

FIRST BANCORP /PR/
Form 10-Q
August 20, 2007

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2006

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

For the transition period from _____ to _____

COMMISSION FILE NUMBER 0-17224

FIRST BANCORP.

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

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

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

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

00908
(Zip Code)

(787) 729-8200

(Registrant's telephone number, including area code)

Not applicable

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

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

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in rule 12b-2 of the Exchange Act).

Large accelerated filer Accelerated filer Non-accelerated filer

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

Yes No

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

Common stock: 83,254,056 outstanding as of June 30, 2007.

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EXPLANATORY NOTE

First BanCorp (the Corporation or First BanCorp) was unable to timely file with the Securities and Exchange Commission (SEC) this Quarterly Report on Form 10-Q for the interim period ended March 31, 2006 and the Quarterly Reports on Form 10-Q for the interim periods ended September 30, 2005 and June 30, 2005 as a result of the delay in completing the restatement of the Corporation s audited financial statements for the years ended December 31, 2004, 2003 and 2002, and the unaudited selected quarterly financial information for each of the four quarters of 2004, 2003 and 2002, which resulted in delays in the filing of an amendment of First BanCorp s Annual Report on Form 10-K for the year ended December 31, 2004 and consequent delays in the filing of the Corporation s subsequent reports. For information regarding the restatement of First BanCorp s previously issued financial statements, see the Corporation s Amendment No. 1 to Annual Report on Form 10-K/A for the year ended December 31, 2004, which was filed with the SEC on September 26, 2006, and Note 1 Restatement of Previously Issued Financial Statements to the accompanying unaudited Consolidated Financial Statements contained in this Quarterly Report on Form 10-Q for the fiscal quarter ended March 31, 2006.

FORWARD LOOKING STATEMENTS

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

First BanCorp wishes to caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made, and represent First BanCorp s expectations of future conditions or results and are not guarantees of future performance. First BanCorp advises readers that various factors could cause actual results to differ materially from those contained in any forward-looking statement. Such factors include, but are not limited to, the following:

risks associated with the Corporation s inability to prepare and timely submit SEC and other regulatory filings;

a reduction in the Corporation s ability to attract new clients and retain existing ones;

general economic conditions, including prevailing interest rates and the performance of the financial markets, which may affect demand for the Corporation s products and services and the value of the Corporation s assets, including the value of the interest rate swaps that hedge the interest rate risk mainly relating to brokered certificates of deposit and medium-term notes;

risks arising from worsening economic conditions in Puerto Rico;

risks arising from credit and other risks of the Corporation s lending and investment activities, including the condo conversion loans in its Miami Agency;

increases in the Corporation s expenses associated with acquisitions and dispositions;

developments in technology;

risks associated with changes to the Corporation s business strategy to no longer acquire mortgage loans in bulk;

risks associated with the failure to obtain a final order from the District Court of Puerto Rico approving the settlement of the class-action lawsuit brought against the Corporation;

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the impact of Doral Financial Corporation's financial condition on its repayment of its outstanding secured loan to the Corporation;

risks associated with being subject to the cease and desist order;

potential further downgrades in the credit ratings of the Corporation's securities;

general competitive factors and industry consolidation; and

risks associated with regulatory and legislative changes for financial services companies in Puerto Rico, the United States, and the U.S. and British Virgin Islands.

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

Investors should carefully consider these factors and the risk factors outlined under Item 1A, Risk Factors, in First BanCorp's 2005 Annual Report on Form 10-K and under Item 1A, Risk Factors, in this Quarterly Report on Form 10-Q.

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FIRST BANCORP
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(Unaudited)

| | March 31, 2006 | December 31, 2005 | March 31, 2005 (As Restated) | March 31, 2004 (As Restated) |
|---|-------------------|----------------------|---------------------------------|---------------------------------|
| Due from banks | \$ 134,396,167 | \$ 155,848,810 | \$ 125,778,620 | \$ 100,000,000 |
| Market instruments, including \$422,773,829 that can be repledged (December 31, 2005 - \$381,848,364; March 31, 2005 - \$0; March 31, 2004 - \$370,731,426) | 806,203,368 | 666,856,432 | 354,858,845 | 600,000,000 |
| Loans sold and securities purchased under agreements to resell | 706,424,916 | 508,967,369 | 31,013,328 | 1,000,000 |
| Loans with other financial institutions | 32,818,084 | 48,967,475 | 3,300,000 | 0 |
| Equity market investments | 1,545,446,368 | 1,224,791,276 | 389,172,173 | 600,000,000 |
| Securities available for sale, at fair value: | | | | |
| Pledged that can be repledged | 1,663,051,384 | 1,744,846,054 | 1,092,221,084 | 800,000,000 |
| Government securities | 196,993,611 | 203,331,449 | 438,656,355 | 300,000,000 |
| Government securities available for sale | 1,860,044,995 | 1,948,177,503 | 1,530,877,439 | 1,100,000,000 |
| Securities held to maturity, at amortized cost: | | | | |
| Pledged that can be repledged | 3,115,116,225 | 3,115,260,660 | 3,255,841,156 | 2,900,000,000 |
| Government securities | 274,109,119 | 323,327,297 | 612,258,022 | 800,000,000 |
| Government securities held to maturity | 3,389,225,344 | 3,438,587,957 | 3,868,099,178 | 3,700,000,000 |
| Equity securities | 30,271,400 | 42,367,500 | 67,808,100 | 500,000,000 |
| Allowance for loan and lease losses of \$152,596,040 (December 31, 2005 - \$147,998,733; March 31, 2005 - \$144,201,333; March 31, 2004 - \$130,356,997) | 12,917,576,250 | 12,436,257,993 | 11,046,645,854 | 7,300,000,000 |
| Loans for sale, at lower of cost or market | 73,326,531 | 101,672,531 | 26,360,027 | 0 |
| Net | 12,990,902,781 | 12,537,930,524 | 11,073,005,881 | 7,300,000,000 |
| Property and equipment, net | 119,783,339 | 116,947,772 | 105,152,437 | 80,000,000 |
| State owned | 4,825,266 | 5,019,106 | 8,257,308 | 0 |
| Interest receivable on loans and investments | 103,738,717 | 103,692,478 | 70,269,595 | 40,000,000 |
| Customers on acceptances | 895,191 | 353,864 | 1,177,538 | 0 |
| Other | 380,215,631 | 343,933,937 | 277,135,766 | 160,000,000 |
| | \$ 20,559,745,199 | \$ 19,917,650,727 | \$ 17,516,734,035 | \$ 13,300,000,000 |

& Stockholders Equity

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| | | | | |
|--|-------------------|-------------------|-------------------|----------|
| Interest-bearing deposits | \$ 806,468,654 | \$ 811,006,126 | \$ 744,764,930 | \$ 62 |
| Time deposits | 12,543,307,152 | 11,652,746,080 | 8,653,011,527 | 5,94 |
| Loans purchased and securities sold under agreements to repurchase from the Federal Home Loan Bank (FHLB) | 4,801,665,500 | 4,833,882,000 | 4,046,419,313 | 3,87 |
| Other | 228,000,000 | 506,000,000 | 1,313,000,000 | 1,04 |
| Accounts receivable | 179,026,710 | 178,693,249 | 178,181,751 | 4 |
| Dividends receivable | 231,646,033 | 231,622,020 | 473,765,384 | 4 |
| Other notes | | | 82,405,446 | 8 |
| Debt outstanding | 895,191 | 353,864 | 1,177,538 | |
| Unsettled investment trade | | | 537,534,792 | 42 |
| Accounts payable and other liabilities | 589,074,731 | 505,506,453 | 303,095,159 | 16 |
| Other | | | | |
| Assets | 19,380,083,971 | 18,719,809,792 | 16,333,355,840 | 12,20 |
| Liabilities and contingencies (Note 17) | | | | |
| Stockholders' equity: | | | | |
| Common stock, authorized 50,000,000 shares: issued and outstanding 10,000,000 shares at \$25 liquidation value per share | 550,100,000 | 550,100,000 | 550,100,000 | 55 |
| Preferred stock, \$1 par value, authorized 10,000,000 shares; issued 93,151,856 shares (December 31, 2005- 90,772,856 shares ; March 31, 2005 - 45,320,780 shares; March 31, 2004 - 45,132,655 shares) | 93,151,856 | 90,772,856 | 45,320,780 | 4 |
| Treasury Stock (at par value) | (9,897,800) | (9,897,800) | (4,920,900) | 0 |
| Common stock outstanding | 83,254,056 | 80,875,056 | 40,399,880 | 4 |
| Additional paid-in capital | 22,269,844 | | 5,034,294 | |
| Reserve | | | 82,825,000 | 8 |
| Retained earnings | 265,844,192 | 265,844,192 | 183,019,192 | 16 |
| Accumulated other comprehensive (loss) income, net of tax expense of \$286,763 (December 31, 2005 - \$16,259; March 31, 2005 - (\$553,072) ; March 31, 2004 (\$1,380,496)) | (46,491,297) | (15,675,284) | 13,007,914 | 4 |
| Stockholders' equity | 1,179,661,228 | 1,197,840,935 | 1,183,378,195 | 1,13 |
| Assets and stockholders' equity | \$ 20,559,745,199 | \$ 19,917,650,727 | \$ 17,516,734,035 | \$ 13,33 |

The accompanying notes are an integral part of these statements.

