager New York banking operations of Banco de Ponce from 1988 to 1990. He had the following responsibilities at the Chase Manhattan Bank, N.A.: Regional Manager for the Ecuador and Colombia operations and corporate finance for the Central American operations, in 1988; Country Manager for Mexico from 1986 to 1988; and Manager of Wholesale Banking in Puerto Rico from 1984 to 1986. Since January 2006, Mr. Beauchamp has serves as Chairman of FirstBank Puerto Rico (FirstBank), First Leasing and Rental Corporation, First Federal Finance Corporation d/b/a Money Express, FirstBank Insurance Agency, Inc., First Insurance Agency, Inc., FirstExpress, Inc., FirstMortgage, Inc., Ponce General Corporation, FirstBank Florida and FirstBank Overseas Corp.[1] Joined the Corporation in 1990. Director since September 30, 2005.

Aurelio Alemán, 48

Senior Executive Vice President and Chief Operating Officer

Senior Executive Vice President and Chief Operating Officer from October 2005 to present. Executive Vice President, responsible for consumer banking and auto financing of FirstBank, since 1998 and since October 2005 also responsible for the retail banking distribution network. President of First Federal Finance Corporation d/b/a Money Express from 2000 to 2005. President of FirstBank Insurance Agency, Inc. from 2001 to 2005. President of First Leasing and Rental Corp. from 1999 to 2005. From 1996 to 1998, Vice President of CitiBank, N.A., responsible for wholesale and retail automobile financing and retail mortgage business. Vice President of Chase Manhattan Bank, N.A., banking operations and technology for corporate capital markets from 1990 to 1996. Director of FirstBank, First Leasing and Rental Corporation, First Federal Finance Corporation d/b/a Money Express, FirstBank Insurance Agency, Inc., First Insurance Agency, Inc., FirstExpress, Inc., FirstMortgage, Inc., Ponce General Corporation, FirstBank Florida, Grupo Empresas Servicios Financieros, Inc. d/b/a PR Finance[2], FirstBank Overseas Corp., and First Trade, Inc. Joined the Corporation in 1998. Director since September 30, 2005.

José Teixidor, 53

Chief Executive Officer and President of B. Fernández & Hnos., Inc. from May 2003 to present; Chairman of the Board of Pan Pepín Inc. from 1998 to present; Chairman of the Board of Baguettes, Inc. from 1998 to 2006; Chairman of the Board of Pan Pepin Baking, Inc. from 2004 to present, President of Eagle Investment Fund, Inc. from 1996 to present; President of Swiss Chalet, Inc. from 2000 to present; Chairman of the Board of Marvel International from 2005 to present; Member of the Board of the Puerto Rico Chamber of Commerce and of the Industry and Food Distribution Chamber of Commerce. Member of the Board of the

[1] First Leasing and Rental Corporation, First Federal Finance Corporation d/b/a Money Express, First Insurance Agency, Inc., FirstExpress,

Inc., FirstMortgage, Inc., and FirstBank Overseas Corp, are wholly-owned subsidiaries of FirstBank. FirstBank Insurance Agency, Inc., and Ponce General Corporation are wholly-owned subsidiary of the Corporation. FirstBank Florida is a wholly-owned subsidiary of Ponce General Corporation.

[2] Grupo Empresas Servicios Financieros, Inc. d/b/a PR Finance is a wholly-owned subsidiary of the Corporation.

92

Table of Contents

Distributors and Manufacturers Association; Member of the Wholesalers Chamber of Puerto Rico; and Member of the Board of El Nuevo Día from 1996 to 2006. Director since January 1994.

Jorge L. Díaz, 52

Executive Vice President and member of the Board of Directors of Empresas Díaz, Inc. from 1981 to present, and Executive Vice President and Director of Betteroads Asphalt Corporation, Betterecycling Corporation, and Coco Beach Development Corporation, and its subsidiaries. Member of the Chamber of Commerce of Puerto Rico, the Association of General Contractors of Puerto Rico and of the U.S. National Association of General Contractors. Member of the Board of Trustees of Baldwin School of Puerto Rico. Director since 1998.

José L. Ferrer-Canals, 48

Doctor of Medicine in private urology practice since 1992. Commissioned as Captain in the United States Air Force in March 1991 and appointed Chief of Aeromedical Service of the 482nd Medical Squadron in December 1992. Member of the American Association of Clinical Urologists, Alpha Omega Alpha Medical Honor Society since 1986. Member of the Hospital Pavía Peer Group Review Committee, Hospital Pavía, San Juan, Puerto Rico, from 1995 to present. Medical Faculty Representative to Hospital Pavía from 1996 to 1998. Professor of Flight Physiology and Aerospace Medicine, InterAmerican University of Puerto Rico. Member of the Board of Directors of American Cancer Society, Puerto Rico Chapter from 1999 to present. Director since 2001.

Richard Reiss-Huyke, 60

Financial and management consultant specializing in crisis management, financial planning, negotiations, valuations and litigation support since 1979. Director of Grupo HIMA from March 2006 to present. Director of Caribbean Petroleum Co. from 2005 to June 2007. Director of Banco Santander Puerto Rico from February 1979 to February 2003, and Director of Santander BanCorp. from May 2000 to February 2003. Employed by Bacardi Corporation in a number of different capacities, including Chief Financial Officer, Chief Operating Officer, Vice President and Director from 1973 to 1979. Member of the Board of Directors and the audit committee of Pepsi Cola Puerto Rico Bottling Company, from February 1996 to July 1998, President of the Board of Directors of the State Insurance Fund of Puerto Rico from 2001 to June 2007. Director since 2003.

Sharee Ann Umpierre-Catinchi, 47

Doctor of Medicine. Assistant Professor at the University of Puerto Rico s Department of Obstetrics and Gynecology from 1993 to present. Director of the Division of Gynecologic Oncology of the University of Puerto Rico s School of Medicine from 1993 to present. Board Certified by the National Board of Medical Examiners, American Board of Obstetrics and Gynecology and the American Board of Obstetrics and Gynecology, Division of Gynecologic Oncology. Director since 2003.

José Menéndez-Cortada, 59

Attorney at law since 1973. Director and Vice President in charge of the corporate and tax divisions of Martínez-Alvarez, Menéndez-Cortada & Lefranc Romero, PSC, a firm which was formerly a partnership were Mr. Menéndez served as the partner in charge of the corporate and tax divisions, formed since 1977. General Counsel to the Board of Bermudez & Longo, S.E. from 1985 to present. Director of Tasis Dorado School since 2002. Director of the Homebuilders Association of Puerto Rico since 2002. Trustee of the Luis A. Ferré Foundation, Inc., since 2002. Director since April 2004. He has been the Lead Independent Director since February 2006.

Fernando Rodríguez-Amaro, 59

Certified Public Accountant, Certified Fraud Examiner and Certified Valuation Analyst. Managing Partner and Partner in Charge of the Audit and Accounting Division of RSM ROC & Company. Has been with RSM ROC & Company for the past twenty-six years and prior thereto served as Audit Manager with Arthur Andersen & Co. for over nine years. Mr. Rodriguez Amaro has over 36 years of public accounting experience. He has served clients in the banking, insurance, manufacturing, construction, government,

Table of Contents

advertising, radio broadcasting and services industries. Member of the Board of Trustees of Sacred Heart University of Puerto Rico since August 2003 to present, serving as Member of the Executive Committee and Chairman of the Audit Committee since 2004. Member of the Board of Trustees of Colegio Puertorriqueño de Niñas, since 1996 to present, serving as a member of the Board of Directors from 1998 to 2004. Member of the Board of Director of Proyecto de Niños de Nueva Esperanza, Inc. since 2003.

The Corporation s by-laws provide that each director holds office for the term to which he or she was elected and until his or her successor is elected and qualified or until his or her resignation, retirement or removal from office. The Corporation s by-laws also provide that the directors will be divided into three classes as nearly equal in number as possible. The members of each class shall be elected for a three year term and only one class shall be elected by ballot annually. The Corporation s by-laws further provide that any director elected by an affirmative vote of the majority of the Board of Directors to fill a vacancy shall serve until the next election of directors by stockholders. As the Corporation did not hold a stockholders meeting during 2006 nor during the first six month of 2007 due to the inability to file its Form 10-K timely for the years ended 2005 and 2006, and as certain directors were appointed to fill vacancies, the following members of the Board of Directors shall be up for election at the next stockholders meeting: Luis M. Beauchamp, Aurelio Alemán, José Teixidor, José L. Ferrer-Canals, Richard Reiss-Huyke, (Mr. Reiss will not stand for re-election, therefore his term will expire on the date of the stockholder meeting), Sharee Ann Umpierre-Catinchi, and Fernando Rodríguez-Amaro. The term of directors Jorge L. Díaz and José Menéndez-Cortada expire during 2008.

EXECUTIVE OFFICERS

The executive officers of the Corporation, FirstBank and FirstBank Florida who are not directors are listed below.

Fernando Scherrer, 38

Executive Vice President and Chief Financial Officer

Chief Financial Officer and Executive Vice President since July 2006. He is a Certified Public Accountant. Co-Founder, Managing Partner and Head of Audit and Consulting Practices at Scherrer Hernández & Co., from 2000 to 2006. Prior to founding Scherrer Hernández & Co., he worked with PricewaterhouseCoopers LLP for 10 years where he audited financial institutions and insurance companies. He has over 17 years of financial and accounting experience in the financial services, insurance, retail and education industries. Since October 2006, he has served as a director of First Leasing and Rental Corporation, First Federal Finance Corporation d/b/a Money Express, FirstBank Insurance Agency, Inc., FirstMortgage, Inc., Ponce General Corporation.

Lawrence Odell, 59

Executive Vice President, General Counsel and Secretary

Executive Vice President, General Counsel and Secretary since February 2006. Senior Partner at Martínez Odell & Calabria. Has over 25 years of experience in specialized legal issues related to banking, corporate finance and international corporate transactions. Served as Secretary of the Board of Pepsi-Cola Puerto Rico, Inc. from 1992 to 1997. Served as Secretary to the Board of Directors of BAESA, S.A. from 1992 to 1997.

Dacio A. Pasarell, 58

Executive Vice President and Banking Operations Executive

Executive Vice President and Banking Operations Executive since September 2002. Had over 27 years of experience at Citibank N.A. in Puerto Rico which included the following positions: Vice President, Retail Bank Manager, from 2000 to 2002; Vice President and Chief Financial Officer from 1996 to 1998; Vice President, Head of Operations Caribbean Countries from 1994 to 1996; Vice President Mortgage and Automobile Financing; Product Manager, Latin America from 1986 to 1994; Vice President, Mortgage and Automobile Financing Product Manager for Puerto Rico from 1986 to 1996. President of Citiseguros PR, Inc. from 1998 to 2001. Chairman of Ponce General Corporation and Director of FirstBank Florida since April 2005.

Table of Contents

Randolfo Rivera, 53
Executive Vice President and Wholesale Banking Executive
Executive Vice President in charge of corporate banking, middle market, international, government and institutional, structure finance and cash management areas of FirstBank since June 1998 and since October 2005 also in charge of real estate lending, commercial mortgage unit in Puerto Rico and merchant banking. Vice President and component executive for local companies, public sector and institutional markets for Chase Manhattan Bank, N.A. in Puerto Rico from April 1990 to December 1996. Corporate Finance Executive in charge of the Caribbean and Central American region for Chase Manhattan Bank in Puerto Rico from January 1997 to May 1998.
Emilio Martinó, 56
Executive Vice President and Chief Credit Officer
Chief Credit Officer and Executive Vice President of First Bank since October 2005. Director of FirstBank Florida since August 2006. Senior Vice President and Credit Risk Management of FirstBank from June 2002 to October 2005. Staff Credit Executive for FirstBank s Corporate and Commercial Banking Business components since November 2004. First Senior Vice President of Banco Santander Puerto Rico; Director for Credit Administration, Workout and Loan Review, from 1997 to 2002. Senior Vice President for Risk Area in charge of Workout, Credit Administration, and Portfolio Assessment for Banco Santander Puerto Rico from 1996 to 1997. Deputy Country Senior Credit Officer for Chase Manhattan Bank Puerto Rico from 1986 to 1991. Director of FirstBank Florida since August 2006.
Cassan Pancham, 47
Executive Vice President and Eastern Caribbean Region Executive
Executive Vice President of FirstBank since October 2005. First Senior Vice President, Eastern Caribbean Region of FirstBank from October 2002 until October 2005. Director and President of FirstExpress, Inc., First Trade, Inc., and First Insurance Agency, Inc. He held the following positions at JP Morgan Chase Bank Eastern Caribbean Region Banking Group: Vice President and General Manager, from December 1999 to October 2002; Vice President, Business, Professional and Consumer Executive, from July 1998 to December 1999; Deputy General Manager from March 1999; and Vice President, Consumer Executive, from December 1997 to 1998. Member of the Governing Board of Directors of the Virgin Islands Port Authority since June 2007.
The Corporation s by-laws provide that each officer shall be elected annually at the first meeting of the Board of Directors after the annual meeting of stockholders and that each officer shall hold office until his or her successor has been duly elected and qualified or until his or her death, resignation or removal from office.

CERTAIN OTHER OFFICERS

Miguel A. Babilonia, 41
Senior Vice President and Chief Credit Risk Officer
Senior Vice President and Chief Credit Risk Officer since 2006. Vice President of Consumer Credit Policy and Portfolio Risk Management, promoted to Senior Vice President in 1999. In 2005, the mortgage risk management and centralized collections responsibilities were added to his scope. He has sixteen years of experience including, Consumer Scorecard Manager at Citibank, N.A. from 1997 to 1998; Assistant Vice President/Risk Manager at First Union National Bank from 1996-1997; Assistant Vice President/Segmentation Manager at First Union National Bank from 1993 to 1996; Portfolio Risk Senior Analyst at National City Bank from 1991 to 1993. Chairman of the Consumer Credit Committee of the Puerto Rico Bankers Association. Joined the Corporation in 1998.
Nayda Rivera-Batista, 33
Senior Vice President, Chief Risk Officer and Assistant Secretary
Chief Risk Officer and Senior Vice president since April 2006. Assistant Secretary of the Board since November 2006. Senior Vice President and General Auditor from July 2002 to April 2006. She is a Certified Public Accountant and Certified Internal Auditor. More than 12 years of combined work experience in public company, auditing, accounting, financial reporting, internal controls, corporate governance, risk management and regulatory compliance. Serving as member of the Board of Trustees of the Bayamón Central University from January 2005 to January 2006. Joined the Corporation in 2002.

95

Table of Contents

Pedro Romero, 34
Senior Vice President and Chief Accounting Officer
Chief Accounting Officer since August 2006. Senior Vice President since May 2005. Comptroller from May 2005 to August 2006. Vice President and Assistant Comptroller from December 2002 to May 2005. He is a Certified Public Accountant with a Master of Science in Accountancy and has technical expertise in management reporting, financial analysis, corporate tax, internal controls and compliance with US GAAP, SEC rules and Sarbanes Oxley. He has more than ten years of experience including, big four public accounting company, banking and financial services. Joined the Corporation in December 2002.
Víctor M. Barreras-Pellegrini, 39
Senior Vice President and Treasurer
Treasurer and Senior Vice President since July 6, 2006. Previously held various positions with Banco Popular de Puerto Rico from January 1992 to June 2006, including, Fixed-Income Portfolio Manager of the Popular Assets Management division from 1998 to 2006 and Investment Officer in the Treasury division from 1995 to 1998. Director of FirstBank Overseas Corp. and First Mortgage. He has over 15 years of experience in banking and investments and holds the Chartered Financial Analyst designation. Joined the Corporation in 2006.

CORPORATE GOVERNANCE AND RELATED MATTERS

General

The following discussion summarizes the Corporation s corporate governance including director independence, board and committee structure, function and composition, and governance charters, policies and procedures. The Corporate Governance Standards, including the text of the Corporation s charters approved by the Board of Directors (the Board) for the Audit Committee, the Compensation and Benefits Committee, the Corporate Governance and Nominating Committee, the Asset/Liability Risk Committee and the Corporation s Code of Ethics and Code of Ethics for Senior Financial Officers are available at the Corporation s web site at www.firstbancorppr.com, under Investor Relations / Governance Documents . FirstBanCorp shareholders may obtain printed copies of these documents by writing to Lawrence Odell, Secretary of the Board of Directors, First BanCorp, 1519 Ponce de León Avenue, Santurce, Puerto Rico 00908.