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FIRST BANCORP
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

| | March 31, 2006 | Quarter Ended March 31, 2005 (As Restated) | March 31, 2004 (As Restated) |
|---|---------------------------|---|---|
| Interest income: | | | |
| Loans | \$ 246,089,307 | \$ 153,724,886 | \$ 103,995,379 |
| Investment securities | 71,640,717 | 56,784,795 | 46,104,242 |
| Money market investments | 9,974,864 | 1,867,116 | 717,145 |
| Total interest income | 327,704,888 | 212,376,797 | 150,816,766 |
| Interest expense: | | | |
| Deposits (Note 11) | 186,838,073 | 93,981,959 | (13,380,428) |
| Federal funds purchased and repurchase agreements | 53,565,529 | 34,374,299 | 28,331,688 |
| Advances from FHLB | 4,177,732 | 11,425,002 | 5,300,021 |
| Notes payable and other borrowings | 10,304,945 | 7,319,184 | 1,779,213 |
| Total interest expense | 254,886,279 | 147,100,444 | 22,030,494 |
| Net interest income | 72,818,609 | 65,276,353 | 128,786,272 |
| Provision for loan and lease losses | 19,375,887 | 10,954,409 | 13,200,000 |
| Net interest income after provision for loan and lease losses | 53,442,722 | 54,321,944 | 115,586,272 |
| Non-interest income: | | | |
| Other service charges on loans | 1,486,270 | 1,121,227 | 1,155,299 |
| Service charges on deposit accounts | 3,277,029 | 2,689,552 | 2,783,414 |
| Mortgage banking activities (loss) gain | (574,847) | 509,706 | 1,545,454 |
| Net (loss) gain on investments and impairments | (708,768) | 9,513,564 | 3,964,646 |
| Rental income | 773,290 | 865,898 | 616,674 |
| Gain on sale of credit card portfolio | | | 5,235,543 |
| Other operating income | 6,335,216 | 5,551,312 | 5,662,511 |
| Total non-interest income | 10,588,190 | 20,251,259 | 20,963,541 |
| Non-interest expenses: | | | |
| Employees compensation and benefits | 34,124,921 | 23,315,132 | 19,735,549 |
| Occupancy and equipment | 12,706,090 | 10,639,473 | 9,377,798 |

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|--|-----------------------|----------------------|----------------------|
| Business promotion | 3,774,060 | 4,547,523 | 3,469,054 |
| Professional fees | 7,392,966 | 1,895,551 | 734,046 |
| Taxes, other than income taxes | 2,555,269 | 2,269,017 | 1,948,023 |
| Insurance and supervisory fees | 1,701,012 | 1,063,541 | 1,076,098 |
| Other operating expenses | 9,483,337 | 9,276,895 | 6,389,579 |
| Total non-interest expenses | 71,737,655 | 53,007,132 | 42,730,147 |
| (Loss) Income before income tax | (7,706,743) | 21,566,071 | 93,819,666 |
| Income tax benefit (provision) | 11,569,985 | 3,648,870 | (28,390,014) |
| Net income | \$ 3,863,242 | \$ 25,214,941 | \$ 65,429,652 |
| Net (loss) income attributable to common stockholders | \$ (6,205,757) | \$ 15,145,942 | \$ 55,360,653 |
| Net (loss) income per common share: | | | |
| Basic | \$ (0.08) | \$ 0.19 | \$ 0.69 |
| Diluted | \$ (0.08) | \$ 0.18 | \$ 0.67 |
| Dividends declared per common share | \$ 0.07 | \$ 0.07 | \$ 0.06 |

The accompanying notes are an integral part of these statements.

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FIRST BANCORP
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

| | March 31, 2006 | Quarter Ended March 31, 2005 (As Restated) | March 31, 2004 (As Restated) |
|---|---------------------------------|---|---|
| Cash flows from operating activities: | | | |
| Net income | \$ 3,863,242 | \$ 25,214,941 | \$ 65,429,652 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation | 4,112,001 | 3,544,846 | 3,384,168 |
| Amortization of core deposit intangible | 932,041 | 599,155 | 599,155 |
| Provision for loan and lease losses | 19,375,887 | 10,954,409 | 13,200,000 |
| Deferred income tax (benefit) provision | (28,644,913) | (17,654,943) | 13,023,113 |
| Stock-based compensation recognized | 4,892,360 | | |
| Gain on sale of investments, net | (1,424,484) | (9,513,564) | (3,964,646) |
| Other-than-temporary impairments on available-for-sale securities | 2,133,252 | | |
| Unrealized loss (gain) on derivative instruments | 64,737,546 | 42,236,667 | (46,036,174) |
| Net loss (gain) on sale of loans and impairments | 677,005 | (528,072) | (1,496,515) |
| Net amortization of premiums and discounts and deferred loan fees and costs | (1,014,516) | 277,270 | 373,385 |
| Amortization of broker placement fees | 3,956,091 | 3,657,340 | 4,793,527 |
| Net (accretion) amortization of discount and premiums on investment securities | (9,528,614) | (7,957,812) | 946,843 |
| Amortization of discount on subordinated notes | | 125,028 | 114,399 |
| Gain on sale of credit card portfolio | | | (5,235,543) |
| Increase in accrued income tax payable | 14,299,995 | 42,681,184 | 11,334,443 |
| (Increase) decrease in accrued interest receivable | (46,239) | (10,573,143) | 4,365 |
| Increase (decrease) in accrued interest payable | 4,500,098 | 4,458,981 | (2,585,944) |
| (Increase) decrease in other assets | (5,088,301) | (3,290,737) | 8,691,571 |
| (Decrease) increase in other liabilities | (3,331,116) | (17,665,290) | 1,266,096 |
| Total adjustments | 70,538,093 | 41,351,319 | (1,587,757) |
| Net cash provided by operating activities | 74,401,335 | 66,566,260 | 63,841,895 |
| Cash flows from investing activities: | | | |
| Principal collected on loans | 892,646,456 | 742,149,279 | 521,193,844 |
| Loans originated | (1,336,279,411) | (1,694,615,596) | (1,058,516,779) |
| Purchase of loans | (58,803,859) | (142,582,255) | (35,204,000) |
| Proceeds from sale of loans | 17,502,647 | 29,006,204 | 57,142,731 |
| Proceeds from sale of repossessed assets | 10,136,316 | 9,027,134 | 8,597,035 |
| Purchase of servicing assets | (147,754) | | |
| Proceeds from sale of available for sale securities | 12,670,690 | 213,065,038 | 14,965,411 |

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|--|------------------|-----------------|----------------|
| Purchase of securities held to maturity | (144,226,030) | (794,757,906) | (483,924,843) |
| Purchase of securities available for sale | (11,975,700) | (302,908,003) | (1,543,433) |
| Principal repayments and maturities of securities held to maturity | 203,391,488 | 685,203,825 | 320,663,891 |
| Principal repayments of securities available for sale | 55,367,989 | 56,603,556 | 82,657,286 |
| Additions to premises and equipment | (6,947,568) | (5,303,319) | (3,195,727) |
| Decrease (increase) in other equity securities | 12,096,100 | 16,250,000 | (6,500,000) |
| Cash paid for net assets acquired in acquisition of business | | (71,996,013) | |
| Net cash used in investing activities | (354,568,636) | (1,260,858,056) | (583,664,584) |
| Cash flows from financing activities: | | | |
| Net increase (decrease) in deposits | 885,705,546 | 1,044,702,228 | (206,112,778) |
| Net (decrease) increase in federal funds purchased and securities sold under repurchase agreements | (32,216,500) | (118,941,600) | 233,121,351 |
| Net FHLB advances (paid) taken | (278,000,000) | (325,000,000) | 130,000,000 |
| Net proceeds from issuance of notes payable and other borrowings | | 197,049,120 | 45,000,000 |
| Dividends paid | (15,875,780) | (15,724,042) | (14,886,224) |
| Exercise of stock options | 19,756,484 | 181,720 | 2,160,335 |
| Net cash provided by financing activities | 579,369,750 | 782,267,426 | 189,282,684 |
| Net increase (decrease) in cash and cash equivalents | 299,202,449 | (412,024,370) | (330,540,005) |
| 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 | \$ 1,679,842,535 | \$ 514,950,793 | \$ 721,567,832 |

The accompanying notes are an integral part of these statements.

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

| | March 31, | Quarter Ended | March 31, 2004 |
|---|------------------|-----------------------|-----------------------|
| | 2006 | March 31, 2005 | March 31, 2004 |
| | | (As Restated) | (As Restated) |
| Preferred Stock | \$ 550,100,000 | \$ 550,100,000 | \$ 550,100,000 |
| Common Stock outstanding: | | | |
| Balance at beginning of period | 80,875,056 | 40,389,155 | 40,027,285 |
| Common stock issued under stock option plan | 2,379,000 | 10,725 | 184,470 |
| Balance at end of period | 83,254,056 | 40,399,880 | 40,211,755 |
| Additional Paid-In-Capital: | | | |
| Balance at beginning of period | | 4,863,299 | 268,855 |
| Shares issued under stock option plan | 17,377,484 | 170,995 | 1,975,865 |
| Stock-based compensation recognized | 4,892,360 | | |
| Balance at end of period | 22,269,844 | 5,034,294 | 2,244,720 |
| Capital Reserve | | 82,825,000 | 80,000,000 |
| Legal Surplus | 265,844,192 | 183,019,192 | 165,709,122 |
| Retained Earnings: | | | |
| Balance at beginning of period | 316,696,971 | 299,501,016 | 201,903,993 |
| Net income | 3,863,242 | 25,214,941 | 65,429,652 |
| Cash dividends declared on common stock | (5,806,781) | (5,655,043) | (4,817,225) |
| Cash dividends declared on preferred stock | (10,068,999) | (10,068,999) | (10,068,999) |
| Balance at end of period | 304,684,433 | 308,991,915 | 252,447,421 |
| Accumulated Other Comprehensive (Loss) | | | |
| Income, net of tax: | | | |
| Balance at beginning of period | (15,675,284) | 43,635,624 | 35,812,500 |
| Other comprehensive (loss) income, net of tax | (30,816,013) | (30,627,710) | 6,241,745 |
| Balance at end of period | (46,491,297) | 13,007,914 | 42,054,245 |

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| | | | |
|----------------------------|------------------|------------------|------------------|
| Total stockholders' equity | \$ 1,179,661,228 | \$ 1,183,378,195 | \$ 1,132,767,263 |
|----------------------------|------------------|------------------|------------------|

The accompanying notes are an integral part of these statements.

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FIRST BANCORP
CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME
(Unaudited)

| | March 31, | Quarter Ended March 31, 2005 | March 31, 2004 (As Restated) |
|--|------------------|---|---|
| | 2006 | (As Restated) | Restated) |
| Net income | \$ 3,863,242 | \$ 25,214,941 | \$ 65,429,652 |
| Other comprehensive (loss) income: | | | |
| Unrealized (loss) gain on securities: | | | |
| Unrealized holding (loss) gain arising during the period | (31,795,285) | (21,455,470) | 10,973,806 |
| Less: Reclassification adjustments for net loss (gain) and other than temporary impairments included in net income | 708,768 | (9,513,564) | (3,964,646) |
| Income tax benefit (expense) related to items of other comprehensive income | 270,504 | 341,324 | (767,415) |
| Other comprehensive (loss) income for the period, net of tax | (30,816,013) | (30,627,710) | 6,241,745 |
| Total comprehensive (loss) income | \$ (26,952,771) | \$ (5,412,769) | \$ 71,671,397 |

The accompanying notes are an integral part of these statements.

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FIRST BANCORP
PART I NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

1 RESTATEMENT OF PREVIOUSLY ISSUED FINANCIAL STATEMENTS

As previously reported, on December 13, 2005 the Corporation concluded that its financial statements for the interim and annual periods from January 1, 2000 through March 31, 2005 should no longer be relied upon and that its consolidated financial statements for some or all of the periods included therein should be restated (the 2004 restatement). On September 26, 2006, the Corporation filed with the SEC an Amended Annual Report on Form 10-K/A restating its audited financial statements for the years ended December 31, 2004, 2003 and 2002. The following provides a brief description of the principal accounting adjustments included in the 2004 restatement of the Corporation s consolidated financial statements and the effect of the adjustments on the Corporation s Consolidated Statements of Financial Condition as of March 31, 2005 and as of March 31, 2004, its Consolidated Statements of Income for the quarters ended March 31, 2005 and 2004 and its Consolidated Statements of Cash Flows for the quarters ended March 31, 2005 and 2004. In addition, with the filing of its 2006 Annual Report on Form 10-K, First BanCorp restated its 2005 and 2004 Statements of Cash Flows due to some incorrect classifications. 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), 2) the classification of cash flows from the disposition of repossessed assets, and 3) purchases of zero coupon bonds and agency discount notes amounts presented as part of investing activities (the 2006 restatement). All financial information for the quarters ended March 31, 2005 and 2004 included in any subsequent notes is presented on a restated basis. A more detailed description of the accounting adjustments made in connection with the 2004 restatement, as well as a background discussion of the 2004 restatement, is included in Note 1 Restatement of Previously Issued Financial Statements to First BanCorp audited Consolidated Financial Statements, included in the Corporation s amended 2004 Annual Report on Form 10-K. A more detailed description of the accounting adjustments made in connection with the 2006 restatement, is included in Note 1 Restatement of 2005 and 2004 Consolidated Statements of Cash Flows to First BanCorp audited Consolidated Financial Statements, included in the Corporation s 2006 Annual Report on Form 10-K.

As discussed in more detail below, First BanCorp has separately quantified the impact of various accounting adjustments on its interim unaudited Consolidated Financial Statements.

Table of Contents**RECONCILIATION OF PREVIOUSLY REPORTED TO RESTATED FIGURES
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION**

| <i>(In thousands)</i> | As of March 31, 2005 | As of March 31, 2004 |
|---|-------------------------------------|-------------------------------------|
| Cash and due from banks, as previously reported | \$ 22,877 | \$ 100,528 |
| Impact of accounting errors and corrections: | | |
| Reclassifications | 102,902 | |
| Cash and due from banks, as restated | \$ 125,779 | \$ 100,528 |
| Money market investments, as previously reported | \$ 228,443 | \$ 595,739 |
| Impact of accounting errors and corrections: | | |
| Reclassifications | 160,729 | 25,300 |
| Money market investments, as restated | \$ 389,172 | \$ 621,039 |
| Investment securities including FHLB Stock, as previously reported | \$ 5,892,081 | \$ 5,038,087 |
| Impact of accounting errors and corrections: | | |
| Accounting for investment securities | 2,195 | 163 |
| Recharacterization of pass-through certificates as secured loans | (266,609) | (50,000) |
| Reclassifications | (160,882) | (25,300) |
| Investment securities including FHLB stock, as restated | \$ 5,466,785 | \$ 4,962,950 |
| Total loans, net of allowance for loan and lease losses, as previously reported | \$ 10,823,960 | \$ 7,315,916 |
| Impact of accounting errors and corrections: | | |
| Accounting for derivative instruments and broker placement fees | 131 | (508) |
| Accounting for origination fees and costs and premiums and discounts on loans | (2,651) | (1,825) |
| Recharacterization of pass-through certificates as secured loans | 263,269 | 50,000 |
| Reclassifications | (9,436) | 298 |
| Other accounting adjustments | (2,267) | (2,287) |
| Total loans, net of allowance for loan and lease losses, as restated | \$ 11,073,006 | \$ 7,361,594 |
| Total other assets, as previously reported | \$ 416,545 | \$ 297,192 |
| Impact of accounting errors and corrections: | | |
| Accounting for derivative instruments and broker placement fees | 2,929 | (1,285) |
| Tax impact of accounting adjustments | 29,081 | (3,270) |
| Reclassifications | 11,809 | (1,093) |

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| | | |
|---|---------------|---------------|
| Valuation of financial instruments | 1,200 | 1,200 |
| Other accounting adjustments | 428 | 613 |
| | | |
| Total other assets, as restated | \$ 461,992 | \$ 293,357 |
| | | |
| Total assets, as restated | \$ 17,516,734 | \$ 13,339,468 |
| | | |
| Total liabilities, as previously reported | \$ 16,150,021 | \$ 12,223,690 |
| Impact of accounting errors and corrections: | | |
| Accounting for derivative instruments and broker placement fees | 73,363 | (15,457) |
| Tax impact of accounting adjustments | 4,863 | 519 |
| Reclassifications | 105,122 | (795) |
| Other accounting adjustments | (13) | (1,256) |
| | | |
| Total liabilities, as restated | \$ 16,333,356 | \$ 12,206,701 |
| | | |
| Stockholders' equity, as previously reported | \$ 1,233,885 | \$ 1,123,772 |
| Impact of accounting errors and corrections: | | |
| Accounting for derivative instruments and broker placement fees | (70,694) | 12,564 |
| Accounting for investment securities | 4,451 | 1,963 |
| Accounting for origination fees and costs and premiums and discounts on loans | (2,651) | (1,825) |
| Valuation of financial instruments | 1,200 | 1,200 |
| Tax impact of accounting adjustments | 24,218 | (3,789) |
| Impact of accounting adjustments in other comprehensive income | (5,205) | (700) |
| Other accounting adjustments | (1,826) | (418) |
| | | |
| Stockholders' equity, as restated | \$ 1,183,378 | \$ 1,132,767 |

Table of Contents**RECONCILIATION OF PREVIOUSLY REPORTED TO RESTATED FIGURES
CONSOLIDATED STATEMENTS OF INCOME**

| | Quarter Ended March 31, 2005 | Quarter Ended March 31, 2004 |
|---|---|---|
| <i>(In thousands, except per share amounts)</i> | | |
| Net interest income, as previously reported | \$ 109,602 | \$ 88,183 |
| Impact of accounting errors and corrections: | | |
| Accounting for derivative instruments and broker placement fees | (45,424) | 39,735 |
| Accounting for investment securities | 968 | 573 |
| Accounting for origination fees and costs and premiums and discounts on loans | (121) | 139 |
| Reclassification of late charges, penalty fees on loans and other | 40 | 36 |
| Other accounting adjustments | 211 | 120 |
| Net interest income, as restated | \$ 65,276 | \$ 128,786 |
| Provision for loan and lease losses (no adjustment required) | \$ 10,954 | \$ 13,200 |
| Non-interest income, as previously reported | \$ 19,618 | \$ 20,018 |
| Impact of accounting errors and corrections: | | |
| Accounting for derivative instruments and broker placement fees | 1,063 | 424 |
| Accounting for origination fees and costs and premiums and discounts on loans | (390) | (628) |
| Reclassification of late charges, penalty fees on loans and other | (40) | (36) |
| Valuation of financial instruments | | 1,200 |
| Other accounting adjustments | | (14) |
| Non-interest income, as restated | \$ 20,251 | \$ 20,964 |
| Non-interest expenses, as previously reported | \$ 52,651 | \$ 43,158 |
| Impact of accounting errors and corrections: | | |
| Accounting for origination fees and costs and premiums and discounts on loans | (290) | (251) |
| Other accounting adjustments | 646 | (177) |
| Non-interest expenses, as restated | \$ 53,007 | \$ 42,730 |
| Income tax expense, as previously reported | \$ (12,182) | \$ (11,639) |
| Impact of accounting errors and corrections | 15,831 | (16,751) |

| | | | | |
|---|----|--------|----|----------|
| Income tax benefit (expense), as restated | \$ | 3,649 | \$ | (28,390) |
| Net income, as restated | \$ | 25,215 | \$ | 65,430 |
| Basic earnings per common share, as previously reported | \$ | 0.54 | \$ | 0.38 |
| Effect of adjustments | | (0.35) | | 0.31 |
| Basic earnings per common share, as restated | \$ | 0.19 | \$ | 0.69 |
| Diluted earnings per common share, as previously reported | \$ | 0.52 | \$ | 0.36 |
| Effect of adjustments | | (0.34) | | 0.31 |
| Diluted earnings per common share, as restated | \$ | 0.18 | \$ | 0.67 |

The Corporation classified the accounting practices and related adjustments that were affected by the restatement into the categories described below.

Accounting for Derivative Instruments and Broker Placement Fees. As part of the restatement, the Corporation reviewed its accounting for derivative instruments and concluded that its use of the short-cut method of hedge accounting under Statement of Financial Accounting Standard No. (SFAS) 133, *Accounting for Derivative Instruments and Hedging Activities*, for interest rate swaps that economically hedge mainly brokered certificates of deposit (CDs) was not consistent with generally accepted accounting principles in the United States of America (GAAP) because the fee received from the swap counterparty at the inception of the relationship caused

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the swap not to have a fair value of zero at inception (which is required under SFAS 133 to qualify for the short-cut method). In connection with the evaluation of hedge accounting transactions, the Corporation concluded that the short-cut method was also incorrectly used for certain interest rate swaps hedging medium-term notes, certain corporate bonds and certain commercial loan receivables.