Independence of the Board of Directors

The Board annually evaluates the independence of its members based on the criteria for determining independence identified by the New York Stock Exchange (NYSE), the Securities and Exchange Commission (SEC) and the Corporation s Independence Principles for Directors. The Corporation s Corporate Governance Standards provides that a majority of the Board be composed of directors who meet the requirements for independence established in the Corporation s Independence Principles of Directors which shall incorporate, at a minimum, those established by the NYSE and the SEC. The Independence Principles for Directors is included as Exhibit 14.4 to this 2006 Form 10-K. The Board has concluded that the Corporation has a majority of independent directors. The Board determined that Messrs. José Teixidor-Méndez, José L. Ferrer-Canals, Jorge L. Díaz, Fernando Rodríguez-Amaro, Richard Reiss-Huyke, José Menéndez-Cortada and Sharee Ann Umpierre-Catinchi are independent under the Independence Principles for Directors. Related to director Richard Reiss-Huyke, in determining independence, the Board took into consideration a relationship that his adult daughter had with the Corporation for services rendered by her consulting company which amounted to $1,500 during 2006. Messrs. Luis M. Beauchamp, President and Chief Executive Officer, and Aurelio Alemán, Senior Executive Vice President and Chief Operating Officer, are not considered to be independent as they are management Board members. During 2006, the independent directors usually met in executive sessions without the Corporation s management on days were there were regularly scheduled Board meetings. In addition, non-management directors separately met two (2) times during 2006 with José Menéndez-Cortada serving as chairman during the meetings.

Board Meetings

The Board is responsible for directing and overseeing the business and affairs of the Corporation. The Board represents the Corporation s stockholders and its primary purpose is to build

Table of Contents

long term shareholder value. The Board meets on a regularly scheduled basis during the year to review significant developments affecting the Corporation and to act on matters that require Board approval. It also holds special meetings when an important matter requires Board action between scheduled meetings. The Board of the Corporation met thirty two (32) times during 2006. Each member of the Board participated in at least 75% of Board and applicable committee meetings held during 2006.

Board Committees

The Board has five standing committees: the Audit Committee, the Compensation and Benefits Committee, the Corporate Governance and Nominating Committee, the Asset/Liability Risk Committee, and an Ad Hoc Committee. The members of the committees are appointed and removed by the Board, which also appoints a chair of each committee. The functions of those committees, their current members and the number of meetings held during 2006 are set forth below.

Audit Committee. The Audit Committee is composed of three outside directors who meet the independence criteria established by the NYSE, the SEC, and the Corporation s Independence Principles for Directors. Under the terms of its charter, the Audit Committee represents and assists the Board in fulfilling its oversight responsibility relating to the integrity of the Corporation s financial statements and the financial reporting process, the effectiveness of the Corporation s internal controls over financial reporting and adequacy of internal control disclosures and procedures, the Corporation s compliance with legal and regulatory requirements, the performance of the Corporation s internal audit function, the annual independent audit of the Corporation s financial statements and the qualifications, independence and performance of the Corporation s independent registered public accounting firm. The Audit Committee also monitors the quality of the Corporation s assets in order to provide for early identification of possible problem assets.

The members of this Committee are Fernando Rodríguez-Amaro, appointed Chairman effective in January 2006, José Ferrer-Canals and Richard Reiss-Huyke. Each member of the Corporation s Audit Committee is financially literate, knowledgeable and qualified to review financial statements. The audit committee financial experts designated by the Corporation s Board are Richard Reiss-Huyke and Fernando Rodríguez-Amaro. The Audit Committee met a total of thirty two (32) times during fiscal year 2006.

Compensation and Benefits Committee. The Compensation and Benefits Committee is composed of three directors who meet the independence criteria established by the NYSE and the Corporation s Independence Principles for Directors. In addition, the members of the Committee are independent as defined in Rule 16b-3 under the Exchange Act. The Committee is responsible for the oversight and determination of the proper salary and incentive compensation of the executive officers and key employees of the Corporation. The responsibilities and duties of the Committee include the following:

- Review and approve the annual goals and objectives relevant to compensation of the CEO, including the balance of the components of total compensation.

- Evaluate the performance of the CEO in light of the agreed upon goals and objectives and set the compensation level of the CEO based on such evaluation.

- Establish and approve the salaries, annual incentive awards and long term incentives of the CEO, executive officers and selected senior executives.

- Evaluate and approve severance arrangements and employment contracts for executive officers and selected senior executives.

- Approve and administer the Corporation s cash and equity based incentive plans for senior executives.

- Prepare and publish an annual executive compensation report in the Corporation s proxy statement.

Periodically review the operation of the Corporation s overall compensation program for key employees and evaluate its effectiveness in promoting shareholder value and Corporation objectives. The Committee establishes criteria for evaluating its performance and conducts an annual evaluation of the charter and discusses the results of the annual evaluation with the full Board. The Committee has the sole authority to engage and terminate outside consultants to assist in determining appropriate compensation levels for the CEO and other executive officers, and to

Table of Contents

set fees and retention arrangements for such consultants. The Committee has full access to any relevant records of the Corporation and may request any employee of the Corporation or other person to meet with the Committee or its consultants. The Committee has the authority to delegate all or a portion of the authority granted to it by the Board to one or more of the Committee members, senior executives or committees, subject to applicable plans, laws and regulations.

The members of this Committee are Sharee Ann Umpierre-Catinchi, appointed Chairman in August 2006, Richard Reiss-Huyke and Jose Teixidor-Méndez. The Compensation and Benefit Committee met a total of six (6) times during fiscal year 2006.

Corporate Governance and Nominating Committee. The Corporate Governance and Nominating Committee of the Board of the Corporation is composed of three directors who meet the independence criteria established by the NYSE, the SEC and the Corporation s Independence Principles for Directors. The responsibilities and duties of the Committee include, among others, the following:

Develop a set of corporate governance principles applicable to the Corporation for Board approval, and following such approval shall annually review the principles for continued compliance.

Establish the criteria for selecting new directors in accordance with the requirements of the NYSE.

Recommend the director nominees for approval by the Board.

Have the authority to retain and terminate outside consultants or search firms to advice the Committee regarding the identification and review of candidates, including sole authority to approve such consultant s or search firm s fees, and other retention terms.

Review annually the Corporation s Insider Trading Policy to ensure continued compliance with applicable legal standards and corporate best practices. In connection with its annual review of the Insider Trading Policy, the Committee also reviews the list of executive officers subject to Section 16 of the Securities and Exchange Act of 1934, as amended, and the list of affiliates subject to the trading windows contained in the Policy.

Review annually and update, as necessary, this Charter s adequacy and the performance of the Committee, and receive approval from the Board of any proposed changes.

Consistent with the foregoing, take such actions as it deems necessary to encourage continuous improvement of, and foster adherence to, the Corporation s corporate governance policies, procedures and practices at all levels and shall perform other corporate governance oversight functions as requested by the Board.

The members of this Committee are José Luis Ferrer-Canals, appointed Chairman in February 2006, Jorge Diaz-Irizarry and José Menéndez-Cortada. The Corporate Governance and Nominating Committee met a total of eight (8) times during fiscal year 2006.

Asset/Liability Risk Committee. The Asset/Liability Risk Committee is composed of four directors who meet the independence criteria established by the NYSE, the SEC, and the Corporation s Independence Principles for Directors. Under the terms of its charter the Asset/Liability Risk Committee assists the Board in its oversight of the Corporation s policies and procedures related to asset and liability management, including funds management, investment management and credit management. 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 assets and liabilities;

The identification of the Corporation s risk tolerance levels related to its assets and liabilities;

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

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

The approval of loans and other business matters following the lending authorities approved by the Board.

98

Table of Contents

The members of this Committee are Jorge Díaz-Irizarry, appointed Chairman in June 2006, José Menéndez-Cortada, Sharee Ann Umpierre-Catinchi, and José Teixidor-Méndez. The Asset/Liability Risk Committee met a total of nine (9) times during fiscal year 2006.

Stockholder Communications with the Board

Any stockholder who desires to communicate with the Corporation s Board may do so by writing to the Chairman of the Board or to the non-management Directors as a group in care of the Office of the Corporate Secretary at the Corporation s headquarters, 1519 Ponce de León Avenue, Santurce, Puerto Rico 00908 or by email to directors@firstbankpr.com or thenetwork@firstbankpr.com. Communications may also be made by calling the following toll-free hotline telephone number: 1-877-888-0002. Communications related to accounting, internal accounting controls or auditing matters will be referred to the Chair of the Audit Committee, communications regarding other matters will be directed to the General Counsel for his or her proper referral.

Code of Ethics

In November 2003, the Corporation adopted a Code of Ethics for Senior Financial Officers (the Code). The Code which applies to the Corporation s Chief Executive Officer, Chief Operating Officer, Chief Financial Officer, Chief Accounting Officer, Comptroller, Executive Vice Presidents and to all professional employees in the areas of finance, internal audit and treasury, and members of the corporation s risk management council, states the principles to which senior financial officers must adhere in order to act in a manner consistent with the highest moral and ethical standards. The Code imposes a duty to avoid conflicts of interest, comply with the laws and regulations that apply to the Corporation and its subsidiaries. Any waiver of any part of the Code may be made only by the Audit Committee and will be promptly disclosed to shareholders as required by the rules of the SEC and the NYSE. Neither the Audit Committee nor the General Counsel received any requests for waivers under the Code in fiscal year 2006.

The Corporation has also adopted a Code of Ethics that is applicable to all employees of the Corporation and all of its subsidiaries which purports to strengthen the ethical culture that prevails in the Corporation. The Code of Ethics addresses, among other matters, conflicts of interest, operational norms and confidentiality of the Corporation s and its customers information.

SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Exchange Act requires our directors and executive officers, and persons who own more than ten percent of a registered class of our equity securities, to file with the SEC initial reports of ownership and reports of changes in ownership of our common stock and other equity securities. Officers, directors and greater than ten percent stockholders are required by SEC regulation to furnish us with copies of all Section 16(a) forms they file.

To our knowledge, based solely on a review of the copies of such reports furnished to us and written representations that no other reports were required, during the fiscal year ended December 31, 2006, all Section 16(a) filing requirements applicable to our officers, directors and greater than ten percent stockholders were complied with, except as follows:

Table of Contents

Luis Beauchamp, Aurelio Alemán, Randolfo Rivera, Dacio A. Pasarell, Emilio Martino, Cassan Pancham, and Luis Cabrera each filed one late Form 4 relating to stock options granted in January 2006; Lawrence Odell filed a late Form 3 upon becoming a Section 16(a) reporting person, which also reported, on a late basis, stock options granted in connection with employment; Pedro Romero, Nayda Rivera and Miguel Babilonia each filed a late Form 3 upon their becoming Section 16(a) reporting persons, which also reported, on a late basis, stock options granted in January 2006.

Item 11. Executive Compensation.

COMPENSATION DISCUSSION AND ANALYSIS

The Compensation Discussion and Analysis (CD&A) describes the objectives of the Corporation s Executive Compensation Program, the process for determining executive officer compensation, and the elements of the compensation for the Corporation s President and Chief Executive Officer (CEO), Chief Financial Officer (CFO), and the next three highest paid executive officers of the Corporation (the Named Executives).

The Executive Compensation Program is administered by the Compensation and Benefits Committee (the Compensation Committee). The Compensation Committee is responsible for the oversight and determination of the proper salary, incentive compensation, nonqualified benefits and perquisites of the executive officers and key employees of the Corporation. To fulfill its responsibilities and duties the Compensation Committee reviews and recommends to the Board the annual goals and objectives relevant to the CEO and evaluates and recommends to the Board the salaries, annual incentives awards and long term incentives of the CEO, executive vice presidents and other selected executives of the Corporation.

Executive Compensation Policy

The Corporation operates in a highly competitive industry where the quality, creativity and professionalism of its executives are of utmost importance to the success, profitability and growth of the institution. The underlying philosophy of the Executive Compensation Program is to attract and retain a highly qualified workforce that will make significant contributions to the promotion and achievement of the Corporation s goals, with a view to maximizing shareholder value, and to motivate high level of individual and group performance and reward contributions and achievement of strategic objectives under the responsibility of the executives. Accordingly, the Corporation has adopted a compensation policy that is designed to recruit, retain and motivate the best executive talent to deliver superior short term and long term performance to stockholders. To support those goals, the Corporation provides it s Named Executives with a competitive base salary, a cash bonus, stock option awards, and other fringe benefits. The cash bonus and stock awards, which are the variable components of the compensation, are based on the performance of the objectives

assigned to the Named Executives. In 2006, variable compensation accounted for approximately 70% of the CEO s total compensation and approximately 50% to 60% for the other Named Executives.

Objectives of the Corporation s Executive Compensation Program:

- Attract and retain top executives.
- Promote behavior that will lead to the attainment of the Corporation s goals.
- Provide a short term and long term variable compensation structure aimed at rewarding performance that is measured against the achievement of goals and management objectives.
- Promote the alignment of interest with those of the stockholders by providing a significant portion of the executive compensation in the form of stock-based compensation.

For the year 2006, the Board set forth the following management key objectives:

- Recruit key corporate executives to strengthen the restructured management organization, retain key corporate officers in the face of potential adverse consequences to the Corporation resulting from a Restatement Process with respect to its financial statements for 2004 and the corresponding filing of the Corporation s Amended Annual Report restating years 2000-2004 (the Restatement Process) and maintain high moral of the employees of the Corporation in such circumstances.
- Establish effective working relations with key constituencies to enhance the impaired Corporation s reputation resulting from the Restatement Process; i.e., regulators, rating agencies, credit counterparts, financial analysts investors, clients and employees.
- Create a strong enterprise risk management function and develop programs to remedy critical issues and correct material weaknesses identified by management, regulatory agencies, internal audit and independent auditors.
- Reduce credit risk concentration in connection with certain loans outstanding to two large mortgage originators in Puerto Rico to levels acceptable to regulatory agencies and to bring it within parameters set forth in the policies adopted by the Corporation.
- Fulfill all directives and requirements imposed by the various enforcement actions issued by the regulators upon the Corporation and its banking subsidiaries.
- Undertake steps towards satisfactorily resolving significant litigation brought against the Corporation as a result of the Restatement Process.
- Undertake steps towards satisfactorily resolving a formal investigation initiated by the SEC principally pertaining to the accounting for certain mortgage-related transactions with two large mortgage originators in Puerto Rico during calendar years 1999 through 2005.
- Initiate a process involving the raising of equity capital for the Corporation.
- Successful completion of the Restatement Process with the filing of the Amended 2004 Form 10-K/A.
- Maintain the Corporation s business components moving forward through the effective implementation of key business strategies to grow the core business and retain existing clients during the period of potential adverse consequences and impaired reputation of the Corporation.

Sustain the Corporation s market share goals in each business segment.

Compensation Review Process

The Compensation Committee typically reviews and determines executive compensation in January of each year. The Corporation s President and Chief Executive Officer, makes recommendations concerning the amount of compensation to be awarded to executive officers, excluding himself, but does not participate in the Compensation Committee s deliberations or decisions. The Compensation Committee reviews and considers his recommendations and makes a final determination, subject to the ratification of the Board. In making it s determinations, the Compensation Committee reviews the Corporation s performance as a whole and the performance of the executives as it relates to the accomplishment of the goals and objectives set forth for management for the year, together with any such goals that have been established for the relevant lines of business of the Corporation. The determinations in terms of accomplishments are ultimately judgments based on the Compensation Committee s assessment of the year end performance of the Corporation against its annual financial and strategic objectives established by the Board at the beginning of the year, and the level of responsibility and individual performance of each executive. The Compensation Committee, typically, also takes into consideration the performance of the Corporation in comparison with the performance of other corporations in similar markets who provide similar financial services and products and executive compensation at comparable companies.

Table of Contents

During 2006, in lieu of the typical process, the Compensation Committee gave substantial weight to the achievement and/or progress made towards the accomplishment of the key management objectives mentioned above, in the final determination of management effectiveness. In light of the Corporation s extraordinary efforts with respect to management s work on the Restatement Process and the legal and regulatory matters affecting the Corporation, the Compensation Committee in its deliberations and determinations, gave substantial weight to the significant time and effort employed by management towards the resolutions of such adversities affecting the Corporation. Specifically, these included: completion of the Restatement Process; development of a strong enterprise risk management framework; completion and delivery of all items required by the Cease and Desist orders entered into with the FDIC, the Commissioner of Financial Institutions of Puerto Rico and the Federal Reserve Bank of New York; defending against securities class action and shareholder derivatives claims, and working towards a successful resolution thereof; cooperating with a SEC formal investigation and undertaking a process for a settlement of a potential enforcement action in connection therewith; and commencing a process involving the raising of equity capital for the Corporation to ensure its compliance under the Bank Holding Company Act which requires that the Corporation serve as a source of financial strength to its banking subsidiaries.

The following financial factors were also considered in the evaluation of management overall effectiveness: attainment of financial results versus plan, overall effectiveness in the implementation of business strategies, market penetration and market positioning, and adjusted asset growth and adjusted earnings performance, among other factors.