Prior to the restatement, the Corporation recorded, under the short-cut method, the effective portion of the change in fair value of the hedged item as an adjustment to income that offsets the fair value adjustment on the related interest rate swap. Furthermore, prior to the restatement, the broker placement fees were offset with the upfront fees received from the swap counterparties at inception with no separate accounting recognition.

The adjustments related to the correction of the accounting for derivative instruments and broker placement fees primarily consisted of: (1) eliminating the fair value adjustments previously made to the brokered CDs, medium-term notes and other hedged items; (2) recognizing the fair value of the interest rate swaps at inception, which is the equivalent of the upfront fees received from swap counterparties; (3) recognizing the placement fees paid to the brokers that placed the brokered CDs and medium-term notes as deferred costs required to be amortized over the expected maturities of the related economically hedged items; and (4) correcting the fair value of derivative instruments as of the end of each reporting period.

The net cumulative effect on the Corporation's pre-tax income through March 31, 2005 related to the correction of the accounting for derivative instruments and broker placement fees was a decrease of \$70.7 million. The following table details the components of the pre-tax income effect from the correction in the accounting for derivative instruments and broker placement fees for the quarters ended March 31, 2005 and 2004:

| | Quarter Ended March 31, 2005 | Quarter Ended March 31, 2004 |
|---|---|---|
| Elimination of fair value adjustments previously made to hedged items | \$ (53,096) | \$ 39,616 |
| Recognition of interest rate swap up-front fees | 5,886 | 5,220 |
| Broker placement fees amortization | (2,978) | (4,295) |
| Corrections to derivative instruments valuations | 5,827 | (382) |
| Total | \$ (44,361) | \$ 40,159 |

Recharacterization of purchases of mortgage loans and pass-through trust certificates as commercial loans secured by mortgage loans. Prior to the restatement, the Corporation had inaccurately recorded as purchases of residential mortgages, commercial mortgage loans and pass-through trust certificates certain mortgage-related transactions with local financial institutions. Certain of these transactions included or likely included recourse provisions, which had not been analyzed as part of the Corporation's financial reporting process. The Corporation determined that such transactions did not satisfy the reasonable assurance standard of SFAS 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, regarding the isolation of assets in bankruptcy, with the result that they did not qualify as a true sale for accounting purposes. The restatement reflects these mortgage-related transactions as commercial loans secured by mortgage loans and pass-through trust certificates. This conclusion resulted in the revised classification of approximately \$4.4 billion and \$2.4 billion in mortgage-related loans to secured loans to local financial institutions as of March 31, 2005 and 2004, respectively, and \$263.3 million and \$50.0 million pass-through trust certificates to secured loans to local financial institutions as of March 31, 2005 and 2004, respectively. The recharacterization of the mortgage-related transactions did not impact the Corporation's retained earnings as of March 31, 2005.

Accounting for Investment Securities. The Corporation historically amortized premiums and discounts related to most of its investment securities into interest income over the life of the related securities using a straight-line method adjusted for prepayment of securities. As part of the restatement, the Corporation concluded that it needed to correct its methodology and adjust its financial statements to reflect the amortization of premiums and discounts into interest

income over the terms of the securities using the effective interest method instead of the straight-line

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method. The cumulative effect of this correction on the Corporation's pre-tax income through March 31, 2005 was an increase of \$4.5 million, of which approximately \$1.0 million and \$0.6 million relate to the quarters ended March 31, 2005 and 2004, respectively.

In addition, the Corporation identified other types of investment instruments that had not been recognized in the Consolidated Statement of Financial Condition in accordance with the provisions of SFAS 115 Accounting for Certain Investments in Debt and Equity Securities.

Accounting for deferral and recognition of origination fees and costs on loans. As part of the restatement process, the Corporation reviewed the methodology used to measure origination fees and costs associated with its loans origination, in accordance with SFAS 91, Accounting for Nonrefundable Fees and Costs Associated with Origination or Acquiring Loans and Initial Direct Costs of Leases, which establishes the accounting treatment for nonrefundable fees and costs associated with lending, committing to lend or purchasing loans. The Corporation concluded that throughout the restatement period, it did not apply SFAS 91 requirements to one of its consumer loans portfolios. Accordingly, the Corporation concluded that, in order to comply with SFAS 91, it needed to defer and amortize loan origination fees and costs on this portfolio using the interest method. The cumulative effect of this correction on the Corporation's pre-tax income through March 31, 2005 was a decrease of approximately \$2.7 million, of which \$0.2 million was recorded as a reduction in pre-tax income for each of the quarters ended March 31, 2005 and 2004.

Valuation of financial instruments. In connection with a loan restructuring, First BanCorp became the holder of warrants. The warrant certificate gives the Corporation the right to purchase common stock from a privately held company at a fixed price. This transaction was not formally evaluated or documented as part of the Corporation's financial reporting process. As part of the restatement process, the Corporation concluded that this transaction meets the definition of a derivative instrument as stated in SFAS 133. Accordingly, the warrant was marked to market and the valuation recognized in earnings as part of Other operating income. The cumulative effect of this correction on the Corporation's pre-tax income through March 31, 2005 was an increase of \$1.2 million, all of which related to the quarter ended March 31, 2004.

Other Accounting Adjustments and Reclassifications. As part of the restatement, the Corporation also made corrections to various other aspects of its Consolidated Financial Statements, including adjustments to the gain on sale of credit card portfolios, accrual of rental expense on lease contracts and income from a loan origination subsidiary. The cumulative effect of all these other adjustments on the Corporation's pre-tax income through March 31, 2005 was a decrease of \$1.8 million, of which approximately \$0.4 million was recorded as a reduction of pre-tax income for the quarter ended March 31, 2005 and \$0.3 million was recorded as an increase to pre-tax income for the quarter ended March 31, 2004.

The reclassifications made to conform to GAAP included, among other things, reclassifying late charges and prepayment fees on loans from non-interest income to interest income on loans, and reclassifying dividends on equity securities from non-interest income to interest income on investments. Other reclassifications included reclassifying loans receivable balances within loan categories, reclassifying certain amounts previously reported as repurchase agreements to other borrowings, adjustments to the estimated fair value of assets and liabilities acquired in a business combination, reclassifying cash balances previously reported as a reduction to non-interest-bearing deposits and reclassifying certain short-term investments previously reported as part of the available for sale and held to maturity investment portfolio to money market investments.

Income Taxes. As a result of the corrections reflected in the restatement, the Corporation's cumulative income tax expense through March 31, 2005 was reduced by approximately \$24.2 million, of which \$15.8 million was recorded as a reduction to income tax expense for the quarter ended March 31, 2005 and \$16.8 million was recorded as an increase to income tax expense for the quarter ended March 31, 2004. The cumulative reduction through March 31, 2005 resulted principally from changes in deferred taxes. See Note 15 for additional details regarding the Corporation's income taxes.

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The following tables show the impact of all restated adjustments on the previously reported unaudited Consolidated Statements of Financial Condition as of March 31, 2005 and 2004.

FIRST BANCORP
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(Unaudited)

| <i>(Dollars in thousands)</i> | March 31, 2005 (As Previously | Adjustments | March 31, 2005 (As Restated) |
|--|--|--------------------|---|
| Assets | Reported) | | |
| Cash and due from banks | \$ 22,877 | \$ 102,902 | \$ 125,779 |
| Money market instruments | 215,143 | 139,716 | 354,859 |
| Federal funds sold and securities purchased under agreements to resell | 10,000 | 21,013 | 31,013 |
| Time deposits with other financial institutions | 3,300 | | 3,300 |
| Total money market investments | 228,443 | 160,729 | 389,172 |
| Investment securities available for sale, at fair value: | | | |
| Securities pledged that can be repledged | 1,358,831 | (266,610) | 1,092,221 |
| Other investment securities | 439,774 | (1,117) | 438,657 |
| Total investment securities available for sale | 1,798,605 | (267,727) | 1,530,878 |
| Investment securities held to maturity, at amortized cost: | | | |
| Securities pledged that can be repledged | 3,254,133 | 1,708 | 3,255,841 |
| Other investment securities | 772,910 | (160,652) | 612,258 |
| Total investment securities held to maturity | 4,027,043 | (158,944) | 3,868,099 |
| Other equity securities | 66,433 | 1,375 | 67,808 |
| Loans, net of allowance for loan and lease losses | 10,797,600 | 249,046 | 11,046,646 |
| Loans held for sale, at lower of cost or market | 26,360 | | 26,360 |
| Total loans, net | 10,823,960 | 249,046 | 11,073,006 |
| Premises and equipment, net | 105,166 | (14) | 105,152 |
| Other real estate owned | 8,299 | (42) | 8,257 |
| Accrued interest receivable | 70,391 | (121) | 70,270 |
| Due from customers on acceptances | 1,178 | | 1,178 |
| Other assets | 231,511 | 45,624 | 277,135 |
| Total assets | \$ 17,383,906 | \$ 132,828 | \$ 17,516,734 |

Liabilities & Stockholders Equity

Liabilities:

| | | | | | | |
|--|----|-------------------|----|----------------|----|-------------------|
| Non-interest-bearing deposits | \$ | 641,851 | \$ | 102,914 | \$ | 744,765 |
| Interest-bearing deposits | | 8,605,237 | | 47,775 | | 8,653,012 |
| Federal funds purchased and securities sold under agreements to repurchase | | 4,299,840 | | (253,421) | | 4,046,419 |
| Advances from the Federal Home Loan Bank (FHLB) | | 1,313,000 | | | | 1,313,000 |
| Notes payable | | 175,484 | | 2,698 | | 178,182 |
| Other borrowings | | 231,548 | | 242,217 | | 473,765 |
| Subordinated notes | | 82,823 | | (418) | | 82,405 |
| Bank acceptance outstanding | | 1,178 | | | | 1,178 |
| Payable for unsettled investment trade | | 537,535 | | | | 537,535 |
| Accounts payable and other liabilities | | 261,525 | | 41,570 | | 303,095 |
| Total liabilities | | 16,150,021 | | 183,335 | | 16,333,356 |

Stockholders equity:

| | | | | | | |
|---|----|-------------------|----|-----------------|----|-------------------|
| Preferred stock, authorized 50,000,000 shares: issued and outstanding 22,004,000 shares at \$25 liquidation value per share | | 550,100 | | | | 550,100 |
| Common stock, \$1 par value, authorized 250,000,000 shares; issued 45,320,780 shares | | 45,321 | | | | 45,321 |
| Less: Treasury Stock (at par value) | | (4,921) | | | | (4,921) |
| Common stock outstanding | | 40,400 | | | | 40,400 |
| Additional paid-in capital | | 5,034 | | | | 5,034 |
| Capital reserve | | 82,825 | | | | 82,825 |
| Legal surplus | | 180,572 | | 2,447 | | 183,019 |
| Retained earnings | | 356,741 | | (47,749) | | 308,992 |
| Accumulated other comprehensive income, net of tax | | 18,213 | | (5,205) | | 13,008 |
| Total stockholders equity | | 1,233,885 | | (50,507) | | 1,183,378 |
| Total liabilities and stockholders equity | \$ | 17,383,906 | \$ | 132,828 | \$ | 17,516,734 |

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FIRST BANCORP
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(Unaudited)

| <i>(Dollars in thousands)</i> | March 31, 2004 (As Previously | Adjustments | March 31, 2004 (As Restated) |
|--|--|--------------------|---|
| Assets | Reported) | | |
| Cash and due from banks | \$ 100,528 | \$ | \$ 100,528 |
| Money market instruments | 582,139 | 25,300 | 607,439 |
| Federal funds sold and securities purchased under agreements to resell | 13,000 | | 13,000 |
| Time deposits with other financial institutions | 600 | | 600 |
| Total money market investments | 595,739 | 25,300 | 621,039 |
| Investment securities available for sale, at fair value: | | | |
| Securities pledged that can be repledged | 870,877 | (50,000) | 820,877 |
| Other investment securities | 362,634 | (23) | 362,611 |
| Total investment securities available for sale | 1,233,511 | (50,023) | 1,183,488 |
| Investment securities held to maturity, at amortized cost: | | | |
| Securities pledged that can be repledged | 2,926,597 | (111) | 2,926,486 |
| Other investment securities | 825,829 | (25,378) | 800,451 |
| Total investment securities held to maturity | 3,752,426 | (25,489) | 3,726,937 |
| Other equity securities | 52,150 | 375 | 52,525 |
| Loans, net of allowance for loan and lease losses | 7,314,571 | 45,678 | 7,360,249 |
| Loans held for sale, at lower of cost or market | 1,345 | | 1,345 |
| Total loans, net | 7,315,916 | 45,678 | 7,361,594 |
| Premises and equipment, net | 85,081 | | 85,081 |
| Other real estate owned | 5,839 | | 5,839 |
| Accrued interest receivable | 41,595 | (63) | 41,532 |
| Due from customers on acceptances | 300 | | 300 |
| Other assets | 164,377 | (3,772) | 160,605 |
| Total assets | \$ 13,347,462 | \$ (7,994) | \$ 13,339,468 |

Liabilities & Stockholders Equity

Liabilities:

| | | | | | | |
|--|----|-------------------|----|-----------------|----|-------------------|
| Non-interest-bearing deposits | \$ | 619,816 | \$ | 1,028 | \$ | 620,844 |
| Interest-bearing deposits | | 5,981,530 | | (32,322) | | 5,949,208 |
| Federal funds purchased and securities sold under agreements to repurchase | | 3,926,672 | | (54,078) | | 3,872,594 |
| Advances from the Federal Home Loan Bank (FHLB) | | 1,043,000 | | | | 1,043,000 |
| Other borrowings | | | | 45,000 | | 45,000 |
| Subordinated notes | | 82,819 | | (939) | | 81,880 |
| Bank acceptance outstanding | | 300 | | | | 300 |
| Payable for unsettled investment trade | | 427,801 | | | | 427,801 |
| Accounts payable and other liabilities | | 141,752 | | 24,322 | | 166,074 |
| Total liabilities | | 12,223,690 | | (16,989) | | 12,206,701 |

Stockholders equity:

| | | | | | | |
|---|----|-------------------|----|----------------|----|-------------------|
| Preferred stock, authorized 50,000,000 shares: issued and outstanding 22,004,000 shares at \$25 liquidation value per share | | 550,100 | | | | 550,100 |
| Common stock, \$1 par value, authorized 250,000,000 shares; issued 45,132,655 shares | | 45,133 | | | | 45,133 |
| Less: Treasury Stock (at par value) | | (4,921) | | | | (4,921) |
| Common stock outstanding | | 40,212 | | | | 40,212 |
| Additional paid-in capital | | 2,245 | | | | 2,245 |
| Capital reserve | | 80,000 | | | | 80,000 |
| Legal surplus | | 163,106 | | 2,603 | | 165,709 |
| Retained earnings | | 245,355 | | 7,092 | | 252,447 |
| Accumulated other comprehensive income, net of tax | | 42,754 | | (700) | | 42,054 |
| Total stockholders equity | | 1,123,772 | | 8,995 | | 1,132,767 |
| Total liabilities and stockholders equity | \$ | 13,347,462 | \$ | (7,994) | \$ | 13,339,468 |

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The following tables show the impact of all restatement adjustments on the previously reported unaudited Consolidated Statements of Income and basic and diluted earnings per share for the quarters ended March 31, 2005 and 2004.

FIRST BANCORP
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

(In thousands, except per share data)

| | Quarter Ended | | |
|---|--|--------------------|---|
| | March 31, 2005 (As Previously Reported) | Adjustments | March 31, 2005 (As Restated) |
| Interest income: | | | |
| Loans | \$ 148,910 | \$ 4,815 | \$ 153,725 |
| Investment securities | 58,070 | (1,285) | 56,785 |
| Money market investments | 1,867 | | 1,867 |
| Total interest income | 208,847 | 3,530 | 212,377 |
| Interest expense: | | | |
| Deposits | 47,280 | 46,702 | 93,982 |
| Federal funds purchased and repurchase agreements | 34,559 | (184) | 34,375 |
| Advances from FHLB | 11,425 | | 11,425 |
| Notes payable and other borrowings | 5,981 | 1,338 | 7,319 |
| Total interest expense | 99,245 | 47,856 | 147,101 |
| Net interest income | 109,602 | (44,326) | 65,276 |
| Provision for loan and lease losses | 10,954 | | 10,954 |
| Net interest income after provision for loan and lease losses | 98,648 | (44,326) | 54,322 |
| Non-interest income: | | | |
| Other service charges on loans | 2,033 | (912) | 1,121 |
| Service charges on deposit accounts | 2,690 | | 2,690 |
| Mortgage banking activities | 510 | | 510 |
| Net gain on investments and impairments | 9,513 | | 9,513 |
| Rental income | 866 | | 866 |
| Other operating income | 4,006 | 1,545 | 5,551 |
| Total non-interest income | 19,618 | 633 | 20,251 |

| | | | |
|---|-----------|-------------|-----------|
| Non-interest expenses: | | | |
| Employees compensation and benefits | 23,605 | (290) | 23,315 |
| Occupancy and equipment | 10,342 | 297 | 10,639 |
| Business promotion | 4,548 | | 4,548 |
| Professional fees | 1,647 | 249 | 1,896 |
| Taxes, other than income taxes | 2,269 | | 2,269 |
| Insurance and supervisory fees | 1,063 | | 1,063 |
| Other operating expenses | 9,177 | 100 | 9,277 |
| Total non-interest expenses | 52,651 | 356 | 53,007 |
| Income before income tax | 65,615 | (44,049) | 21,566 |
| Income tax (provision) benefit | (12,182) | 15,831 | 3,649 |
| Net income | \$ 53,433 | \$ (28,218) | \$ 25,215 |
| Net income attributable to common stockholders | \$ 43,364 | \$ (28,218) | \$ 15,146 |
| Net income per common share: | | | |
| Basic | \$ 0.54 | \$ (0.35) | \$ 0.19 |
| Diluted | \$ 0.52 | \$ (0.34) | \$ 0.18 |

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FIRST BANCORP
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

(In thousands, except per share data)

| | March 31, 2004 (As Previously Reported) | Quarter Ended Adjustments | March 31, 2004 (As Restated) |
|---|--|--------------------------------------|---|
| Interest income: | | | |
| Loans | \$ 103,877 | \$ 119 | \$ 103,996 |
| Investment securities | 45,933 | 171 | 46,104 |
| Money market investments | 717 | | 717 |
| Total interest income | 150,527 | 290 | 150,817 |
| Interest expense: | | | |
| Deposits | 27,047 | (40,427) | (13,380) |
| Federal funds purchased and repurchase agreements | 28,333 | (1) | 28,332 |
| Advances from FHLB | 5,300 | | 5,300 |
| Notes payable and other borrowings | 1,664 | 115 | 1,779 |
| Total interest expense | 62,344 | (40,313) | 22,031 |
| Net interest income | 88,183 | 40,603 | 128,786 |
| Provision for loan and lease losses | 13,200 | | 13,200 |
| Net interest income after provision for loan and lease losses | 74,983 | 40,603 | 115,586 |
| Non-interest income: | | | |
| Other service charges on loans | 2,116 | (961) | 1,155 |
| Service charges on deposit accounts | 2,783 | | 2,783 |
| Mortgage banking activities | 1,545 | | 1,545 |
| Net gain on investments and impairments | 3,965 | | 3,965 |
| Rental income | 617 | | 617 |
| Gain on sale of credit card portfolio | 5,236 | | 5,236 |
| Other operating income | 3,756 | 1,907 | 5,663 |
| Total non-interest income | 20,018 | 946 | 20,964 |
| Non-interest expenses: | | | |

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| | | | |
|---|---------------|---------------|---------------|
| Employees compensation and benefits | 19,987 | (251) | 19,736 |
| Occupancy and equipment | 9,383 | (5) | 9,378 |
| Business promotion | 3,469 | | 3,469 |
| Professional fees | 733 | 1 | 734 |
| Taxes, other than income taxes | 1,948 | | 1,948 |
| Insurance and supervisory fees | 1,076 | | 1,076 |
| Other operating expenses | 6,562 | (173) | 6,389 |
| Total non-interest expenses | 43,158 | (428) | 42,730 |
| Income before income tax | 51,843 | 41,977 | 93,820 |
| Income tax provision | (11,639) | (16,751) | (28,390) |
| Net income | \$ 40,204 | \$ 25,226 | \$ 65,430 |
| Net income attributable to common stockholders | \$ 30,135 | \$ 25,226 | \$ 55,361 |
| Net income per common share: | | | |
| Basic | \$ 0.38 | \$ 0.31 | \$ 0.69 |
| Diluted | \$ 0.36 | \$ 0.31 | \$ 0.67 |

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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), 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.