Elements of Executive Compensation

The Corporation s compensation program primarily consists of the following components:

Base salary;

Short term incentives annual performance bonuses;

Long term incentives stock-based compensation in the form of stock option grants; and

Other compensation

Base Salary

Base salary is the basic element of direct cash compensation, designed to attract and motivate highly qualified executives. In setting base salary, the Compensation Committee takes into consideration the experience, skills, knowledge and responsibilities required of the executive and senior officers in their roles, and the Corporation s performance. The Compensation Committee seeks to maintain base salaries that are competitive with the marketplace, to allow it to attract and retain executive talent. Salaries for executive and senior officers are reviewed on an annual basis as well as at the time of a promotion or other change in level of responsibilities.

Considering the financial performance of the Corporation and the large amounts of extraordinary expenses incurred during 2006 relating to the regulatory and legal issues that the Corporation was facing, the base salaries of the CEO, the Chief Operating Officer (COO) and the Executive Vice Presidents were not increased during 2006 and have not been increased as of the date of this filing.

During 2006, the Corporation, because of the adversities affecting it during the year, faced certain challenges which impacted the entities ability to hire and retain employees and executives with the necessary skills and experience to execute extensive actions directed towards improving corporate governance, greater transparency, higher quality of financial reporting, enhanced internal control policies, programs and processes, and the resolution of legal and regulatory actions. As part of the recruitment process, the Corporation designed compensation packages, which included, in some instances, guaranteed performance bonuses, signing bonus and stock option awards, all of which were aimed to compensate the executives for the risk of leaving their respective prior employers and/or professions. In meeting these objectives, the Corporation entered into an employment agreement with Lawrence Odell in February 2006 relating to his retention as Executive Vice President and General Counsel of the Corporation and its subsidiaries and at the same time entered into a services agreement with his law firm Martinez Odell & Calabria (the Law Firm) in consideration of his employment with the Corporation. The services agreement provides for monthly

payments to the Law Firm of $60,000. Separately, under the terms of his employment agreement, Mr. Odell receives a nominal base salary of $100.00 a year and the opportunity to

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Table of Contents

receive annual performance bonuses based upon his achievement of predetermined business objectives. In addition, at the time of his employment he received a stock options exercisable for 100,000 shares of common stock. The payments under the services agreement with the Law Firm have been taken into consideration in determining total compensation for identifying the Named Executives. The employment agreement has a four-year term with automatic one-year extensions. The services agreement has a four-year term.

Also, in July 2006, the Corporation entered into an employment agreement with Fernando Scherrer relating to his retention as Executive Vice President and Chief Financial Officer of the Corporation and its subsidiary FirstBank. Under the terms of his employment agreement, Mr. Scherrer receives a base salary of $700,000 a year and a guaranteed bonus of $400,000 upon the first anniversary of his employment. Every year thereafter, Mr. Scherrer s performance bonus will be determined based upon his achievement of predetermined business objectives. In addition, Mr. Scherrer received stock options exercisable for 100,000 shares of common stock and a signing bonus of $200,000.

Short Term Annual Performance Bonuses

Generally, the annual cash bonus element of the Corporation s Executive Compensation Program is designed to provide incentives for executive officers on generating strong corporate financial performance and therefore seeks to link the payment of cash bonuses to the achievement of key strategic, operational and financial performance objectives. Other criteria, beside financial performance, may include objectives and goals that may not involve actions that specifically and directly relate to financial matters, but the resolutions of which would necessarily protect the financial soundness of the Corporation. The performance of the executive officer was evaluated on the basis of the Corporation s achievement of the predetermined business objectives, such as the 2006 Management Key objectives detailed in the Executive Compensation Policy section above and which are discussed in more detail below. The contributions of the executive to the achievement of the Corporation s business objectives were evaluated by the Compensation Committee to determine, at its discretion, the amount of the performance bonus. The Compensation Committee does not use a formula to calculate bonus payments.

During 2006, the Corporation placed emphasis on compliance with various regulatory provisions and enhancement of the Corporation s overall corporate governance and risk management. Notwithstanding the substantial progress realized during the year in accomplishing these objectives, and considering the financial performance of the corporation and the large amounts of extraordinary expenses incurred during 2006 relating to the regulatory and legal issues the Corporation was facing, the Compensation Committee approved the performance bonuses listed in the Summary Compensation Table, which were equal to those approved for 2005. Such bonuses considered individual performance given certain milestones which included but were not limited to:

- Strict adherence and completion of deliverables in connection with the FDIC, the Commissioner of Financial Institutions of Puerto Rico, and the Federal Reserve Bank of New York with respect to the mortgage related Cease and Desist Orders.

- A complete assessment of management s compliance with the Bank Secrecy Act (BSA), a revamping of the Corporation s BSA program, and substantial implementation of recommendations and action items required by the BSA Cease and Desist Order.

- Active negotiation towards a Memorandum of Understanding for settlement of the Class Action Lawsuit.

- Dismissal of the Derivative Action Lawsuit.

- Active settlement negotiation with the Enforcement Division of the SEC in connection with its formal investigation.

- Completion of the Corporation s Amended Annual Report for the year ended December 31, 2004.

- Substantial completion of the Corporation s Annual Report for the year ended December 31, 2005, which was subsequently filed on February 9, 2007.

Complete Corporate Governance Review and implementation of changes in accordance with consultant recommendations.

Revision of the Corporation s risk management program resulting in a realignment of risk management functions and the adoption of an enterprise-wide risk management framework.

Substantial reduction of the credit risk concentration in connection with loans outstanding to two large mortgage originators in Puerto Rico.

Maintaining market leadership positioning in key business segments.

103

Table of Contents

Long Term Equity Incentive

Long term incentives were provided under the Executive Compensation Program in the form of stock options under the Corporation s 1997 Stock Option Plan. The 1997 Stock Option Plan (the 1997 Plan) was effective through January 21, 2007, at which time it expired. Under the 1997 Plan, the Compensation Committee had discretion to select which of the eligible persons would be granted stock options, whether stock appreciation rights would be granted with such options, and generally to determine the terms and conditions of such options in accordance with the provisions of the 1997 Plan. Under the 1997 Plan, options are granted at a price not less than the fair market value of the stock at the date of grant. Accordingly, all options have been awarded at the market value of the Corporation s common stock on the date of grant. The options are fully vested upon grant. The purpose of the 1997 Plan was to further the success of the Corporation and its subsidiaries by enabling executive officers to maintain an equity interest in the Corporation, which aligns their compensation with the shareholders interest. The Corporation makes initial grants of options to new executives to quickly align their interests.

In determining equity awards to the executives in 2006, the Compensation Committee, based on recommendations submitted by the CEO, took into account the executive s position and scope of responsibility, ability to affect profitability and shareholder value, the accomplishment of the goals and objectives set forth by the Corporation, recent job performance, and the value of the equity award in relation to other compensation elements. The Compensation Committee in granting the equity awards to executives in 2006 placed great weight in the accomplishment and progress made by management towards the resolution of the adversities facing the Corporation during 2005 and 2006 that included substantial legal actions against the Corporation, several regulatory enforcement actions and the Restatement Process. The Corporation does not have a practice of coordinating the timing of stock option grants with the release of material, nonpublic information. Management has no intervention or role with respect to the timing of stock option awards. During 2006, the equity awards were granted in accordance with the Corporation s historical practice of granting equity awards to executives and other management personnel at the beginning of each year. Further, the amounts were consistent with those granted in prior years.

Other Compensation

The use of personal benefits and perquisites as an element of compensation is extremely limited. Under our current plan, Named Executives are provided with a corporate-owned automobile, club memberships and participation in the same corporate-wide plans and programs available to other employees such as the 401(k) plan (including Corporation s match), group medical and dental plans, long term and short term disability, health care, and group life insurance. The Corporation offers to all executive officers a life insurance policy of $1,000,000 ($500,000 in excess of other employees). In addition, the CEO is provided personal security solely for business purposes.

In 2007, the Compensation Committee retained Mercer Human Resources Consulting to provide services as compensation consultants. Mercer will perform an executive compensation review which includes a market competitiveness study, a pay for performance assessment, and will assist the Compensation Committee in developing a new compensation program for the Corporation s management.

Compensation Committee Report

The Compensation Committee has reviewed the Compensation Discussion and Analysis and discussed it with management. Based on its review and discussions with management, the Compensation Committee recommended to our Board of Directors that the Compensation Discussion and Analysis be included in the Corporation s Annual Report on Form 10-K for 2006. This report is provided by the following independent directors, who comprise the committee:

Sharee Ann Umpierre-Catinchi (Chairperson)

Richard Reiss

José Teixidor

TABULAR EXECUTIVE COMPENSATION DISCLOSURE
SUMMARY COMPENSATION TABLE

The Summary Compensation Table set forth below discloses compensation for the Chief Executive Officer, Chief Financial Officer and the next three highest paid executive officers of the Corporation, FirstBank or its subsidiaries.

Name and Principal Position	Year	Salary ($) (d)	Bonus ($) (e)	Stock Awards ($)	Option Awards ($) (f)	Non-Equity Incentive Plan Compensation ($)	Change in Pension Value and Nonqualified Deferred Compensation Earnings ($)	All Other Compensation ($) (g)	Total ($)
Luis Beauchamp Chairman, President and Chief Executive Officer	2006	1,000,000	852,200		1,595,676			77,340	3,525,216
Aurelio Alemán Senior Executive Vice President and Chief Operating Officer	2006	750,000	602,200		683,861			36,824	2,072,885
Fernando Scherrer (a) Executive Vice President and Chief Fiancial Officer	2006	290,769	202,200		288,000			22,180	803,149
Lawrence Odell (b) Executive Vice President, General Counsel and Secretary of the Board of Directors	2006	630,100	402,200		459,000			8,505	1,499,805
Randolfo Rivera Executive Vice President and Corporate Banking Operations Executive	2006	550,000	402,200		341,931			31,656	1,325,787
Luis Cabrera (c) Former Executive Vice President, Interim Chief Financial Officer and Chief Investment Officer	2006	409,846	225,000		227,954			614,472	1,477,272

(a) Fernando Scherrer was hired in July 2006, his employment

agreement stipulates a base salary of no less than $700,000 a year and a guaranteed bonus of $400,000 upon the first anniversary of his employment. In addition, Mr. Scherrer received a signing bonus of $200,000 which is included in the bonus section of the Summary Compensation Table and stock options exercisable for 100,000 shares of common stock.

(b) As discussed in more detail in the Compensation Disclosure and Analysis section, in February 2006, the Corporation entered into an employment agreement with Lawrence Odell and at the same time entered into a services agreement with his law firm Martinez Odell & Calabria relating to the services of Mr. Odell as

Executive Vice President and General Counsel of the Corporation. Mr. Odell received a nominal base salary of $100.00 a year and the opportunity to receive annual performance bonus based upon his achievement of predetermined business objectives. In addition, he received a stock option exercisable for 100,000 shares of common stock. The services agreement provides for monthly payments to the Law Firm of $60,000 which has been taken into consideration in determining Mr. Odell salary and has been included as such in the Summary Compensation Table.

(c) Mr. Luis Cabrera resigned as Chief Investment Officer and

Executive Vice President on August 11, 2006. He ceased being Interim Chief Financial Officer on July 18, 2006. Pursuant to an agreement with the Corporation, Mr. Cabrera received monthly payments, based on his yearly salary of $480,000, through September 30, 2006. Upon his separation from the Corporation, he received a lump sum payment consisting of (i) a pro rata bonus of $225,000, less required deductions, (ii) a severance payment of $313,860, less required deductions, (iii) a second severance payment of $286,140 and (iv) payment for unused vacation days of $50,769.

Table of Contents

(d) Includes regular base pay before deductions for 2006.

(e) Includes the Christmas bonus paid during 2006 and performance bonus payments granted during a meeting of the Compensation Committee held in January 2007, which were meant as compensation for performance of the Named Executives during fiscal year 2006 under the Executive Compensation Program as discussed in the Compensation Discussion and Analysis section.

(f) The assumptions made when calculating the amounts in this column for 2006 awards are found in Note 20 of the Consolidated Financial Statements of the Corporation on this Form 10-K for 2006. The Corporation

uses the Black/Scholes option pricing model to value stock options. The fair value of the stock options appearing in the Summary Compensation Table were calculated in accordance with December 2006 SEC regulations. The regulations require disclosure of the cost of equity awards if compensation expense was recorded in the income statement of the employer for each such award in 2006, as required by the applicable accounting rule (SFAS 123(R)). The amounts disclosed in the Summary Compensation Table are the same as the amounts reported in financial statements.

(g) Set forth below is a breakdown of all other Compensation (i.e., personal benefits):

Name and Principal Position	Year	Company-owned Vehicles ($)	1165(e) Plan Contribution ($) (a)	Security ($)	Memberships & Dues ($)	Pursuant to Agreement ($)	Other ($) (b)	Total ($)
Luis Beauchamp	2006	16,863	5,783	41,612	8,780		4,302	77,340
Aurelio Alemán	2006	16,192	5,600		9,530		5,502	36,824
Fernando Scherrer	2006	7,058			10,850		4,272	22,180
Lawrence Odell	2006	2,313					6,192	8,505
Randolfo Rivera	2006	16,736	5,600		6,080		3,240	31,656
Luis Cabrera	2006	11,307	185			600,000	2,980	614,472

(a) Includes the Corporation s pro-rata contribution to the executive s participation in the Defined Contribution Retirement Plan.

(b) Other compensation includes life insurance policy premium paid by the Corporation in excess of $500,000 available to all employees and expenses incurred by the Corporation for family members who accompanied the executive in employer sponsored activities. None of these benefits individually exceed $10,000.

GRANTS OF PLAN-BASED AWARDS

The table set forth below discloses the information regarding the stock options granted to the Corporation s Chief Executive Officer, Chief Financial Officer and the three most highly paid executives during 2006.

Table of Contents

Name	Grant Date	Estimated Possible Payouts Under Non-Equity Incentive Plan Awards( )			Estimated Possible Payouts Under Equity Incentive Plan Awards( )			All Other Stock Awards: Number of Shares of stock or units (#)	All Other Option Awards: Number of Securities Underlying Options(#)	Exercise or Base Price for Options Awards ($/SH)	Market Price on Grant Date ($/SH) (a)	Grant Date Fair Value of Stock and Option Awards (b)
		Threshold($)	Target($)	Maximum($)	Threshold(#)	Target(#)	Maximum(#)					
Luis Beauchamp	1/24/2006								350,000	12.68	12.68	1,595,676
Aurelio Alemán	1/24/2006								150,000	12.68	12.68	683,861
Fernando Scherrer	7/24/2006								100,000	9.20	9.20	288,000
Lawrence Odell	2/15/2006								100,000	12.64	12.64	459,000
Randolfo Rivera	1/24/2006								75,000	12.68	12.68	341,931
Luis Cabrera	1/24/2006								50,000	12.68	12.68	227,954

(a) 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 is granted. All options were granted at the closing market price of the Corporation s common stock on the day of the grant. Stock options are fully vested upon issuance. The maximum term

to exercise the options is ten years.

(b) The assumptions made when calculating the amounts in this column for 2006 awards are found in Note 20 of the Consolidated Financial Statements of the Corporation on this Form 10-K for 2006. The date in which the Compensation Committee granted the option award is the grant date determined in accordance with FAS 123(R).

OUTSTANDING EQUITY AWARDS AT FISCAL YEAR END

The following table sets forth certain information with respect to the unexercised options awarded to the named executives as of December 31, 2006.

107

Table of Contents

	Option Awards					Stock Awards			
Name	Number of Securities Underlying Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable	Equity Incentive Plan Awards: Number of Securities Underlying Unexercised Unearned Options (#)	Option Exercise Price($)	Option Expiration Date	Number of Shares or Units of Stock that have not vested	Market Value of Shares or Units of Stock that have not vested	Equity Incentive Plan Awards: Number of Unearned Shares, Unit or Other Rights that have not Vested (#)	Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, that have not Vested ($)
Luis Beauchamp	54,000			8.67	11/17/2008				
	90,000			7.44	12/13/2010				
	96,000			9.34	2/26/2012				
	64,000			12.81	2/25/2013				
	76,800			21.45	2/20/2014				
	76,800			23.92	2/22/2015				
	350,000			12.68	1/24/2016				
Aurelio Alemán	36,000			8.67	11/17/2008				
	36,000			6.54	11/23/2009				
	78,000			7.44	12/13/2010				
	90,000			9.34	2/26/2012				
	60,000			12.81	2/25/2013				
	72,000			21.45	2/20/2014				
	72,000			23.92	2/22/2015				
	150,000			12.68	1/24/2016				
Fernando Scherrer	100,000			9.2	7/24/2016				
Lawrence Odell	100,000			12.64	2/15/2016				
Randolfo Rivera	120,000			9.03	5/26/2008				
	2,110			7.44	12/13/2010				
	60,000			9.34	2/26/2012				
	50,000			12.81	2/25/2013				
	60,000			21.45	2/20/2014				

60,000	23.92	2/22/2015
75,000	12.68	1/24/2016

OPTIONS EXERCISED AND STOCK VESTED TABLE

During 2006, no stock options were exercised by the named executive mainly as a result of a black-out period which is in effect since the end of 2005**.**

PENSION BENEFITS

The Corporation does not have a defined benefit or pension plan in place for executive officers.