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 quarters ended March 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, including items related to the 2004 restatement (see footnotes in table below), and the classification of short-term held-to-maturity investments (less than 90 days) from investments to cash and cash equivalents.

Also, the Corporation has corrected the classification of cash receipts from sales and repayments as well as cash disbursements in originations of loans classified as held-for-sale on the consolidated statements of cash flows. The Corporation previously reported the cash receipts from sales and repayments as well as cash disbursements in originations of loans classified as held-for-sale that were originally acquired for investment as cash flows of operating activities in the consolidated statements of cash flows. Since these loans were originally acquired by the Corporation for investment purposes, cash receipts from sales and repayments as well as cash disbursements in originations of these loans should be classified as cash flows of investing activities in the consolidated statements of cash flows.

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The following comparative table presents the effects of the aforementioned classification corrections as well as the impact of all restatement adjustments related with the 2004 restatement on the Consolidated Statement of Cash Flows for the quarters ended March 31, 2005 and 2004:

| Quarter Ended March 31, (in thousands) | 2005 | | | 2004 | | |
|--|------------------------------|----------------|--------------------|------------------------------|----------------|------------------|
| | As Previously Reported | Adjustments | (As Restated) | As Previously Reported | Adjustments | (As Restated) |
| Cash flows from operating activities: | | | | | | |
| Net income | \$ 53,433 | \$ (28,218) | \$ 25,215 | \$ 40,204 | \$ 25,226 | \$ 65,430 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | | | | |
| Deferred income tax (benefit) provision (1) | (290) | (17,365) | (17,655) | (2,791) | 15,814 | 13,023 |
| Unrealized derivatives loss (gain)(2) | 854 | 41,383 | 42,237 | (381) | (45,655) | (46,036) |
| Amortization of brokers' placement fees (2) | | 3,657 | 3,657 | | 4,794 | 4,794 |
| Accretion) amortization of premiums and discounts on investment securities (3) | | (7,958) | (7,958) | | 947 | 947 |
| Decrease (increase) in other assets (3) | 6,284 | (9,575) | (3,291) | 16,117 | (7,425) | 8,692 |
| Other adjustments to cash flows from operating activities (4)(5) | (9,540) | 33,902 | 24,362 | 12,999 | 3,993 | 16,992 |
| Total adjustments to reconcile net income to net cash provided by operating activities | (2,692) | 44,044 | 41,352 | 25,944 | (27,532) | (1,588) |
| Net cash provided by operating activities | 50,741 | 15,826 | 66,567 | 66,148 | (2,306) | 63,842 |
| Cash flows from investing activities: | | | | | | |
| Proceeds from sale of repossessed assets (3) | | 9,027 | 9,027 | | 8,597 | 8,597 |
| Purchase of securities held to maturity (3) | (2,393,777) | 1,599,019 | (794,758) | (1,728,741) | 1,244,816 | (483,925) |
| Principal repayments and maturities of securities held to maturity (3) | 2,115,712 | (1,430,508) | 685,204 | 1,534,593 | (1,213,929) | 320,664 |
| Other adjustments to cash flows from investing activities (4)(5) | (1,134,695) | (25,636) | (1,160,331) | (427,599) | (1,402) | (429,001) |
| Net cash used in investing activities | (1,412,760) | 151,902 | (1,260,858) | (621,747) | 38,082 | (583,665) |
| Cash flows from financing activities: | | | | | | |
| Net increase (decrease) in deposits (2)(6) | 956,995 | 87,707 | 1,044,702 | (203,773) | (2,340) | (206,113) |
| Other adjustments to cash flows from financing activities (5) | (262,435) | | (262,435) | 395,395 | | 395,395 |
| Net cash provided by financing activities | 694,560 | 87,707 | 782,267 | 191,622 | (2,340) | 189,282 |
| Net decrease in cash and cash equivalents | (667,459) | 255,435 | (412,024) | (363,977) | 33,436 | (330,541) |
| Cash and cash equivalents at beginning of period | 918,779 | 8,196 | 926,975 | 1,060,244 | (8,136) | 1,052,108 |

Cash and cash equivalents at end of period (7) \$ 251,320 \$ 263,631 \$ 514,951 \$ 696,267 \$ 25,300 \$ 721,567

- (1) Deferred tax effect of items related to the 2004 restatement; refer to explanation of change in Note 1 Restatement of previously issued financial statements
Income Taxes above.
- (2) Refer to explanation of change in Note 1 Restatement of previously issued financial statements
Accounting for Derivative Instruments and Broker Placement Fees above.
- (3) Refer to explanation of change in the first paragraph of Restatement of 2005 and 2004 Consolidated Statements of Cash Flows above.
- (4) Refer to explanation of change in the third paragraph of Restatement of 2005 and 2004 Consolidated Statements of

Cash Flows
above.

- (5) Change resulting from certain not significant 2004 restatement adjustments (refer to Note 1 Restatement of previously issued financial statements) and the correction of immaterial classification errors.
- (6) Refer to explanation of change in Note 1 Restatement of previously issued financial statements Other Accounting Adjustments and Reclassifications above.
- (7) Mostly related with the correction of the classification of short-term held-to-maturity investments (less than 90 days) from investments to cash and cash equivalents.

Table of Contents**2 BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES**

The Consolidated Financial Statements (unaudited) have been prepared in conformity with the accounting policies stated in the Corporation's Annual Audited Financial Statements included in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2005. Certain information and note disclosures normally included in the financial statements prepared in accordance with GAAP have been condensed or omitted from these statements pursuant to the rules and regulations of the SEC and, accordingly, these financial statements should be read in conjunction with the audited Consolidated Financial Statements of the Corporation for the year ended December 31, 2005, included in the Corporation's 2005 Annual Report on Form 10-K. All adjustments (consisting only of normal recurring adjustments) which are, in the opinion of management, necessary for a fair presentation of the statement of financial position, results of operations and cash flows for the interim periods have been reflected. All significant intercompany accounts and transactions have been eliminated in consolidation.

The results of operations for the quarter ended on March 31, 2006, are not necessarily indicative of the results to be expected for the entire year.

On May 24, 2005, the Corporation's Board of Directors declared a two-for-one split in the Corporation's common stock. The record date of the stock split was June 15, 2005, and the distribution date was June 30, 2005. The per share data contained in the Consolidated Financial Statements prior to the quarter ended June 30, 2005 has been adjusted to reflect the two-for-one stock split.

Recently issued accounting pronouncements

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. 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 economically 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, the Corporation selected the fair value measurement for approximately 63% of the brokered CDs portfolio and certain 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 economically 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 credit was not recognized in current earnings. Regulatory capital increased by the positive adjustment to retained earnings, exceeding by higher margins the capital levels required to be classified as well-capitalized and strengthened the Corporation's regulatory capital ratios.

With the Corporation's 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 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

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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, as part of the adoption adjustment to retained earnings, 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 de-recognition 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.

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 both 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 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 and SFAS 159, refer to the discussion on SFAS 159 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 No. 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 No. 156, *Accounting for Servicing of Financial Assets*, an amendment of SFAS No. 140. This Statement requires that servicing assets and servicing liabilities be initially measured at fair value along with any derivative instruments used to mitigate inherent risks. This Statement is

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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 No. 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 No. 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.

In December 2004, the Financial Accounting Standard Board (FASB) issued SFAS 123R, Share-Based Payment. This statement is a revision of SFAS 123, Accounting for Stock- Based Compensation, and it also supersedes APB No. 25, Accounting for Stock Issued to Employees, (APB 25), and its related implementation guidance.

This Statement requires a public entity to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award (with limited exceptions). The cost will be recognized over the period during which an employee is required to provide service in exchange for the award-the requisite service period (usually the vesting period). No compensation cost is recognized for equity instruments for which employees do not render the requisite service.

SFAS 123R eliminates the alternative to use APB 25's intrinsic value method of accounting that was provided in SFAS 123 as originally issued. Under APB 25, issuing stock options to employees generally resulted in recognition of no compensation cost.

The Corporation prospectively applied SFAS123R to its financial statements as of January 1, 2006. Refer to Note 4 to these consolidated financial statements for required disclosures and further information on the impact of the adoption of this accounting pronouncement.