DEFINED CONTRIBUTION RETIREMENT PLAN

108

Table of Contents

The Corporation provides a Defined Contribution Retirement Plan pursuant to Section 1165(e) of Puerto Rico Internal Revenue Code (PRIRC) for Puerto Rico employees and a Defined Contribution Retirement Plan pursuant to Section 401(K) of the U.S. Internal Revenue Code for U.S.V.I. and U.S. employees, which provides participating employees with retirement, death, disability and termination of employment benefits in accordance with their participation. The Defined Contribution Retirement Plans complies with the Employee Retirement Income Security Act of 1974, as amended (ERISA) and the Retirement Equity Act of 1984, as amended (REA). The Corporation s employees are eligible to participate in the Defined Contribution Retirement Plan after completing one year of service, and there is no age requirement. An individual account is maintained for each participant and benefits are paid based solely on the amount of each participant s account.

Participating employees may defer from 1% to 10% of their annual salary, up to a maximum of $8,000, for Puerto Rico participants and $15,000 for U.S.V.I. and U.S participants, into the Defined Contribution Retirement Plan on a pre-tax basis as employee salary savings contributions. Each year the Corporation will make a contribution equal to 25% of each participating employee s salary savings contribution; however, no match is provided for salary savings contributions in excess of 4% of compensation. At the end of the fiscal year, the Corporation may, but is not obligated to make, additional contributions in an amount determined by the Board; however, the maximum of any additional contribution in any year may not exceed 15% of the total compensation of all eligible employees participating in the Defined Contribution Retirement Plan and no basic monthly or additional annual matches need be made on years during which the Corporation incurs a loss.

In fiscal year 2006, the total contribution to the Defined Contribution Retirement Plans by the Corporation amounted to $952,546 which funds were distributed on a pro rata basis among all participating employees. The table below sets forth the total of the Corporation s contribution during fiscal year 2006 to the Named Executives of the Corporation who participate in the Defined Contribution Retirement Plan.

Name	Corporate Contribution
Luis M. Beauchamp	$ 5,783
Aurelio Alemán	$ 5,600
Randolfo Rivera	$ 5,600
Luis Cabrera	$ 185

NON-QUALIFIED DEFERRED COMPENSATION

The Deferred Compensation Plan is an unfunded deferred compensation arrangement available to a select group of management or highly compensated personnel whereby the personnel entitled to participate may elect to do so by executing an Individual Deferred Compensation Agreement (the Agreement). Pursuant to the Agreement the participant may defer a portion of his/her compensation to be earned from the date in which the Agreement is executed. These deferred amounts, if any, are included in the amounts disclosed in the Summary Compensation Table. The Corporation does not match any of the deferred amounts. The deferred amounts are deposited in a Trust that is administered by FirstBank. Investments by the Trust may be made in stocks, bonds or other securities. The income, gains and losses both realized and unrealized from investments made by the Trust, net of any expenses properly chargeable, shall be determined annually at the close of each year and allocated among the accounts of the participants in proportion to the values of their respective contingent future benefits. The Corporation does not guarantee a return on the investment of these funds. Payment of the amount allocated to a participant shall be deferred until such participants retirement, resignation, disability or death, or in the event of unforeseeable emergency or necessity.

Name	Executive Contribution in last FY($)	Registrant Contribution in last FY($)	Aggregate Earnings in last FY($)	Aggregate Withdrawals/ Distributions ($)(a)	Aggregate Balance at Last FYE($)

Luis Beauchamp	25,209	46,213	883,873
Aurelio Alemán	33,554	41,819	793,991

(a) Withdrawals from the plan assets are pursuant to Act 250 of November 29, 2006 which amends the PRIRC to allow through December 31, 2006 a window period within which taxpayers may elect to

109

prepay a 5% special tax on amounts held in deferred compensation plans. Act 250 allowed distributions from the deferred compensation plan for the sole purpose of satisfying the 5% special tax.

EMPLOYMENT CONTRACTS, TERMINATION OF EMPLOYMENT AND CHANGE IN CONTROL ARRANGEMENTS

Employment Agreements

The following table discloses information regarding the employment agreements of the Named Executives.

Name	Effective Date	Current Base Salary	Term of Years
Luis M. Beauchamp	5/14/1998	$ 1,000,000	4
Aurelio Alemán	2/24/1998	$ 750,000	4
Randolfo Rivera	5/26/1998	$ 550,000	4
Lawrence Odell	2/15/2006	$ 720,100	4
Fernando Scherrer	7/24/2006	$ 700,000	1

The agreements provide that on each anniversary of the date of commencement of each agreement the term of such agreement shall be automatically extended for an additional one (1) year period beyond the then-effective expiration date, unless either party receives written notice that the agreement shall not be further extended.

Under the employment agreements, the Board may terminate the contracting officer at any time; however, unless such termination is for cause, the contracting officer will be entitled to a severance payment of four years his/her base salary (base salary defined as $450,000 in the case of Lawrence Odell), less all required deductions and withholdings, which payment shall be made semi-monthly over a period of one year, except under Fernando Scherrer s employment agreement, were the severance payment shall equal the annual base salary, plus the guaranteed bonus upon his first anniversary of $400,000. In relations to a termination for cause, Cause is defined to include personal dishonesty, incompetence, willful misconduct, breach of fiduciary duty, intentional failure to perform stated duties, material violation of any law, rule or regulation (other than traffic violations or similar offenses) or final cease and desist order or any material breach of any provision of the employment agreement.

In the event of a change in control of the Corporation during the term of the employment agreements, the executive shall be entitled to receive a lump sum severance payment equal to his or her then current base annual salary (base salary defined as $450,000 in the case of Lawrence Odell) plus (i) the highest cash performance bonus received by the executive in any of the four (4) fiscal years prior to the date of the change in control and (ii) the value of any other benefits provided to the executive during the year in which the change in control occurs, multiplied by four (4), except for Fernando Scherrer which would receive as severance a lump sum cash payment equal to the annual base compensation plus the guaranteed bonus of $400,000. Termination of employment is not a requirement for a change in control severance payment. Pursuant to the employment agreements, a change in control shall be deemed to have taken place if a third person, including a group as defined in Section 13(d)(3) of the Securities Exchange Act of 1934, as amended, becomes the beneficial owner of shares of the Corporation having 25% or more of the total number of

votes which may be cast for the election of directors of the Corporation, or which, by cumulative voting, if permitted by the Corporation s charter or by-laws, would enable such third person to elect 25% or more of the directors of the Corporation; or if, as a result of, or in connection with, any cash tender or exchange offer, merger or other business combination, sales of assets or contested election, or any combination of the foregoing transactions, the persons who were directors of the Corporation before such transactions shall cease to constitute a majority of the Board of the Corporation or any successor institution.

The following table describes and quantifies the benefits and compensation to which the Named Executives would have been entitled to under existing plans and arrangements if their employment had terminated on December 31, 2006, based on their compensation and services on that date. The amounts shown on the table do not include payments and benefits available generally to salaried employees upon termination of

110

Table of Contents

employment, such as accrued vacation pay, distribution from the 401(K) plan, or any death, disability or post retirement welfare benefits available under broad-based employee plans.

Name	Death, Disability, Termination Without Cause, Termination With Cause and Change in control	Severance ($)	Non-Qualified Plans ($) (c)	Disability Benefits ($)	Insurance Benefit ($)	Total ($)
Luis Beauchamp	Death (a)		883,873		500,000	1,383,873
	Permanent Disability (b)		883,873	2,400,000		3,283,873
	Termination without cause	4,000,000	883,873			4,883,873
	Termination with cause		883,873			883,873
	Change in Control	7,709,360	883,873			8,593,233
Aurelio Alemán	Death (a)		793,991		500,000	1,293,991
	Permanent Disability (b)		793,991	1,800,000		2,593,991
	Termination without cause	3,000,000	793,991			3,793,991
	Termination with cause		793,991			793,991
	Change in Control	5,547,296	793,991			6,341,287
Fernando Scherrer	Death (a)				500,000	500,000
	Permanent Disability (b)			420,000		420,000
	Termination without cause	1,100,000				1,100,000
	Termination with cause					
	Change in Control	1,100,000				1,100,000
Lawrence Odell	Death (a)				500,000	500,000
	Permanent Disability (b)			1,728,240		1,728,240
	Termination without cause	1,800,000				1,800,000
	Termination with cause					
	Change in Control	3,434,020				3,434,020
Randolfo Rivera	Death (a)				500,000	500,000
	Permanent Disability (b)			1,320,000		1,320,000
	Termination without cause	2,200,000				2,200,000
	Termination with cause					
	Change in Control	3,926,624				3,926,624

(a) Amount includes life insurance benefits in excess of those amounts

available generally to other employees.

(b) If the executive shall become disabled or incapacitated for a number of consecutive days exceeding those the executive is entitled as sick-leave and it is determined that the executive will continue to temporarily be unable to perform his/her duties, the executive shall receive 60% of his/her compensation exclusive of any other benefits entitled to receive under the corporate-wide plans and programs available to other employees. If it is determined that the executive is permanently disabled, the executive shall receive 60% of his/her compensation for the remaining term of the

employment agreement. The executive shall be considered permanently disabled if absent due to physical or mental illness on a full time-time basis for three consecutive months.

(c) The Nonqualified Plan includes the accumulated balance of the deferred compensation plan as of December 31, 2006 as applicable for the Named Executive.

COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

The Corporation s Compensation Committee consists of directors Sharee Ann Umpierre-Catinchi, appointed Chairman in August 2006, Richard Reiss-Huyke and Jose Teixidor-Méndez. None of the current members, nor the members during fiscal year 2006, has served as an officer of, or been an employee of, the Corporation, FirstBank or a subsidiary of the Corporation or of FirstBank. No Executive Officer of the Corporation serves on any board of directors or compensation committee of any entity that compensates any member of the Compensation Committee. Other than disclosed in the Certain Relationships and Related Transactions and Director Independence section under Item 13 of this 2006 Form 10-K, none of the members of the Compensation Committee had any relationship with the Corporation requiring disclosure under Item 404 of the SEC Regulation S-K.

COMPENSATION OF DIRECTORS

Non-employee directors of the Corporation do not receive compensation for meetings of the Board of the Corporation when these are held in conjunction with meetings of the Board of Directors of FirstBank. Directors who are also officers of the Corporation, of FirstBank or of any other subsidiaries do not receive

Table of Contents

fees or other compensation for service on the Board of the Corporation, the Board of Directors of FirstBank, the Board of Directors of the subsidiaries or any of their committees. Accordingly, Luis Beauchamp and Aurelio Alemán are not included in this table because they were employees during 2006 and therefore received no compensation for their services as a director. The compensation set forth in the table is based on the following schedule of fees for 2006 compensation of non-employee directors:

Meeting Fees. During 2006, each non-employee director received $1,400 for each regular meeting attended.

Compensation and Benefits Committee and Asset/Liability Risk Committee. During 2006, each non-employee director received $650 for each regular meeting attended.

Audit Committee. During 2006, each director received $1,050 for each regular meeting attended.

As part of the Audit Committee s investigation, certain independent directors of the Board of Directors actively engaged in activities related to said investigation. As a result, the Compensation and Benefits Committee, in September 2005, approved the payment of additional fees in an amount equal to $250 per hour for these independent directors in order to compensate them for the additional work and time incurred by them in said investigation.

In January 2007, the Board of Directors approved an increase in fees to the members of the Board effective February 2007. Fees increased as follows:

Meeting Fees. Currently, each non-employee director receives $1,750 for each regular meeting attended.

Compensation and Benefits Committee and Asset/Liability Risk Committee. Currently, each non-employee director receives $1,200 for each regular meeting attended.

Audit Committee. Currently, each director receives $1,500 for each regular meeting attended.

The Corporation reimburses the Board member for travel, lodging and other reasonable out-of-pocket expenses in connection with attendance at board and committee meetings or performing other services for the Corporation in their capacities as directors.

The following table sets forth fees paid to non-employee directors for their attendance at meetings of the Board and committees during fiscal year 2006, as well as the additional fees paid to the certain independent directors for the additional work and time incurred by them as part of the Audit Committee s investigation:

Name	Fees Earned or Paid in Cash ($)	Stock Awards ($)	Option Awards ($)	Non -Equity Incentive Plan Compensation ($)	Nonqualified Deferred Compensation Earnings ($)	All Other Compensation ($) (b)	Total ($)
José Teixidor-Méndez	44,750						44,750
José Julian Álvarez-Bracero (a)	11,750						11,750
Jorge Díaz-Irizarry	60,700					3,222	63,922
José Ferrer-Canals	80,800					41,388	122,188
Sharee Ann Umpierre-Catinchi	54,650					3,222	57,872
Richard Reiss-Huyke	75,050					40,625	115,675
	58,850					25,198	84,048

José Menéndez-Cortada		
Fernando Rodríguez-Amaro	81,800	81,800

(a) José Julian Álvarez-Bracero resigned as director of the Corporation effective March 31, 2006.

(b) All other compensation includes: (1) additional fees paid to certain independent directors for the additional work and time incurred by them as part of the Audit Committee s investigation detailed as follows; José Ferrer-Canals $24,750, Richard Reiss-Huyke $40,625, and José Menéndez-Cortada $21,976; (2) a club membership in the case of José Ferrer-Canals; and (3) expenses incurred by the Corporation for family members who accompanied the directors in Board related activities.

PERFORMANCE OF FIRST BANCORP COMMON STOCK

The stock performance graph set forth below compares the cumulative total stockholder return of the Corporation s common stock from December 31, 2001 to December 31, 2006, with cumulative total return of the S&P 500 Market Index. The S&P 500 Market Index is a broad index that includes a wide variety of

issuers and industries representative of a cross section of the market. The S&P Supercomposite Banks Index is a capitalization-weighted index that is composed of 96 members.

	12/31/2001	12/31/2002	12/31/2003	12/31/2004	12/31/2005	12/31/2006
First Bank	$ 100	$ 121	$ 215	$ 349	$ 138	$ 109
S&P500	$ 100	$ 78	$ 100	$ 111	$ 117	$ 135
S&P Supercom Banks Index	$ 100	$ 100	$ 128	$ 147	$ 145	$ 167

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

BENEFICIAL OWNERSHIP OF SECURITIES

The following sets forth information concerning persons who beneficially own 5% or more of the Corporation s issued and outstanding common stock and is derived solely from Schedule 13 Gs and a Form 4 that were submitted to the SEC and to the Corporation.

Beneficial Owners of 5% or More

113

Table of Contents

Name and Address	Number of Shares	Percentage
FMR Corp. 82 Devonshire Street Boston, MA 02109	8,038,800(a)	9.66%
Angel Alvarez-Pérez Condominio Plaza Stella Apt.1504 Avenida Magdalena 1362 San Juan, Puerto Rico 00907	7,308,918(b)	8.78%
Barclays Global Investors, NA 45 Fremont Street San Francisco, CA 94105	4,397,412(c)	5.28%
Schneider Capital Management Corporation 460 E. Swedesford Rd., Suite 2000 Wayne, PA 19087	4,540,100(d)	5.45%

(a) Based solely on a Schedule 13G/A filed with the SEC on February 14, 2007, FMR Corp. reported aggregate beneficial ownership of approximately 9.66% or 8,038,800 shares of the Corporation as of December 31, 2006. FMR Corp. reported that it possessed sole voting power over 14,800 shares and sole dispositive power over 8,038,800 shares. FMR Corp. also

reported that it did not possess shared voting or shared dispositive power over any shares beneficially owned.

(b) Based solely on a Form 4 filed with the SEC on April 3, 2006 by Mr. Angel Alvarez Pérez, which is the most recent filing of the reporting person known to the Corporation as of May 31, 2007.

(c) Based solely on a Schedule 13G filed with the SEC on January 23, 2007, Barclays Global Investors, NA and certain of its affiliates reported aggregate beneficial ownership of approximately 5.28% or 4,397,412 shares of the Corporation as of December 31, 2006. Barclays Global Investors, NA and certain of its affiliates reported that it possessed sole voting power over 4,114,549

shares and sole dispositive power over 4,397,412 shares. Barclays Global Investors, NA and certain of its affiliates also reported that it did not possess shared voting or shared dispositive power over any shares beneficially owned.

(d) Based solely on a Schedule 13G filed with the SEC on February 12, 2007, Schneider Capital Management Corporation reported aggregate beneficial ownership of approximately 5.45% or 4,540,100 shares of the Corporation as of December 31, 2006. Schneider Capital Management Corporation reported that it possessed sole voting power over 3,060,825 shares and sole dispositive power over 4,540,100 shares. Schneider

Capital Management Corporation also reported that it did not possess shared voting or shared dispositive power over any shares beneficially owned.

Beneficial Ownership by Directors or Nominees

The following table sets forth information with regard to the total number of shares of the Corporation s common stock beneficially owned, as of May 31, 2007, by (i) each current member of the Board of Directors, (ii) each nominee to the Board of Directors, (iii) each current executive officer, and (iv) all current directors and executive officers as a group. Information regarding the beneficial ownership by executive officers and directors is derived from information submitted to the Corporation by such executive officers and directors.

114

Table of Contents

Name	Number of Shares (a)	Percentage
Directors:		
Luis M. Beauchamp, Chairman, President & CEO	2,231,672(b)	2.68%
Aurelio Alemán, COO & Senior Executive VP	794,000(c)	*
José Teixidor	120,740	*
Jorge L. Díaz	23,660(d)	*
José Ferrer-Canals	500	*
Richard Reiss-Huyke		*
Sharee Ann Umpierre-Catinchi	75,500(e)	*
José Menéndez- Cortada	15,364(f)	*
Fernando Rodríguez-Amaro	5,250	*
Executive Officers:		*
Fernando Scherrer, CFO & Executive VP	175,000(g)	*
Lawrence Odell, General Counsel, Secretary & Executive VP	175,000(h)	*
Dacio Pasarell, Executive VP	126,000(i)	*
Randolfo Rivera, Executive VP	518,450(j)	*
Emilio Martinó, Chief Credit Officer & Executive VP	68,323(k)	*
Cassan Pancham, Executive VP	113,188(l)	*
Nayda Rivera-Batista, Chief Risk Officer & Senior VP	70,366(m)	*
Miguel Babilonia, Chief Credit Risk Officer & Senior VP	28,000(n)	*
Pedro Romero, Chief Accounting Officer and Senior VP	35,091(o)	*
Victor Barreras, Treasurer & Senior VP	70,000(p)	*
Current Directors and Executive Officers as a group	4,646,104	5.58%

115

Table of Contents

* Represents less than 1%.

(a) The options to purchase shares held by the Directors and Executive Officers cannot be exercised until the Corporation is up to date with all of its securities filings.

(b) Includes options, which are exercisable upon grant, to purchase 1,157,600 shares.

(c) Includes options, which are exercisable upon grant, to purchase 744,000 shares.

(d) Includes 22,460 shares owned by the spouse of Mr. Díaz to which Mr. Díaz disclaims beneficial ownership.

(e) Includes 9,000 shares owned jointly with her spouse. Excludes 2,091,070 shares owned by Ms. Umpierre-Catinchi s father and former director, Angel L. Umpierre, to which Ms. Umpierre-Catinchi disclaims ownership.

(f) Includes 550 shares owned by Martínez-Alvarez, Menéndez-Cortada & Lefranc Romero, PSC of which Mr. Menéndez-Cortada is an indirect beneficial owner.

(g) These are options, which are exercisable upon grant, to purchase 175,000 shares.

(h) These are options, which are exercisable upon grant, to purchase 175,000 shares.

(i) Includes options, which are exercisable upon grant, to purchase 96,000 shares.

(j) Includes options, which are exercisable upon grant, to purchase 502,110 shares.

(k) Includes options, which are exercisable upon grant, to purchase 68,000 shares.

(l) Includes options, which are exercisable upon grant, to purchase 110,000 shares.

(m) Includes options, which are exercisable upon grant, to purchase 70,000 shares.

(n) Includes options, which are exercisable upon grant, to purchase 28,000 shares

(o) Includes options, which are exercisable upon grant, to purchase 35,000 shares.

(p) Includes options, which are exercisable upon grant, to purchase 70,000 shares.

Equity Compensation Plan Information

The following table provides information about the securities authorized for issuance under the Corporation s Equity Compensation Plan:

116

Table of Contents

Plan category	(A) Number of Securities to be Issued Upon Exercise of Outstanding Options	(B) Weighted-Average Exercise Price of Outstanding Options	(C) Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (A))
Equity compensation plans approved by stockholders:			
Stock option plans	3,024,410	$13.95	1,856,267
Sub-total	3,024,410	$13.95	1,856,267
Equity compensation plans not approved by stockholders	N/A	N/A	N/A
Total	3,024,410	$13.95	1,856,267

(a) The 1997 Plan expired on January 21, 2007, of the 1,856,267 options available for future issuance at December 31, 2006, 1,170,000 options were granted before expiration of the 1997 plan.

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

BUSINESS TRANSACTIONS BETWEEN FIRSTBANK OR ITS SUBSIDIARIES AND EXECUTIVE OFFICERS OR DIRECTORS

The Corporation reviews all transactions and relationships in which the Corporation and its directors and executive officers or their immediate family members are participants to determine whether such persons have a direct or indirect material interest. In addition, the Corporation s Corporate Governance Standards and Code of Ethics for Senior Financial Officers require our directors, executive officers and principal financial officers to report to the Board or the Audit Committee any situation that could be perceived as a conflict of interest. In addition, applicable law and

regulations require that all loans or extensions of credit to executive officers and directors must be made in the ordinary course of business on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons (unless the loan or extension of credit is made under a benefit program generally available to all employees and does not give preference to any insider over any other employee) and must not involve more than the normal risk of repayment or present other unfavorable features. All loans to directors, executive officers and their related interest are required to be approved by the Board where the aggregate amount loaned exceeds the greater of $25,000 or 5% of FirstBank s unimpaired surplus. Loans and aggregate loans of $500,000 or greater are also reviewed and approved by the Board, pursuant to Regulation O of the Federal Reserve Board.

During fiscal year 2006, directors and officers and persons or entities related to such directors and officers were customers of and had transactions with the Corporation and/or its subsidiaries. All such transactions, except for the ones set forth below, were made in the ordinary course of business on substantially the same terms, including interest rates and collateral, as those prevailing at the time they were made for comparable transactions with other persons who are not insiders, and did not either involve more than the normal risk of uncollectibility or present other unfavorable features:

Lawrence Odell is a partner at Martínez Odell & Calabria (the Law Firm). During 2006, the Corporation entered into a Services Agreement, approved by the Board, see Exhibit 10.4 and 10.5 to the 2006 Form 10-K, with the Law Firm effective as of February 15, 2006 and amended on February 24, 2006 pursuant to which it agreed to pay to the Law Firm $60,000 per month, except for the payment to be made in February 2006 which was for $30,000, as consideration for the services rendered to the Corporation by Lawrence Odell. The Services Agreement has a term of four years unless earlier terminated. The Corporation has also hired the Law Firm to be the corporate and regulatory counsel to it and FirstBank. In 2006, the Corporation paid $1,242,823 to the Law Firm for its legal services and $630,000 to the Law Firm in accordance with the terms of the Services Agreement.

Fernando Scherrer was the Managing Partner and Head of Audit and Consulting Practices of Scherrer Hernández & Co. (Scherrer Hernández) until July 23, 2006. During fiscal year 2006 through July 24, 2006, Scherrer Hernández provided accounting services to the Corporation in the aggregate amount of $502,972.

Information about the directors independence is incorporated by reference from Item 11, Corporate Governance and Related Matters- Independence of the Board of Directors .

Item 14. Principal Accountant Fees and Services.

Total fees paid to the external auditors for the years ended December 31, 2005 and 2006, were $7,603,198 and $1,453,000 respectively, distributed as follows:

Audit Fees: $7,579,428 in 2005 for the audit of financial statements and internal control over financial reporting and the internal investigation and restatement of the 2004 financial statements, of which $5,361,404 relates to the internal investigation and restatement of the Corporation s 2004 Amended Annual Report restating years 2000-2004 and $2,239,524 relates to the audit of the Corporation s financial statements for the year ended December 31, 2005; and $1,362,500 in 2006 for the audit of financial statements and internal control over financial reporting for the year ended December 31, 2006.

Audit-Related Fees: $21,500 in 2005 and $87,500 in 2006 audit-related fees, which consisted mainly of the audits of employee benefit plans.

Tax Fees: none in 2005 and none in 2006.

Other Fees: $2,270 in 2005 and $3,000 in 2006 related to fees paid for access to an accounting and auditing electronic library.

Table of Contents

The Audit Committee has established controls and procedures that require the pre-approval of all audit, audit-related and permissible non-audit services provided by the independent auditor in order to ensure that the rendering of such services does not impair the auditor s independence. The Audit Committee may delegate to one or more of its members the authority to pre-approve any audit, audit-related or permissible non-audit services, and the member to whom such delegation was made must report any pre-approval decisions at the next scheduled meeting of the Audit Committee. Under the pre-approval policy, audit services for the Corporation are negotiated annually. In the event that any additional audit services not included in the annual negotiation, audit-related or permissible non-audit services are required by the Corporation, an amendment to the existing engagement letter or an additional proposed engagement letter should be obtained from the independent registered public accounting firm and evaluated by the Audit Committee or the member(s) of the Audit Committee with authority to pre-approve such services.

Table of Contents

PART IV

Item 15. Exhibits, Financial Statement Schedules

(a)(1) The following financial statements are included in Item 8:

- Report of Independent Registered Public Accounting Firm

- Consolidated Statements of Financial Condition as of December 31, 2006 and 2005.

- Consolidated Statements of Income for Each of the Three Years in the Period Ended December 31, 2006.

- Consolidated Statements of Changes in Stockholders Equity for Each of the Three Years in the Period Ended December 31, 2006.

- Consolidated Statements of Comprehensive Income for each of the Three Years in the Period Ended December 31, 2006.

- Consolidated Statements of Cash Flows for Each of the Three Years in the Period Ended December 31, 2006.

- Notes to the Consolidated Financial Statements.

(a)(2) Financial statement schedules.

None.

(a)(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	Certificate of Incorporation(1)
3.2	By-Laws(1)
4.0	Form of Common Stock Certificate(1)
10.1	FirstBank s 1987 Stock Option Plan(2)
10.2	FirstBank s 1997 Stock Option Plan(2)
14.1	Code of Ethics for Senior Financial Officers(3)
14.2	Code of Ethics applicable to all employees(3)
14.3	Policy Statement and Standards of Conduct for Members of Board of Directors, Executive Officers and Principal Shareholders(3)
14.4	Independence Principles for Directors of First BanCorp
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

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

(2) Incorporated by reference from the Form 10-K for the year ended December 31, 1998 filed by the Corporation on March 26, 1999.

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

Table of Contents

SIGNATURES

Pursuant to the requirements of Section 13 or 15 (d) of the Securities Exchange Act of 1934 the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

FIRST BANCORP.

By: /s/ Luis M. Beauchamp   Date: 7/05/07

Luis M. Beauchamp
Chairman 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/ Luis M. Beauchamp   Date: 7/05/07

Luis M. Beauchamp
Chairman
President and Chief Executive
Officer

/s/ Aurelio Alemán   Date: 7/05/07

Aurelio Alemán
Senior Executive Vice President
and
Chief Operating Officer

/s/ Fernando Scherrer   Date: 7/05/07

Fernando Scherrer, CPA
Executive Vice President and
Chief Financial Officer

/s/ Fernando Rodríguez-Amaro   Date: 7/05/07

Fernando Rodríguez Amaro,
Director

/s/ Richard Reiss-Huyke   Date: 7/05/07

Richard Reiss-Huyke, Director

/s/ Jorge L. Díaz   Date: 7/05/07

Jorge L. Díaz, Director

/s/ Sharee Ann Umpierre-Catinchi   Date: 7/05/07

Sharee Ann Umpierre-Catinchi,
Director

/s/ José Teixidor Date: 7/05/07

José Teixidor, Director

/s/ José L. Ferrer-Canals Date: 7/05/07

José L. Ferrer-Canals, Director

/s/ José Menéndez-Cortada Date: 7/05/07

José Menéndez-Cortada, Lead
Director

/s/ Pedro Romero Date: 7/05/07

Pedro Romero, CPA
Senior Vice President and
Chief Accounting Officer

Table of Contents

TABLE OF CONTENTS

First BanCorp Index to Consolidated Financial Statements	
Management s Report on Internal Control over Financial Reporting	1
Report of Independent Registered Public Accounting Firm	2
Consolidated Statements of Financial Condition	3
Consolidated Statements of Income	4
Consolidated Statements of Cash Flows	5
Consolidated Statements of Changes in Stockholders Equity	6
Consolidated Statements of Comprehensive Income	7
Notes of Consolidated Financial Statements	8

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.

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, 2006. 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, 2006.

The Corporation s independent registered public accounting firm, PricewaterhouseCoopers, LLP, has audited management s assessment of the effectiveness of the Corporation s internal control over financial reporting as of December 31, 2006 as stated in their report dated July 5, 2007.

/s/ Luis Beauchamp
Luis Beauchamp
Chairman of the Board, President
and Chief Executive Officer

/s/ Fernando Scherrer
Fernando Scherrer
Senior Executive Vice President
and Chief Financial Officer

Table of Contents

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

We have completed integrated audits of First BanCorp s consolidated financial statements and of its internal control over financial reporting as of December 31, 2006, in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

Consolidated financial statements

In our opinion, the accompanying consolidated statements of financial condition and the related consolidated statements of income, comprehensive 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, 2006 and 2005, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2006 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Corporation s management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes 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. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1 to the consolidated financial statements, the Corporation changed the manner in which it accounts for share-based compensation in 2006.

As discussed in Note 1 to the consolidated financial statements, the Corporation has restated its 2005 and 2004 consolidated statements of cash flows.

Internal control over financial reporting

Also, in our opinion, management s assessment, included in Management s Report on Internal Control Over Financial Reporting, that the Corporation maintained effective internal control over financial reporting as of December 31, 2006 based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control Integrated Framework* issued by the COSO. The Corporation s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management s assessment and on the effectiveness of the Corporation s internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management s assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

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. 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
July 5, 2007
CERTIFIED PUBLIC ACCOUNTANTS
(OF PUERTO RICO)
License No. 216 Expires Dec. 1, 2007
Stamp 2213236 of the P.R. Society of
Certified Public Accountants has been
affixed to the file copy of this report

F-2

FIRST BANCORP
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

	December 31, 2006	December 31, 2005
Assets		
Cash and due from banks	$ 112,340,615	$ 155,848,810
Money market instruments, including, for 2005, $381,848,364 of collateral that can be repledged	377,296,017	666,856,432
Federal funds sold and securities purchased under agreements to resell	42,051,281	508,967,369
Time deposits with other financial institutions	37,123,111	48,967,475
Total money market investments	456,470,409	1,224,791,276
Investment securities available-for-sale, at fair value:		
Securities pledged that can be repledged	1,373,466,630	1,744,846,054
Other investment securities	326,956,340	203,331,449
Total investment securities available-for-sale	1,700,422,970	1,948,177,503
Investment securities held-to-maturity, at amortized cost:		
Securities pledged that can be repledged	2,661,088,022	3,115,260,660
Other investment securities	686,042,717	323,327,297
Total investment securities held-to-maturity, fair value $3,256,965,610 (2005 - $3,336,558,646)	3,347,130,739	3,438,587,957
Other equity securities	40,159,185	42,367,500
Loans, net of allowance for loan and lease losses of $158,295,662 (2005 - $147,998,733)	11,070,446,401	12,436,257,993
Loans held for sale, at lower of cost or market	35,238,127	101,672,531
Total loans, net	11,105,684,528	12,537,930,524
Premises and equipment, net	155,661,727	116,947,772
Other real estate owned	2,869,713	5,019,106
Accrued interest receivable on loans and investments	112,505,003	103,692,478
Due from customers on acceptances	149,716	353,864
Other assets	356,861,273	343,933,937
Total assets	$ 17,390,255,878	$ 19,917,650,727

Liabilities & Stockholders Equity

Liabilities:				
Non-interest bearing deposits	$	790,985,153	$	811,006,126
Interest-bearing deposits		10,213,302,047		11,652,746,080
Federal funds purchased and securities sold under agreements to repurchase		3,687,724,000		4,833,882,000
Advances from the Federal Home Loan Bank (FHLB)		560,000,000		506,000,000
Notes payable		182,827,572		178,693,249
Other borrowings		231,719,406		231,622,020
Bank acceptances outstanding		149,716		353,864
Accounts payable and other liabilities		493,994,798		505,506,453
		16,160,702,692		18,719,809,792
Commitments and contingencies (Note 29 and 32)				
Stockholders equity:				
Preferred stock, authorized 50,000,000 shares; issued and outstanding 22,004,000 shares at $25 liquidation value per share		550,100,000		550,100,000
Common stock, $1 par value, authorized 250,000,000 shares; issued 93,151,856 shares (2005 - 90,772,856 shares)		93,151,856		90,772,856
Less: Treasury Stock (at par value)		(9,897,800)		(9,897,800)
Common stock outstanding		83,254,056		80,875,056
Additional paid-in capital		22,756,994		
Legal surplus		276,847,825		265,844,192
Retained earnings		326,761,462		316,696,971
Accumulated other comprehensive loss, net of tax of $221,389 (2005 - $16,259)		(30,167,151)		(15,675,284)
		1,229,553,186		1,197,840,935
Total liabilities and stockholders equity	$	17,390,255,878	$	19,917,650,727

The accompanying notes are an integral part of these statements.