3 EARNINGS PER COMMON SHARE

The calculations of (loss) earnings per common share for the quarters ended on March 31, 2006, 2005 and 2004 are as follows:

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| | Quarter Ended March 31, | | |
|--|--|-----------------------------------|-----------------------------------|
| | 2006 | 2005 (As Restated) | 2004 (As Restated) |
| | (In thousands, except per share data) | | |
| Net Income: | | | |
| Net income | \$ 3,863 | \$ 25,215 | \$ 65,430 |
| Less : Preferred stock dividend | (10,069) | (10,069) | (10,069) |
| Net (loss) income available to common stockholders | \$ (6,206) | \$ 15,146 | \$ 55,361 |
| Weighted-Average Shares: | | | |
| Basic weighted average common shares outstanding | 81,556 | 80,784 | 80,128 |
| Average potential common shares | | 2,742 | 2,632 |
| Diluted weighted-average number of common shares outstanding | 81,556 | 83,526 | 82,760 |
| (Loss) Earnings per common share: | | | |
| Basic | \$ (0.08) | \$ 0.19 | \$ 0.69 |
| Diluted | \$ (0.08) | \$ 0.18 | \$ 0.67 |

Potential common shares consist of common stock issuable under the assumed exercise of stock options using the treasury stock method. This method assumes that the potential common shares are issued and the proceeds from exercise are used to purchase common stock at the exercise date. The difference between the number of potential shares issued and the shares purchased is added as incremental shares to the actual number of shares outstanding to compute diluted earnings per share. Stock options that result in lower potential shares issued than shares purchased under the treasury stock method are not included in the computation of dilutive earnings per share since their inclusion would have an antidilutive effect in earnings per share. As of March 31, 2006, there were 3,043,410 outstanding stock options that were excluded from the computation of diluted earnings per common share because the Corporation reported a net loss available to common stockholders for such period. All options were included in the computation of outstanding shares for the quarter ended March 31, 2005. For the quarter ended on March 31, 2004, a total of 931,800 stock options were not included in the computation of outstanding shares because they were antidilutive.

4 STOCK OPTION PLAN

Since 1997, the Corporation has had a stock option plan covering certain employees. This plan allowed for the granting of up to 8,696,112 purchase options on shares of the Corporation's common stock to certain employees. According to the plan, the options granted cannot exceed 20% of the number of common shares outstanding. Each option provides for the purchase of one share of common stock at a price not less than the fair market value of the stock on the date the option is granted. Stock options are fully vested upon issuance. The maximum term to exercise the options is ten years. The stock option plan provides for a proportionate adjustment in the exercise price and the number of shares that can be purchased in the event of a stock dividend, stock split, reclassification of stock, merger or reorganization and certain other issuances and distributions such as stock appreciation rights.

Under the Corporation's stock option plan, the Compensation Committee may grant stock appreciation rights at any time subsequent to the grant of an option. Pursuant to the stock appreciation rights, the Optionee surrenders the

right to exercise an option granted under the plan in consideration for payment by the Corporation of an amount equal to the excess of the fair market value of the shares of common stock subject to such option surrendered over the total option price of such shares. Any option surrendered shall be cancelled by the Corporation and the shares subject to the option shall not be eligible for further grants under the option plan.

Prior to the adoption of SFAS 123R on January 1, 2006, the Corporation accounted for stock options under the recognition and measurement principles of APB 25 and related Interpretations. No stock-based employee

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compensation cost was reflected in net income for the quarters ended March 31, 2005 and 2004, 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. The table below illustrates the effect on net income and earnings per common share if the Corporation had applied the fair value recognition provisions of SFAS 123 to stock-based employee compensation granted during the first quarter of 2005 and 2004.

Pro-forma information:

| | Quarter ended March 31, | |
|--|---|-----------------------------------|
| | 2005 (As Restated) (In thousands, except per share data) | 2004 (As Restated) |
| Net income | | |
| As reported | \$ 25,215 | \$ 65,430 |
| Deduct: Stock-based employee compensation expense determined under fair value method | 6,118 | 4,963 |
| Pro forma | \$ 19,097 | \$ 60,467 |
| Earnings per common share-basic: | | |
| As reported | \$ 0.19 | \$ 0.69 |
| Pro forma | \$ 0.11 | \$ 0.63 |
| Earnings per common share-diluted: | | |
| As reported | \$ 0.18 | \$ 0.67 |
| Pro forma | \$ 0.11 | \$ 0.61 |

On January 1, 2006, the Corporation adopted SFAS 123R using the modified prospective method. Under this method, and since all previously issued stock options were fully vested at the time of the adoption, the Corporation expenses the fair value of all employee stock options granted after January 1, 2006 (same as the prospective method). The compensation expense associated with expensing stock options for the quarter ended March 31, 2006 was approximately \$4.9 million. All employee stock options granted during 2006 were fully vested at the time of grant.

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The activity of stock options during the first quarter of 2006 is set forth below:

| | Number of Options | Weighted-Average Exercise Price | Quarter Ended March 31, 2006 | |
|--|----------------------|---------------------------------------|--|--|
| | | | Weighted-Average Remaining Contractual Term (Years) | Aggregate Intrinsic Value (In thousands) |
| Beginning of period | 5,316,410 | \$ 13.28 | | |
| Options granted | 1,070,000 | 12.68 | | |
| Options exercised | (2,379,000) | 8.30 | | |
| Options expired unexercised | (964,000) | 21.95 | | |
| End of period outstanding and exercisable | 3,043,410 | \$ 14.21 | 7.6 | \$ 3,329 |

The fair value of options granted in 2006, 2005 and 2004, that was estimated using the Black-Scholes option pricing, and the assumptions used follow:

| | 2006 | 2005 | 2004 |
|--|---------------|----------------|---------------|
| Weighted Average Stock Price at grant date and exercise price | \$ 12.68 | \$ 23.92 | \$ 21.45 |
| Stock option estimated fair value | \$4.56-\$4.60 | \$ 6.40-\$6.41 | \$5.30-\$5.45 |
| Weighted-average estimated fair value | \$ 4.57 | \$ 6.40 | \$ 5.33 |
| Expected stock option term (years) | 4.22-4.31 | 4.25 - 4.27 | 4.08-4.33 |
| Expected volatility | 46% | 28% | 28% |
| Expected dividend yield | 2.2% | 1.0% | 1.0% |
| Risk-free interest rate | 4.7% - 5.0% | 4.2% | 3.1% |

The Corporation uses empirical research data to estimate options exercises and employee termination within the valuation model; separate groups of employees that have similar historical exercise behavior are considered separately for valuation purposes. For 2006, the expected volatility is based on the historical implied volatility of the Corporation's common stock at each grant date. For periods prior to 2006, the expected volatility is based on the historical volatility of the Corporation's common stock over a 260-working days period. The dividend yield is based on the historical 12-month dividend yield observable at each grant date. The risk-free rate for periods is based on historical zero coupon curves obtained from Bloomberg at the time of grant based on the option expected term.

The total intrinsic value of options exercised during the first quarter of 2006, 2005 and 2004 was approximately \$10.0 million, \$0.3 million and \$6.4 million, respectively. Cash proceeds from options exercised during the first quarter of 2006, 2005 and 2004 amounted to approximately \$19.8 million, \$0.2 million and \$2.6 million, respectively.

Table of Contents**5 INVESTMENT SECURITIES****Investment Securities Available for Sale**

The amortized cost, gross unrealized gains and losses, approximate fair value, weighted-average yield and contractual maturities of investment securities available for sale at March 31, 2006, December 31, 2005, March 31, 2005 and March 31, 2004 were as follows:

| | March 31, 2006 | | | | | December 31, 2005 | | | | |
|---|-------------------|------------------------------|----------------------|---------------|--------------------------------|-------------------|------------------------------|----------------------|---------------|--------------------------------|
| | Amortized cost | Gross Unrealized gains | Unrealized losses | Fair value | Weighted average yield % | Amortized cost | Gross Unrealized gains | Unrealized losses | Fair value | Weighted 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 | 398,079 | | 17,530 | 380,549 | 4.29 | 392,939 | | 4,289 | 388,650 | 4.27 |
| After 10 years | 7,993 | | 131 | 7,862 | 6.10 | | | | | |
| Puerto Rico Government Obligations: | | | | | | | | | | |
| After 1 to 5 years | 4,604 | 189 | | 4,793 | 6.17 | 4,594 | 223 | | 4,817 | 6.17 |
| After 5 to 10 years | 15,335 | 273 | 778 | 14,830 | 4.84 | 15,271 | 196 | 678 | 14,789 | 4.84 |
| After 10 years | 5,327 | 113 | 100 | 5,340 | 5.88 | 5,311 | 131 | 42 | 5,400 | 5.88 |
| United States and Puerto Rico Government Obligations | 431,338 | 575 | 18,539 | 413,374 | 4.38 | 419,115 | 550 | 5,009 | 414,656 | 4.34 |
| Mortgage-backed Securities: FHLMC certificates: | | | | | | | | | | |
| Within 1 year | 3 | | | 3 | 5.24 | 2 | | | 2 | 4.26 |
| After 1 to 5 years | 1,568 | 16 | | 1,584 | 6.40 | 1,762 | 30 | | 1,792 | 6.43 |
| After 5 to 10 years | 1,179 | 54 | | 1,233 | 7.82 | 1,336 | 82 | | 1,418 | 7.98 |
| After 10 years | 6,422 | 61 | 222 | 6,261 | 5.49 | 6,839 | 77 | 166 | 6,750 | 5.55 |
| | 9,172 | 131 | 222 | 9,081 | 5.95 | 9,939 | 189 | 166 | 9,962 | 6.03 |
| GNMA certificates: | | | | | | | | | | |
| After 1 to 5 years | 857 | 8 | | 865 | 6.37 | 939 | 14 | | 953 | 6.39 |
| After 5 to 10 years | 1,068 | 11 | 1 | 1,078 | 5.10 | 291 | 10 | | 301 | 6.64 |
| After 10 years | 424,511 | 619 | 8,800 | 416,330 | 5.23 | 438,565 | 1,021 | 1,959 | 437,627 | 5.19 |
| | 426,436 | 638 | 8,801 | 418,273 | 5.24 | 439,795 | 1,045 | 1,959 | 438,881 | 5.20 |