Table of Contents

FIRST BANCORP
CONSOLIDATED STATEMENTS OF INCOME

	Year ended December 31,		
	2006	**2005**	**2004**
Interest income:			
Loans	$ 936,051,816	$ 772,099,930	$ 458,180,082
Investment securities	281,846,817	273,603,902	228,417,189
Money market investments	70,914,409	21,886,150	3,736,452
Total interest income	1,288,813,042	1,067,589,982	690,333,723
Interest expense:			
Deposits	605,033,331	393,151,942	119,843,691
Federal funds purchased and repurchase agreements	195,327,443	179,124,075	129,572,722
Advances from FHLB	13,703,933	32,756,084	27,668,471
Notes payable and other borrowings	31,054,377	30,238,672	15,767,897
Total interest expense	845,119,084	635,270,773	292,852,781
Net interest income	443,693,958	432,319,209	397,480,942
Provision for loan and lease losses	74,991,171	50,644,344	52,799,550
Net interest income after provision for loan and lease losses	368,702,787	381,674,865	344,681,392
Non-interest income:			
Other service charges on loans	5,944,913	5,430,713	3,910,483
Service charges on deposit accounts	12,591,257	11,796,185	10,937,998
Mortgage banking activities	2,258,940	3,798,145	3,921,135
Net loss on partial extinguishment of secured commercial loan to local financial institution	(10,640,344)		
Net (loss) gain on investments and impairments	(8,193,859)	12,338,969	9,457,190
Rental income	3,264,097	3,462,504	3,070,697
Gain on sale of credit card portfolio	500,000		5,532,684
Other non-interest income	25,611,064	26,250,063	22,793,769
Total non-interest income	31,336,068	63,076,579	59,623,956
Non-interest expenses:			
Employees compensation and benefits	127,523,015	102,077,927	82,439,613
Occupancy and equipment	54,439,927	47,582,007	39,430,288
Business promotion	17,672,482	18,717,468	16,348,849
Professional fees	32,095,277	13,387,333	4,165,093
Taxes, other than income taxes	12,427,916	9,809,320	8,467,962
Insurance and supervisory fees	7,066,522	5,509,429	4,125,835
Provision for contingencies		82,750,000	
Other operating expenses	36,737,539	35,298,372	25,502,068

Total non-interest expenses	287,962,678	315,131,856	180,479,708
Income before income tax provision	112,076,177	129,619,588	223,825,640
Income tax provision	27,441,917	15,015,504	46,500,247
Net income	**$ 84,634,260**	**$ 114,604,084**	**$ 177,325,393**
Dividends to preferred stockholders	40,275,996	40,275,996	40,275,996
Net income available to common stockholders	**$ 44,358,264**	**$ 74,328,088**	**$ 137,049,397**
Net income per common share basic:			
Earnings per common share basic	**$ 0.54**	**$ 0.92**	**$ 1.70**
Net income per common share diluted:			
Earnings per common share diluted	**$ 0.53**	**$ 0.90**	**$ 1.65**
Dividends declared per common share	**$ 0.28**	**$ 0.28**	**$ 0.24**

The accompanying notes are an integral part of these statements.

Table of Contents

FIRST BANCORP
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year ended December 31,		
	2006	2005 (Restated)	2004 (Restated)
Cash flows from operating activities:			
Net income	$ 84,634,260	$ 114,604,084	$ 177,325,393
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	16,810,013	15,412,284	13,939,369
Amortization of core deposit intangibles	3,384,668	3,709,074	2,396,620
Provision for loan and lease losses	74,991,171	50,644,344	52,799,550
Stock-based compensation expense	5,379,510		
Deferred income tax benefit	(31,714,942)	(60,222,881)	(6,508,814)
Gain on sale of investments, net	(7,057,529)	(20,712,604)	(12,156,182)
Other-than-temporary impairments on available-for-sale securities	15,251,388	8,373,635	2,698,992
Unrealized derivative and hedging activities loss (gain)	61,819,516	73,442,943	(15,528,996)
Net gain on sale of loans, net of impairment	(1,689,813)	(3,270,150)	(3,594,875)
Net loss on partial extinguishment of secured commercial loan to local financial institution	10,640,344		
Net amortization of premium and discount and deferred loan fees and cost	(2,568,203)	(1,724,652)	2,305,729
Amortization of broker placement fees	19,955,018	15,123,382	13,874,998
Accretion of basis adjustments on fair value hedges	(3,625,827)		
Net accretion of (discounts) and premiums on investment securities	(35,933,299)	(30,014,251)	(34,944,447)
Amortization of discounts on subordinated notes		544,582	515,029
Gain on sale of credit card portfolio	(500,000)		(5,532,684)
(Decrease) increase in accrued income tax payable	(39,701,921)	28,362,574	(4,766,394)
Increase in accrued interest receivable	(8,812,525)	(43,996,026)	(15,400,487)
Increase in accrued interest payable	33,910,190	58,799,589	6,828,566
Decrease (increase) in other assets	12,088,549	(33,206,463)	(29,531,594)
Increase in other liabilities	14,451,464	103,543,161	14,171,817
Total adjustments	137,077,772	164,808,541	(18,433,803)
Net cash provided by operating activities	**221,712,032**	**279,412,625**	**158,891,590**
Cash flows from investing activities:			
Principal collected on loans	6,022,632,548	3,803,804,421	2,263,042,654
Loans originated	(4,718,927,534)	(6,058,105,287)	(4,979,882,612)
Purchases of loans	(168,662,085)	(454,873,010)	(199,970,917)
Proceeds from sale of loans	169,421,944	120,682,234	137,071,449
Proceeds from sale of repossessed assets	50,895,530	33,337,057	32,867,255
Purchase of servicing assets	(1,155,833)		

Proceeds from sale of available-for-sale investment securities	232,482,872	252,745,618	131,571,934
Purchases of securities held-to-maturity	(447,483,624)	(2,540,827,363)	(2,233,429,192)
Purchases of securities available-for-sale	(225,372,830)	(1,221,389,587)	(505,736,946)
Principal repayments and maturities of securities held-to-maturity	574,796,856	2,511,738,287	2,031,513,591
Principal repayments and maturities of securities available-for-sale	217,828,267	325,981,152	336,840,233
Additions to premises and equipment	(55,523,968)	(28,920,984)	(24,483,512)
Decrease (increase) in other equity securities	2,208,315	41,690,600	(35,250,000)
Cash paid for net assets acquired on acquisition of businesses		(78,404,803)	
Net cash provided by (used in) investing activities	**1,653,140,458**	**(3,292,541,665)**	**(3,045,846,063)**
Cash flows from financing activities:			
Net (decrease) increase in deposits	(1,550,713,900)	4,120,051,019	1,149,976,606
Net (decrease) increase in federal funds purchased and securities sold under repurchase agreements	(1,146,158,000)	668,521,087	525,888,563
Net FHLB advances taken (payments)	54,000,000	(1,132,000,000)	685,000,000
Net proceeds from the issuance of notes payable and other borrowings			595,778,616
Repayments of notes payable and other borrowings		(127,992,616)	(140,185,000)
Dividends	(63,566,136)	(62,914,802)	(59,593,300)
Exercise of stock options	19,756,484	2,094,354	4,956,314
Treasury stock acquired		(965,079)	
Net cash (used in) provided by financing activities	**(2,686,681,552)**	**3,466,793,963**	**2,761,821,799**
Net (decrease) increase in cash and cash equivalents	(811,829,062)	453,664,923	(125,132,674)
Cash and cash equivalents at beginning of period	1,380,640,086	926,975,163	1,052,107,837
Cash and cash equivalents at end of period	**$ 568,811,024**	**$ 1,380,640,086**	**$ 926,975,163**
Cash and cash equivalents include:			
Cash and due from banks	$ 112,340,615	$ 155,848,810	$ 6,211,372
Money market investments	456,470,409	1,224,791,276	920,763,791
Total cash and cash equivalents	**$ 568,811,024**	**$ 1,380,640,086**	**$ 926,975,163**

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,		
	2006	**2005**	**2004**
Preferred Stock:			
Balance at beginning and end of year	$ 550,100,000	$ 550,100,000	$ 550,100,000
Common stock:			
Balance at beginning of year	80,875,056	40,389,155	40,027,285
Stock options exercised (before stock split in 2005 and 2004)	2,379,000	76,373	361,870
Treasury stock acquired before June 30, 2005 stock split		(28,000)	
Shares issued as a result of stock split on June 30, 2005		40,437,528	
Balance at end of year	$ 83,254,056	$ 80,875,056	$ 40,389,155
Additional paid-in capital:			
Balance at beginning of year		4,863,299	268,855
Treasury stock acquired		(937,079)	
Stock options exercised	17,377,484	2,017,981	4,594,444
Stock-based compensation recognized	5,379,510		
Adjustment for stock split on June 30, 2005		(5,944,201)	
Balance at end of year	$ 22,756,994	$	$ 4,863,299
Capital Reserve:			
Balance at beginning of year		82,825,000	80,000,000
Transfer from retained earnings			2,825,000
Transfer to legal surplus		(82,825,000)	
Balance at end of year	$	$	$ 82,825,000
Legal surplus:			
Balance at beginning of year	265,844,192	183,019,192	165,709,122
Transfer from retained earnings	11,003,633		17,310,070
Transfer from capital reserve		82,825,000	
Balance at end of year	$ 276,847,825	$ 265,844,192	$ 183,019,192

Retained earnings:			
Balance at beginning of year	316,696,971	299,501,016	201,903,993
Net income	84,634,260	114,604,084	177,325,393
Cash dividend declared on common stock	(23,290,140)	(22,638,806)	(19,317,304)
Cash dividend declared on preferred stock	(40,275,996)	(40,275,996)	(40,275,996)
Adjustment for stock split on June 30, 2005		(34,493,327)	
Transfer to capital reserve			(2,825,000)
Transfer to legal surplus	(11,003,633)		(17,310,070)
Balance at end of year	$ 326,761,462	$ 316,696,971	$ 299,501,016
Accumulated other comprehensive (loss) income, net of tax:			
Balance at beginning of year	(15,675,284)	43,635,624	35,812,500
Other comprehensive (loss) income, net of deferred tax	(14,491,867)	(59,310,908)	7,823,124
Balance at end of year	$ (30,167,151)	$ (15,675,284)	$ 43,635,624
Total stockholders equity	$ 1,229,553,186	$ 1,197,840,935	$ 1,204,333,286

The accompanying notes are an integral part of these statements.

F-6

Table of Contents

FIRST BANCORP
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Year ended December 31,		
	2006	**2005**	**2004**
Net income	$ 84,634,260	$ 114,604,084	$ 177,325,393
Other comprehensive income:			
Unrealized (losses) gains on securities:			
Unrealized holding (losses) gains arising during the period	(22,890,856)	(47,839,301)	17,561,629
Less: Reclassification adjustment for net losses (gains) and other-than-temporary impairments included in net income	8,193,859	(12,382,262)	(9,457,190)
Income tax benefit (expense) related to items of other comprehensive income	205,130	910,655	(281,315)
Other comprehensive (loss) income for the period, net of tax	(14,491,867)	(59,310,908)	7,823,124
Total comprehensive income	$ 70,142,393	$ 55,293,176	$ 185,148,517

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) and with prevailing practices within the financial services industry. 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 bank 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 US and British Virgin Islands.

The Corporation provides a wide range of financial services for retail, commercial and institutional clients. As of December 31, 2006, the Corporation controlled four wholly-owned subsidiaries: FirstBank Puerto Rico (FirstBank or the Bank), FirstBank Insurance Agency, Inc., Grupo Empresas de Servicios Financieros (d/b/a PR Finance Group) and Ponce General Corporation, Inc. (Ponce General). FirstBank is a Puerto Rico-chartered commercial bank, FirstBank Insurance Agency is a Puerto Rico-chartered insurance agency, PR Finance Group is a domestic corporation and Ponce General is the holding company of a federally chartered stock savings association, FirstBank Florida. 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 and the Federal Deposit Insurance Corporation (the FDIC). Deposits are insured through the FDIC Deposit Insurance Fund. Within FirstBank, there are two separately regulated businesses: (1) the Virgin Islands operations; and (2) the Miami loan agency. The U.S. Virgin Islands operations of FirstBank are subject to regulation and examination by the United States Virgin Islands Banking Board, and the British Virgin Islands operations are subject to regulation by the British Virgin Islands Financial Services Commission. FirstBank s loan agency in the State of Florida is regulated by the Office of Financial Regulation of the State of Florida, the Federal Reserve Bank of Atlanta and the Federal Reserve Bank of New York.

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 Office of the Commissioner of Financial Institutions of the Commonwealth of Puerto Rico. FirstBank Florida is subject to the supervision, examination and regulation of the Office of Thrift Supervision (the OTS).

As of December 31, 2006, FirstBank conducted its business through its main offices located in San Juan, Puerto Rico, forty-eight full service banking branches in Puerto Rico, fourteen branches in the United States Virgin Islands (USVI) and British Virgin Islands (BVI) and a loan agency in Coral Gables, Florida (USA). FirstBank had four wholly-owned subsidiaries with operations in Puerto Rico: First Leasing and Rental Corporation, a vehicle leasing and daily rental company with eight offices in Puerto Rico; First Federal Finance Corp. (d/b/a Money Express La Financiera), a finance company with thirty-nine offices in Puerto Rico; FirstMortgage, Inc., a residential mortgage loan origination company with thirty five offices in FirstBank branches and at stand alone sites; and FirstBank Overseas Corporation, an international banking entity organized under the International Banking Entity Act of Puerto Rico. FirstBank had two subsidiaries with operations outside of Puerto Rico; First Insurance Agency VI, Inc., an insurance agency with four offices that sell insurance products in the USVI and First Express, a small loans company with four offices in the USVI.

Business combinations

On March 31, 2005, the Corporation completed the acquisition of 100% of the outstanding common shares of Ponce General Corporation, the holding company of FirstBank Florida (formerly known as Unibank), a thrift subsidiary, and Ponce Realty, with a total of eleven financial service facilities in the State of Florida. The purpose of the acquisition was to build a platform in Florida from which to initiate further expansion into the United States. As of the acquisition date, excluding the effect of purchase accounting entries, Ponce General had approximately $546.2 million in assets, $476.0 million in loans composed mainly of residential and commercial mortgage loans amounting to approximately $425.8 million, commercial and construction loans amounting to approximately $28.2 million,

consumer loans amounting to approximately $22.1 million and $439.1 million in deposits. The consideration consisted mainly of payments made to principal and minority shareholders of Ponce General s outstanding common stock at acquisition date. This consideration along with other direct acquisition costs and

F-8

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liabilities incurred led to a total acquisition cost of approximately $101.9 million. The purchase price resulted in a premium of approximately $36 million that was mainly allocated to core deposit intangibles and goodwill.

FirstBank Florida is a federally chartered stock savings association which is headquartered in Miami, Florida (USA) and currently is the only operating subsidiary of Ponce General. FirstBank Florida provides a wide range of banking services to individual and corporate customers through its eight branches in Florida (USA).

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 the provisions of Financial Interpretation No. 46R (FIN 46R). Consolidation of Variable Interest Entities an Interpretation of ARB No. 51 .

Reclassifications

For purposes of comparability, certain prior period amounts have been reclassified to conform to the 2006 presentation.

Use of estimates in the preparation of financial statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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.

Stock split

All references to the numbers of common shares and per share amounts in the financial statements and notes to the financial statements, except for the number of shares issued, outstanding and held in treasury as of December 31, 2004 presented in the consolidated statements of changes in stockholders equity, have been restated to reflect the June 30, 2005 two-for-one common stock split.

Cash and cash equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks and short-term money market instruments 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.

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, 2006 and 2005, 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.

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 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 gain (loss) on investments. Purchases and sales of securities are recognized on a trade-date basis.

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

The Corporation evaluates for impairment its debt and equity securities when their fair market value has remained below cost for six months or more, or earlier if other factors indicative of potential impairment exist. Investments are considered to be impaired when their cost exceeds fair market value.

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 the fixed income investments places special emphasis on the analysis of the cash position of the issuer, its cash and capital generation capacity, which could increase or diminish the issuer s ability to repay its bond obligations. The Corporation also considers its intent and ability to hold the fixed income securities until recovery. If management believes, based on the analysis, that the issuer will not be able to service its debt and pay its obligations in a timely manner, the security is written down to management s estimate of net realizable value. For securities written down to their estimated net realizable value, any accrued and uncollected interest is also reversed. Interest income is then recognized when collected.

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, 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 months or more.

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, 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. This policy is also applied to all impaired loans based upon an evaluation of the risk characteristics of said loans, loss experience, economic conditions and other pertinent factors. Loan and lease losses are charged and recoveries are credited to the allowance for loan and lease losses. Closed-end

consumer loans and leases are charged-off when payments are 120 days in arrears. Open-end (revolving credit) consumer loans are charged-off when payments are 180 days in arrears.

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. As of December 31, 2006, the aggregate fair value of loans held for sale exceeded their cost.

Allowance for loan and lease losses

The Corporation follows a systematic methodology to establish and evaluate the adequacy of the allowance for loan and lease losses to provide for inherent losses in the loan portfolio. This methodology includes the consideration of factors such as current economic conditions, portfolio risk characteristics, prior loss experience and results of periodic credit reviews of individual loans. The provision for loan and lease losses charged to current operations is based on such methodology. Loan losses are charged and recoveries are credited to the allowance for loan and lease losses.

The methodology used to establish the allowance for loan and lease losses is based on Statement of Financial Accounting Standard (SFAS) No. 114, Accounting by Creditors for Impairment of a Loan (as amended by SFAS No. 118), and SFAS No. 5, Accounting for Contingencies. Under SFAS No. 114, commercial loans over a predefined amount are identified for impairment evaluation on an individual basis.

The Corporation has defined impaired loans as loans with interest and/or principal past due 90 days or more and other specific loans for which, based on current information and events, it is probable that the debtor will be unable to pay all amounts due according to the contractual terms of the loan agreement. The Corporation measures impairment individually for those commercial, real estate and construction loans with a principal balance exceeding $1 million. An allowance for impaired loans is established based on the present value of expected future cash flows or the fair value of the collateral, if the loan is collateral dependent. Groups of small balance, homogeneous loans are collectively evaluated for impairment considering among other factors, historical charge-off experience, existing economic conditions and risk characteristics relevant to the particular loan category. The portfolios of residential mortgage loans, consumer loans, auto loans and finance leases are individually considered homogeneous and each portfolio is evaluated collectively for impairment.

Under SFAS No. 5, the allowance for loan and lease losses calculation for the Corporation is mainly based on historical net charge-off experience by loan type as adjusted for economic conditions.

Cash payments received on impaired loans are recorded in accordance with the contractual terms of the loan. The principal portion of the payment is used to reduce the principal balance of the loan, whereas the interest portion is recognized as interest income. However, when management believes the ultimate collectibility of principal is in doubt, the interest portion is applied to principal.

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. SFAS No. 140, Accounting for Transfer and Servicing of Financial Assets and Liabilities a Replacement of SFAS No. 125 , sets forth the criteria that must be met for control over transferred assets to be considered to have been surrendered, which 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 SFAS No. 140 criteria, the Corporation is prevented from derecognizing the transferred financial assets and the transaction is accounted for as a secured borrowing.

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, which 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 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.

Servicing assets

The Corporation recognizes as separate assets the rights to service loans for others, whether those servicing assets are originated or purchased. The total cost of the loans to be sold with servicing assets retained is allocated to the servicing assets and the loans (without the servicing asset) based on their relative fair values. Servicing assets are amortized in proportion to and over the period of estimated net servicing income. Loan servicing fees, which are based on a percentage of the principal balances of the loans serviced, are credited to income as loan payments are collected.

To estimate the fair value of servicing assets, the Corporation considers the present value of expected future cash flows associated with the servicing assets. For purposes of measuring impairment of servicing assets, the Corporation stratifies such assets based on the predominant risk characteristics of the underlying loans such as region, terms and coupon. Temporary impairment is recognized through a valuation allowance with changes included in net income for the period in which the change occurs. If it is later determined that all or a portion of the temporary impairment has been recovered for a particular tranche, the valuation allowance is reduced through a recovery of income. Any fair value increase in excess of the cost basis of the servicing asset for a given stratum is not recognized.

Servicing rights are also reviewed for other-than-temporary impairment. When the recoverability of an impaired servicing asset is determined to be remote, the unrecoverable portion of the valuation allowance is applied as a direct write-down to the carrying value of the servicing rights, precluding subsequent recoveries.

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:

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.

Goodwill and other indefinite life intangibles are not amortized but are reviewed periodically for impairment at least annually.

The Corporation performed impairment tests for the years ended December 31, 2006, 2005 and 2004 and determined that no impairment was needed to be recognized for those periods for goodwill and 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.

Table of Contents

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 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.

The Corporation adopted Financial Accounting Standards Board Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (FIN 48) effective January 1, 2007. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with SFAS 109. This Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This Interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The cumulative effect of adoption of FIN 48 resulted in an increase of $2.6 million to tax reserves with offsetting adjustments to retained earnings. Additionally, in connection with the adoption of FIN 48, the Corporation elected to classify interest and penalties related to unrecognized tax portions as components of income tax expense.

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

The Corporation has a stock-based employee compensation plan, which is described more fully in Note 20. On January 1, 2006, the Corporation adopted SFAS 123 (Revised), *Accounting for Stock-Based Compensation* (SFAS 123R), using the modified prospective method. Under this method and since all previously issued stock options were fully vested at the time of adoption, the Corporation expenses the fair value of all employee stock options granted after January 1, 2006 (which is the same as under the prospective method). Prior to adoption, the Corporation accounted for the plan under the recognition and measurement principles of Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, and related Interpretations where no stock-based employee compensation cost was reflected in net income, as all options granted under the plan had an exercise price equal to the market value of the underlying common stock on the date of the grant. Options granted are not subject to vesting requirements. The Compensation expense associated with expensing stock options for 2006 was approximately $5.4 million. The proforma effect information for the years 2005 and 2004 are presented in Note 20 to the consolidated financial statements.

Comprehensive income

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

Derivative financial instruments

As part of the Corporation s overall interest rate risk management, the Corporation utilizes derivatives instruments, including interest rate swaps, interest rate caps and options to manage interest rate risk. In accordance with SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS 133), 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 change in fair value on 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. Similarly, the changes in the fair value of standalone derivative instruments or derivatives not qualifying or designated for hedge accounting under SFAS 133 are reported in current-period earnings. Changes in the fair value of a derivative instrument that is highly effective and that is designated and qualifies as a cash-flow hedge 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).

Prior to entering a 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 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 recognizes unrealized gains and losses arising from any changes in fair value of derivative instruments and hedged items, as applicable, as interest income or interest expense depending upon whether an asset or liability is being hedged.

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 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. Information regarding derivative instruments is included in Note 30 to the Corporation s audited financial statements.

Effective April 3, 2006, the Corporation adopted the long-haul method of effectiveness testing under SFAS 133, for substantially all of the interest rate swaps that hedge its brokered CDs and medium-term notes. The long-haul method requires periodic assessment of hedge effectiveness and measurement of ineffectiveness. The ineffectiveness results to the extent the changes in the fair value of the derivative do not offset changes in the fair value of the debt due to changes in the hedged risk in the Consolidated Statements of Income. Prospectively, changes in the value of the Corporation s brokered CDs and medium-term notes should substantially offset the changes in the value of the interest rate swaps.

First BanCorp s implementation of the long-haul method resulted from its previously reported determination that it should not have used the short-cut method to account for interest rate swaps related to brokered CDs and medium-term notes because of technical issues involving the interpretation of the use of the method (refer to First BanCorp audited Consolidated Financial Statements, included in the Corporation s amended 2004 Annual Report on Form 10-K for additional information). Accordingly, prior to the implementation of the long-haul method, First BanCorp has reflected changes in the fair value of those swaps as well as swaps related to certain loans as non-hedging instruments through operations.

Upon the implementation of the long-haul method with respect to the brokered CDs and medium-term notes (hedged liabilities) on April 3, 2006, the Corporation has been accreting or amortizing the difference between the market value and the book value of the hedged liabilities on April 3, 2006 of approximately $200.0 million as a yield adjustment over the remaining term of the hedged liabilities, as the changes in value since the inception of the long-haul method are recorded to the hedged liabilities. For the year ended December 31, 2006, the Corporation recorded an accretion of $3.6 million as a basis adjustment on the hedged liabilities.

Effective January 1, 2007, the Corporation elected to early adopt Statement of Financial Accounting Standard No. 157, Fair Value Measurements (SFAS 157) and Statement of Financial Accounting Standard No. 159, The Fair

Value Option for Financial Assets and Financial Liabilities (SFAS 159). Following the initial fair value measurement date, ongoing unrealized gains and losses on items for which fair value reporting has been elected are reported in earnings at each subsequent financial reporting date.

The Corporation decided to early adopt SFAS No. 159 for the callable brokered CDs and a portion of the callable fixed medium-term notes (Notes) that were hedged with interest rate swaps. First BanCorp had been following the long-haul method of accounting, which was adopted on April 3, 2006, under SFAS 133 for the portfolio of callable interest rate swaps, callable brokered CDs and callable notes. One of the main considerations in determining to early adopt SFAS 159 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 procedures followed by the Corporation to fulfill the requirements specified by SFAS 133.

Upon adoption of SFAS 159, First BanCorp selected the fair value measurement for approximately $4.4 billion, or 63%, of the brokered CDs portfolio and approximately $29 million, or 16%, of the medium-term notes portfolio (designated liabilities). Interest rate risk on the brokered CDs and medium-term notes chosen for the fair value measurement option will continue to be hedged through callable interest rate swaps with the same terms and conditions. The cumulative after-tax effect on the opening balance of retained earnings from adopting these standards is an approximate increase of $92.2 million. Under SFAS 159, this one-time charge was not recognized in current earnings.

With the elimination of the use of the long-haul method in connection with the adoption of SFAS 159 as of January 1, 2007, the Corporation will no longer amortize or accrete the basis adjustment. The basis adjustment amortization is the reversal of the change in value of the 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 has recognized the basis adjustment and the changes in the value of the brokered CDs and medium-term notes based on the expected call date of the instruments. The adoption of SFAS 159 also requires the recognition to retained earnings as part of the adoption adjustment of all of the unamortized placement fees that were paid to broker counterparties upon the issuance of the brokered CDs and medium-term notes. The Corporation previously amortized those fees through earnings based on the expected call date of the instruments. The impact of the derecognition of the basis adjustment and the unamortized placement fees as of January 1, 2007 results in a cumulative after-tax reduction to retained earnings of approximately $23.8 million. This negative charge is included in the total cumulative after-tax increase to retained earnings of $92.2 million that results with the adoption of SFAS 157 and SFAS 159.

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 for the commissions which 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 available 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. Stock options outstanding under the Corporation s stock option plan are considered in earnings per share-diluted by the application of the treasury stock method, which assumes that the proceeds for the exercise of options are used to repurchase common stock in the open market. Anti-dilutive stock options are excluded from the computation. The computation of earnings per share considers any stock splits or stock dividends and these are retroactively recognized in all periods presented in the financial statements.

Restatement of 2005 and 2004 Consolidated Statements of Cash Flows

During the preparation of the 2006 consolidated financial statements, management became aware of some incorrect classifications in the Consolidated Statements of Cash Flows for the years ended December 31, 2005 and 2004. The classification errors related to three main items: 1) the treatment of discounts and the related accretion activity on certain investment securities (mostly zero coupon securities) purchased by the Corporation which were incorrectly presented as cash flows related to investing activities (principal repayments and maturities of securities held-to-maturity), instead of operating activities (net amortization or accretion of discounts and premiums on

investment securities), 2) the classification of cash flows from the disposition of repossessed assets which was included as part of operating activities (decrease or increase in other assets), instead of investing activities (proceeds from sale of repossessed assets), for the same periods, and 3) purchases of zero coupon bonds and agency discount notes amounts presented as part of investing activities (purchases of securities held-to-maturity)were reported at par amount rather than the actual cash paid for the securities and the discounts on such securities were being presented as investing activities (principal repayments and maturities of securities held-to-maturity) rather than being excluded from the Cash Flow Statements.

Table of Contents

The cash flows related to the accretion of discount on certain investment securities have been properly classified as cash flows from operating activities and the cash flows from the disposition of repossessed assets have been properly classified as cash flows from investing activities in the restated Consolidated Statements of Cash Flows for the years ended December 31, 2005 and 2004. The amounts presented as purchases, principal repayments and maturities of securities under cash flows from investing activities have also been corrected to reflect actual cash outflows and inflows related to zero coupon bonds and discounts notes. In addition, the Corporation has corrected the classification of other items (see footnotes in table below) as well as the 2005 and 2004 amounts of cash paid for interest (to exclude non cash valuations and net settlements on derivatives) and additions to auto repossessions (to include amounts inadvertently excluded in 2005), included in note 28 Supplemental Cash Flow Information to the 2006 consolidated financial statements.

These corrections impacted solely the classification of the aforementioned activities and the cash flows from operating and investing activities presented in the Consolidated Statements of Cash Flows for the years ended December 31, 2005 and 2004. However, the changes made did not impact the net increase (decrease) in the total Cash and cash equivalents set forth in the Consolidated Statements of Cash Flows for any of the previously reported periods. Furthermore, the correction has no effect in the Corporation s Consolidated Statements of Income (including but not limited to net income and earnings per share), Consolidated Statements of Financial Condition or Consolidated Statement of Changes in Stockholder s Equity.

The following comparative table presents the effects of the restatement of the Consolidated Statement of Cash Flows for 2005 and 2004:

Year Ended December 31, (in thousands)	**2005**		**2004**	
	As Previously reported	**Restated**	**As Previously reported**	**Restated**
Cash flows from operating activities:				
Net income	$ 114,604	$ 114,604	$ 177,325	$ 177,325
Net gain on sale of loans, net of impairment (1)	(3,636)	(3,270)	(3,595)	(3,595)
Net amortization of premiums and discounts and deferred loan fees and cost (1)	389	(1,725)	(1,511)	2,306
Net amortization or accretion of (discounts) and premiums on investment securities (2)	14,520	(30,014)	15,090	(34,944)
Increase in accrued interest payable (3)	77,494	58,800	14,588	6,829
Decrease (increase) in other assets (2)	5,662	(33,206)	7,375	(29,532)
Increase in other liabilities (3)	87,255	103,543	4,869	14,172
Total adjustments to reconcile net income to net cash provided by operating activities	252,364	164,808	63,147	(18,434)
Net cash provided by operating activities	**366,969**	**279,413**	**240,472**	**158,891**
Cash flows from investing activities:				
Principal collected on loans (4)	3,823,228	3,803,804	2,266,860	2,263,043
Loans originated (5)	(6,088,695)	(6,058,105)	(4,985,690)	(4,979,883)
Proceeds from sale of loans (1)	122,163	120,682	138,839	137,071
Proceeds from sale of repossessed assets (2)		33,337		32,867
Purchases of securities held-to-maturity (2)	(4,757,904)	(2,540,827)	(5,996,238)	(2,233,429)

Purchases of securities available-for-sale (1)	(1,227,796)	(1,221,390)	(508,237)	(505,737)
Principal repayments and maturities of securities held-to-maturity (2)	4,690,681	2,511,738	5,744,069	2,031,513
Principal repayments and maturities of securities available-for-sale (1)	325,987	325,981	341,102	336,840
Net cash used in investing activities	**(3,380,098)**	**(3,292,542)**	**(3,127,427)**	**(3,045,846)**
Cash flows from financing activities:				
Net cash provided by financing activities	**3,466,794**	**3,466,794**	**2,761,822**	**2,761,822**
Net increase (decrease) in cash and cash equivalents	453,665	453,665	(125,133)	(125,133)
Cash and cash equivalents at beginning of period	926,975	926,975	1,052,108	1,052,108
Cash and cash equivalents at end of period	**$ 1,380,640**	**$ 1,380,640**	**$ 926,975**	**$ 926,975**
Supplemental cash flow information: (6)				
Cash paid for:				
Interest on borrowings	$ 555,870	$ 559,642	$ 278,596	$ 409,512
Non-cash investing activities:				
Additions to auto repossessions	48,967	72,891	43,787	43,787

(1) Change resulting from the correction of immaterial errors.

(2) Refer to explanation of change in the first paragraph of Restatement of 2005 and 2004 Consolidated Statements of Cash Flows above.

(3) Change resulting from reclassification to gross reporting of interest payable on interest rate swaps from line item increase (decrease) in accrued interest payable to line item increase (decrease) in other liabilities to be consistent with 2006 presentation and other immaterial correction.

(4) Change to correct for the exclusion of non-cash transactions resulting from the transfer of loans to repossessed assets.

(5) Change to correct for the exclusion of non-cash transactions resulting from the transfer of repossessed assets to commercial loans originated with floor plan dealers.

(6) Refer to explanation of change in the second paragraph of Restatement of 2005 and 2004 Consolidated Statements of Cash Flows above.

Recently issued accounting pronouncements

The Financial Accounting Standards Board (FASB), its Emerging Issues Task Force (EITF) and the SEC have issued the following accounting pronouncements and Issue discussions relevant to the Corporation s operations:

In February 2007, the FASB issued SFAS No. 159 The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115 . This Statement allows entities to choose to measure certain financial assets and liabilities at fair value with changes in fair value reflected in earnings. The fair value option may be applied on an instrument-by-instrument basis. This Statement is effective for periods after November 15, 2007 however, early adoption is permitted provided that the entity also elects to apply the provisions of SFAS 157 Fair Value Measurements . The Corporation adopted SFAS 159 effective January 1, 2007. For further details and for the effect on the Corporation s financial condition and results of operations upon adoption of SFAS 159, refer to *Derivative financial instruments* above.

Table of Contents

In September 2006, the SEC issued Staff Accounting Bulletin No. 108 Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements (SAB 108). This interpretation expresses the SEC staff s views regarding the process of quantifying financial statement misstatements that could result in improper amounts of assets or liabilities. While a misstatement may not be considered material for the period in which it occurred, it may be considered material in a subsequent year if the corporation were to correct the misstatement through current period earnings. SAB 108 requires a materiality evaluation based on all relevant quantitative and qualitative factors and the quantification of the misstatement using a balance sheet and income statement approach to determine materiality. SAB 108 is effective for periods ending after November 15, 2006. The adoption of this Statement did not have a material effect on the Corporation s financial condition and results of operations.

In September 2006, the FASB issued SFAS No. 158 Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106 and 132(R) . This Statement requires corporations to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income of a business entity or changes in unrestricted net assets of a not-for-profit organization. This Statement is effective for periods ending after December 15, 2006. This Statement is not applicable to the Corporation and therefore has no impact to the Corporation s financial condition or results of operations.

In September 2006, the FASB issued SFAS No. 157 Fair Value Measurements . This Statement defines fair value, establishes a framework for measuring fair value in GAAP and expands disclosures about fair value measurements. This Statement is effective for periods beginning after November 15, 2007. Effective January 1, 2007, the Corporation elected to early adopt this Statement. For further details and for the effect on the Corporation s financial condition and results of operations upon adoption of SFAS 157, refer to *Derivative financial instruments* above.

In June 2006, the FASB issued Financial Interpretation No. 48 Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 . This interpretation clarifies the accounting for uncertainty in income taxes recognized in accordance with SFAS 109. This interpretation provides a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. This interpretation is effective for periods beginning after December 15, 2006. The Corporation adopted FIN 48 effective January 1, 2007. The cumulative effect of adoption of FIN 48 resulted in an increase of $2.6 million to tax reserves with offsetting adjustments to retained earnings. Additionally, in connection with the adoption of FIN 48, the Corporation elected to classify interest and penalties related to unrecognized tax portions as components of income tax expense.

In March 2006, the FASB issued SFAS 156 Accounting for Servicing of Financial Assets, an amendment of SFAS No. 140. This Statement allows servicing assets and servicing liabilities to be initially measured at fair value along with any derivative instruments used to mitigate inherent risks. This Statement is effective for periods beginning after September 15, 2006. The adoption of this Statement in 2007 did not have a material effect on the Corporation s financial condition and results of operations.

In February 2006, the FASB issued SFAS 155 Accounting for Certain Hybrid Financial Instruments, an amendment of FASB Statements No. 133 and 140 . This Statement allows fair value measurement for any hybrid financial instrument that contains an embedded derivative requiring bifurcation. It also establishes a requirement to evaluate interests in securitized financial assets to establish whether the interests are freestanding derivatives or hybrid financial instruments that contain an embedded derivative requiring bifurcation. This Statement is effective for all financial instruments acquired or issued after September 15, 2006. The adoption of this Statement did not have a material effect on the Corporation s financial condition and results of operations.

In May 2005, the FASB issued SFAS 154 Accounting Changes and Error Corrections a replacement of APB Opinion No. 20 and FASB Statement No. 3 . This Statement changes the requirements for the accounting for and reporting of a voluntary change in accounting principle. This Statement requires retrospective application to prior periods financial statements of a change in accounting principle unless it is impracticable to do so; in which case the

earliest period for which retrospective application is practicable should be applied. If it is impracticable to calculate the cumulative effect of a change in accounting principle, the Statement requires prospective application as of the earliest date practicable. This Statement does not change the guidance in APB Opinion No. 20 with regard to the reporting of the correction of an error, or a change in accounting estimate. The Statement s purpose is to improve the comparability of financial information among periods. SFAS No. 154 is effective for fiscal years beginning after December 15, 2005. The adoption of this Statement did not have a material effect on the Corporation s financial condition and results of operations.

Note 2 Restrictions on Cash and Due from Banks

The Corporation s Bank subsidiary is required by law, as enforced by the Office of the Commissioner of Financial Institutions of the Commonwealth of Puerto Rico, to maintain minimum average weekly reserve balances. The amount of those average reserve balances for the week ended December 31, 2006 was $165 million (2005 $161 million). As of December 31, 2006 and 2005, 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, 2006 and 2005 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, equally split between the two IBEs which were considered restricted assets.

Note 3 Money Market Investments

Money market investments are composed of money market instruments, federal funds, securities purchased under agreements to resell and time deposits with other financial institutions.

The securities purchased underlying the agreements to resell were delivered to, and are held by, the Corporation. The counterparties to such agreements maintain effective control over such securities. The Corporation is permitted by contract to repledge the securities, and has agreed to resell to the counterparties the same or substantially similar securities at the maturity of the agreements.

The fair value of the collateral securities held by the Corporation on these transactions as of December 31, 2006 and 2005 was as follows:

	2006		**2005**	
	(Dollars in thousands)			
	Balance	**Market Value of Collateral**	**Balance**	**Market Value of Collateral**
Money market instruments, interest ranging from 4.87% to 5.29% (2005 - 3.81% to 4.25%)	$ 377,296	N/A	$ 666,856	N/A
Federal funds sold, interest 5.15% (2005 - 4.09%)	42,051	N/A	8,967	N/A
Securities purchased under agreements to resell not repledged, interest (2005 - 3.25%)			500,000	510,011
Time deposits with other financial institutions, interest ranging from 5.14% to 5.38% (2005 - 4.10%)	37,123	N/A	48,968	N/A
Total	$ 456,470		$ 1,224,791	

Note 4 Investment Securities

Investment Securities Available-for-Sale

The amortized cost, gross unrealized gains and losses, approximate fair value, and weighted average yield by contractual maturities of investment securities available-for-sale as of December 31, 2006 and 2005 were as follows:

Table of Contents

	December 31, 2006					December 31, 2005				
		Gross Unrealized			Weighted		Gross Unrealized			Weighted
	Amortized cost	gains	losses	Fair value	average yield%	Amortized cost	gains	losses	Fair value	average yield%
	(Dollars in thousands)									
Obligations of U.S. government sponsored agencies:										
Within 1 year	$	$	$	$		$ 1,000	$	$	$ 1,000	6.00
After 5 to 10 years	402,542	6	11,820	390,728	4.31	392,939		4,289	388,650	4.27
After 10 years	12,984		120	12,864	6.16					
Puerto Rico government obligations:										
After 1 to 5 years	4,635	126		4,761	6.18	4,594	223		4,817	6.17
After 5 to 10 years	15,534	219	508	15,245	4.86	15,271	196	678	14,789	4.84
After 10 years	5,376	98	178	5,296	5.88	5,311	131	42	5,400	5.88
United States and Puerto Rico government obligations	$ 441,071	$ 449	$ 12,626	$ 428,894	4.43	$ 419,115	$ 550	$ 5,009	$ 414,656	4.34
Mortgage-backed securities:										
FHLMC certificates:										
Within 1 year	$ 82	$	$	$ 82	5.99	$ 2	$	$	$ 2	4.26
After 1 to 5 years	1,666	36		1,702	6.98	1,762	30		1,792	6.43
After 5 to 10 years						1,336	82		1,418	7.98
After 10 years	5,846	55	110	5,791	5.61	6,839	77	166	6,750	5.55
	7,594	91	110	7,575	5.92	9,939	189	166	9,962	6.03
GNMA certificates:										
After 1 to 5 years	866	10		876	6.44	939	14		953	6.39
After 5 to 10 years	795	3	3	795	5.53	291	10		301	6.64
After 10 years	379,363	470	7,136	372,697	5.26	438,565	1,021	1,959	437,627	5.19
	381,024	483	7,139	374,368	5.26	439,795	1,045	1,959	438,881	5.20

FNMA certificates:										
After 1 to 5 years	90			90	7.34	187	3		190	7.55
After 5 to 10 years	18,040	10	305	17,745	4.87	124	11		135	11.40
After 10 years	864,508	673	11,476	853,705	5.18	1,038,126	1,054	10,031	1,029,149	5.14
	882,638	683	11,781	871,540	5.17	1,038,437	1,068	10,031	1,029,474	5.14
Mortgage pass-through certificates:										
After 10 years	367	3		370	7.28	400	3		403	7.29
Mortgage-backed securities	$ 1,271,623	$ 1,260	$ 19,030	$ 1,253,853	5.21	$ 1,488,571	$ 2,305	$ 12,156	$ 1,478,720	5.16
Corporate bonds:										
After 1 to 5 years	$	$	$	$		$ 2,483	$ 84	$ 1	$ 2,566	7.75
After 5 to 10 years	1,300		83	1,217	7.70	1,912	12	42	1,882	8.09
After 10 years	4,412		668	3,744	7.97	21,857	909	1,833	20,933	7.44
Corporate bonds	$ 5,712	$	$ 751	$ 4,961	7.91	$ 26,252	$ 1,005	$ 1,876	$ 25,381	7.52
Equity securities (without contractual maturity)	$ 12,406	$ 452	$ 143	$ 12,715	3.70	$ 29,931	$ 1,131	$ 1,641	$ 29,421	3.70
Total investment securities available-for-sale	$ 1,730,812	$ 2,161	$ 32,550	$ 1,700,423	5.01	$ 1,963,869	$ 4,991	$ 20,682	$ 1,948,178	5.00

Maturities for mortgage-backed securities are based upon contractual terms assuming no repayments/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; therefore, it does not give effect to changes in fair value. The net unrealized gains or losses on investment securities available-for-sale are presented as part of accumulated other comprehensive income.

The aggregate amortized cost and approximate market value of investment securities available-for-sale as of December 31, 2006, by contractual maturity are shown below:

	Amortized Cost	**Fair Value**
	(Dollars in thousands)	
Within 1 year	$ 82	$ 82
After 1 to 5 years	7,257	7,429
After 5 to 10 years	438,211	425,730
After 10 years	1,272,856	1,254,467

Total	1,718,406	1,687,708
Equity securities	12,406	12,715
Total Investment securities available-for-sale	$ 1,730,812	$ 1,700,423

The following table shows 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, 2006 and 2005:

F-19

Table of Contents

	December 31, 2006					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(Dollars in thousands)					
Debt securities						
U.S. Treasury notes	$ 21,802	$ 146	$ 381,790	$ 11,794	$ 403,592	$ 11,940
Puerto Rico government obligations			13,474	686	13,474	686
Mortgage-backed securities						
FHLMC	30		3,903	110	3,933	110
GNMA	354,073	7,139			354,073	7,139
FNMA	376,813	4,719	465,606	7,062	842,419	11,781
Corporate Bonds						
Corporate Bonds			4,961	751	4,961	751
Equity securities						
Equity securities	1,629	143			1,629	143
	$ 754,347	$ 12,147	$ 869,734	$ 20,403	$ 1,624,081	$ 32,550

	December 31, 2005					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(Dollars in thousands)					
Debt securities						
U.S. Treasury notes	$ 388,650	$ 4,289	$	$	$ 388,650	$ 4,289
Puerto Rico government obligations			13,440	720	13,440	720
Mortgage-backed securities						
FHLMC	4,440	166			4,440	166
GNMA	369,231	1,959			369,231	1,959
FNMA	939,197	10,031			939,197	10,031
Corporate Bonds						
Corporate Bonds	8,711	1,876			8,711	1,876

Equity securities						
Equity securities	16,229	1,641			16,229	1,641
	$ 1,726,458	$ 19,962	$ 13,440	$ 720	$ 1,739,898	$ 20,682

The investment portfolio is structured primarily with highly liquid securities which have historically possessed a large and efficient secondary market. Valuations are performed at least on a quarterly basis using third party providers and dealer quotes. Management has the intent and ability to hold these investments for a reasonable period of time for a forecasted recovery of fair value up to (or beyond) the cost of these investments, as a result, the impairment is considered temporary.

Total proceeds from the sale of securities during the year ended December 31, 2006 amounted to $232.5 million (2005 $252.7 million, 2004 $131.6 million). The Corporation realized gross gains of $7.25 million (2005 $21.4 million, 2004 $12.2 million), and realized gross losses of $0.2 million (2005 $0.7 million, 2004 $0).

During the year ended December 31, 2006, the Corporation recognized through earnings approximately $15.3 million (2005 $8.4 million, 2004 $2.7 million) in losses in the investment securities available-for-sale portfolio that management considered to be other-than-temporarily impaired. The impairment losses were related to equity securities.

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, 2006 and 2005 were as follows:

	December 31, 2006					December 31, 2005				
		Gross Unrealized			Weighted		Gross Unrealized			Weighted
	Amortized cost	gains	losses	Fair value	average yield%	Amortized cost	gains	losses	Fair value	average yield%
	(Dollars in thousands)									
U.S. Treasury securities:										
Due within 1 year	$ 158,402	$ 44	$	$ 158,446	4.97	$ 149,156	$ 48	$	$ 149,204	3.97
Obligations of other U.S. Government sponsored agencies:										
Due within 1 year	24,695	5		24,700	5.25					
After 10 years	2,074,943		53,668	2,021,275	5.83	2,041,558		65,799	1,975,759	5.83
Puerto Rico government obligations:										
After 5 to 10 years	16,716	553	115	17,154	5.84	5,000	20		5,020	5.00
After 10 years	15,000	53		15,053	5.50	9,163	502	143	9,522	5.94
United States and Puerto Rico government obligations	$ 2,289,756	$ 655	$ 53,783	$ 2,236,628	5.76	$ 2,204,877	$ 570	$ 65,942	$ 2,139,505	5.70
Mortgage-backed securities:										
FHLMC certificates After 5 to 10 years	15,438		577	14,861	3.61	$ 20,211	$	$ 778	$ 19,433	3.63
FNMA certificates:										
After 5 to 10 years	14,234		484	13,750	3.80	18,418		602	17,816	3.79
After 10 years	1,025,703	48	36,064	989,687	4.40	1,195,082		35,277	1,159,805	4.32
Mortgage-backed securities:	$ 1,055,375	$ 48	$ 37,125	$ 1,018,298	4.38	$ 1,233,711	$	$ 36,657	$ 1,197,054	4.30
Corporate bonds:										
After 10 years	$ 2,000	$ 40	$	$ 2,040	5.80	$	$	$	$	

Total investment securities held-to-maturity	$ 3,347,131	$ 743	$ 90,908	$ 3,256,966	5.33	$ 3,438,588	$ 570	$ 102,599	$ 3,336,559	5.20

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

The aggregate amortized cost and approximate market value of investment securities held-to-maturity as of December 31, 2006, by contractual maturity are shown below:

	Amortized Cost	Fair Value
	(Dollars in thousands)	
Within 1 year	$ 183,097	$ 183,146
After 1 to 5 years		
After 5 to 10 years	46,388	45,765
After 10 years	3,117,646	3,028,055
Total Investment securities held-to-maturity	$ 3,347,131	$ 3,256,966

The Corporation has securities held-to-maturity that are considered cash and cash equivalents and are classified as money market investments on the Consolidated Statements of Financial Condition:

	December 31, 2006				December 31, 2005			
		Gross Unrealized				Gross Unrealized		
	Amortized Cost	Gains	Losses	Fair Value	Amortized Cost	Gains	Losses	Fair Value
	(Dollars in thousands)							
U.S. government and U.S. government sponsored agencies								
Due within 30 days	$ 199,973	$ 27	$	$ 200,000	$ 171,842	$ 22	$	$ 171,864
After 30 days up to 60 days					31,148	7		31,155
After 60 days up to 90 days	175,885	78		175,963	462,453	37		462,490
	$ 375,858	$ 105	$	$ 375,963	$ 665,443	$ 66	$	$ 665,509

The following table shows 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, 2006 and 2005:

Table of Contents

	December 31, 2006					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(Dollars in thousands)					
Debt securities						
U.S. government sponsored agencies	$	$	$ 2,021,275	$ 53,668	$ 2,021,275	$ 53,668
Puerto Rico government			3,978	115	3,978	115