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|--|--------------|----------|-----------|--------------|-------|--------------|----------|-----------|--------------|-------|
| FNMA certificates: | | | | | | | | | | |
| After 1 to 5 years | 156 | 1 | | 157 | 7.41 | 187 | 3 | | 190 | 7.55 |
| After 5 to 10 years | 157 | 11 | | 168 | 11.14 | 124 | 11 | | 135 | 11.40 |
| After 10 years | 996,375 | 697 | 22,514 | 974,558 | 5.17 | 1,038,126 | 1,054 | 10,031 | 1,029,149 | 5.14 |
| | 996,688 | 709 | 22,514 | 974,883 | 5.17 | 1,038,437 | 1,068 | 10,031 | 1,029,474 | 5.14 |
| Mortgage pass-through certificates: | | | | | | | | | | |
| After 10 years | 391 | 3 | | 394 | 7.29 | 400 | 3 | | 403 | 7.29 |
| Mortgage-backed Securities | | | | | | | | | | |
| | 1,432,687 | 1,481 | 31,537 | 1,402,631 | 5.20 | 1,488,571 | 2,305 | 12,156 | 1,478,720 | 5.16 |
| Corporate Bonds: | | | | | | | | | | |
| After 1 to 5 years | 988 | 25 | | 1,013 | 7.30 | 2,483 | 84 | 1 | 2,566 | 7.75 |
| After 5 to 10 years | | | | | | 1,912 | 12 | 42 | 1,882 | 8.09 |
| After 10 years | 14,012 | 335 | 1,460 | 12,887 | 7.56 | 21,857 | 909 | 1,833 | 20,933 | 7.44 |
| Corporate bonds | 15,000 | 360 | 1,460 | 13,900 | 7.54 | 26,252 | 1,005 | 1,876 | 25,381 | 7.52 |
| Equity securities (without contractual maturity) | | | | | | | | | | |
| | 27,798 | 2,770 | 428 | 30,140 | 2.31 | 29,931 | 1,131 | 1,641 | 29,421 | 3.70 |
| Total Investment Securities | | | | | | | | | | |
| Available for Sale | \$ 1,906,823 | \$ 5,186 | \$ 51,964 | \$ 1,860,045 | 4.99 | \$ 1,963,869 | \$ 4,991 | \$ 20,682 | \$ 1,948,178 | 5.00 |

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| | March 31, 2005 (As Restated) | | | | | March 31, 2004 (As Restated) | | | | |
|---|---------------------------------|-------------------------------------|----------|---------------|--------------------------------|---------------------------------|-------------------------------------|----|---------------|--------------------------------|
| | Amortized cost | Gross Unrealized gains losses | | Fair value | Weighted average yield % | Amortized cost | Gross Unrealized gains losses | | Fair value | Weighted average yield % |
| | (Dollars in thousands) | | | | | | | | | |
| Obligations of U.S. Government Sponsored Agencies: After 5 to 10 years | \$ 292,297 | \$ | \$ 3,967 | \$ 288,330 | 4.32 | \$ | \$ | \$ | | |
| Puerto Rico Government Obligations: After 1 to 5 years | 4,530 | 213 | | 4,743 | 6.17 | 294 | 38 | | 332 | 6.62 |
| After 5 to 10 years | 12,716 | 236 | 767 | 12,185 | 4.58 | 7,003 | 336 | | 7,339 | 5.79 |
| After 10 years | 7,668 | 435 | 90 | 8,013 | 5.94 | 8,127 | 466 | | 8,593 | 5.98 |
| United States and Puerto Rico Government Obligations | 317,211 | 884 | 4,824 | 313,271 | 4.40 | 15,424 | 840 | | 16,264 | 5.91 |
| Mortgage-backed Securities: FHLMC certificates: After 1 to 5 years | 2,305 | 66 | | 2,371 | 6.39 | 2,563 | 158 | | 2,721 | 6.40 |
| After 5 to 10 years | 1,968 | 91 | | 2,059 | 8.08 | 3,718 | 284 | | 4,002 | 7.84 |
| After 10 years | 2,619 | 119 | | 2,738 | 6.95 | 3,473 | 218 | | 3,691 | 6.87 |
| | 6,892 | 276 | | 7,168 | 7.09 | 9,754 | 660 | | 10,414 | 7.12 |
| GNMA certificates: After 1 to 5 years | 1,209 | 65 | | 1,274 | 6.35 | | | | | |
| After 5 to 10 years | 424 | 21 | | 445 | 6.65 | 2,277 | 132 | | 2,409 | 6.39 |
| After 10 years | 90,212 | 1,344 | | 91,556 | 5.10 | 147,925 | 3,545 | | 151,470 | 4.42 |
| | 91,845 | 1,430 | | 93,275 | 5.12 | 150,202 | 3,677 | | 153,879 | 4.45 |
| FNMA certificates: After 1 to 5 years | 135 | 8 | | 143 | 7.48 | 58 | 4 | | 62 | 8.26 |

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| | | | | | | | | | | |
|---|--------------|-----------|----------|--------------|------|--------------|-----------|----------|--------------|------|
| After 5 to 10 years | 197 | 16 | | 213 | 8.81 | 442 | 41 | | 483 | 8.26 |
| After 10 years | 1,019,706 | 4,283 | 898 | 1,023,091 | 5.10 | 876,528 | 21,602 | | 898,130 | 4.87 |
| | 1,020,038 | 4,307 | 898 | 1,023,447 | 5.10 | 877,028 | 21,647 | | 898,675 | 4.87 |
| Mortgage pass-through certificates: | | | | | | | | | | |
| After 10 years | 453 | 4 | | 457 | 7.29 | 676 | 6 | | 682 | 7.28 |
| Mortgage-backed Securities | 1,119,228 | 6,017 | 898 | 1,124,347 | 5.12 | 1,037,660 | 25,990 | | 1,063,650 | 4.83 |
| Corporate Bonds: | | | | | | | | | | |
| Within 1 year | 40,000 | 98 | 200 | 39,898 | 5.16 | | | | | |
| After 1 to 5 years | 875 | 1,966 | | 2,841 | 6.30 | 40,000 | 900 | | 40,900 | 4.24 |
| After 5 to 10 years | 375 | 911 | | 1,286 | 7.73 | 3,750 | 3,400 | | 7,150 | 7.67 |
| Corporate bonds | 41,250 | 2,975 | 200 | 44,025 | 5.21 | 43,750 | 4,300 | | 48,050 | 4.53 |
| Equity securities (without contractual maturity) | 39,627 | 11,223 | 1,615 | 49,235 | 1.49 | 43,218 | 13,407 | 1,101 | 55,524 | 1.24 |
| Total Investment Securities | | | | | | | | | | |
| Available for Sale | \$ 1,517,316 | \$ 21,099 | \$ 7,537 | \$ 1,530,878 | 4.88 | \$ 1,140,052 | \$ 44,537 | \$ 1,101 | \$ 1,183,488 | 4.70 |

Maturities of mortgage-backed securities are based on contractual terms assuming no prepayments. Expected maturities of investments might differ from contractual maturities because they may be subject to prepayments and/or call options. The weighted average yield on investment securities held for sale is based on amortized cost and, therefore, does not give effect to changes in fair value. The net unrealized gains or losses on available for sale securities are presented as part of accumulated other comprehensive income.

The following tables show the Corporation's available-for-sale investments' fair value and gross unrealized losses, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at March 31, 2006, December 31, 2005, March 31, 2005 and March 31, 2004:

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| | Less than 12 months Unrealized | | As of March 31, 2006 12 months or more Unrealized | | Total Unrealized | |
|---|-----------------------------------|-----------|---|----------|---------------------|-----------|
| | Fair Value | Losses | Fair Value | Losses | Fair Value | Losses |
| Debt Securities | | | | | | |
| Obligations of U.S. Government Sponsored Agencies | \$ 388,411 | \$ 17,661 | \$ | \$ | \$ 388,411 | \$ 17,661 |
| Puerto Rico Government Obligations | | | 13,282 | 878 | 13,282 | 878 |
| Mortgage-Backed Securities | | | | | | |
| FHLMC | | | 4,244 | 222 | 4,244 | 222 |
| GNMA | 394,326 | 8,801 | | | 394,326 | 8,801 |
| FNMA | 925,747 | 21,921 | 18,197 | 593 | 943,944 | 22,514 |
| Corporate Bonds | | | 4,360 | 1,460 | 4,360 | 1,460 |
| Equity Securities | 2,160 | 428 | | | 2,160 | 428 |
| | \$ 1,710,644 | \$ 48,811 | \$ 40,083 | \$ 3,153 | \$ 1,750,727 | \$ 51,964 |

| | Less than 12 months Unrealized | | As of December 31, 2005 12 months or more Unrealized | | Total Unrealized | |
|---|-----------------------------------|-----------|--|--------|---------------------|-----------|
| | Fair Value | Losses | Fair Value | Losses | Fair Value | Losses |
| Debt Securities | | | | | | |
| Obligations of U.S. Government Sponsored Agencies | \$ 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 | 8,711 | 1,876 | | | 8,711 | 1,876 |
| Equity Securities | 16,229 | 1,641 | | | 16,229 | 1,641 |
| | \$ 1,726,458 | \$ 19,962 | \$ 13,440 | \$ 720 | \$ 1,739,898 | \$ 20,682 |

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| | Less than 12 months | | As of March 31, 2005 (As Restated) | | Total | |
|---|---------------------|----------|---------------------------------------|--------|------------|----------|
| | Unrealized | | 12 months or more | | Unrealized | |
| | Fair Value | Losses | Fair Value | Losses | Fair Value | Losses |
| | | | (Dollars in thousands) | | | |
| Debt Securities | | | | | | |
| Obligations of U.S. Government Sponsored Agencies | \$ 288,330 | \$ 3,967 | \$ | \$ | \$ 288,330 | \$ 3,967 |
| Puerto Rico Government Obligations | 8,459 | 701 | 4,844 | 156 | 13,303 | 857 |
| Mortgage-Backed Securities | | | | | | |
| FNMA | 231,436 | 898 | | | 231,436 | 898 |
| Corporate Bonds | 19,800 | 200 | | | 19,800 | 200 |
| Equity Securities | 11,755 | 1,288 | 489 | 327 | 12,244 | 1,615 |
| | \$ 559,780 | \$ 7,054 | \$ 5,333 | \$ 483 | \$ 565,113 | \$ 7,537 |
| | | | | | | |
| | Less than 12 months | | As of March 31, 2004 (As Restated) | | Total | |
| | Unrealized | | 12 months or more | | Unrealized | |
| | Fair Value | Losses | Fair Value | Losses | Fair Value | Losses |
| | | | (Dollars in thousands) | | | |
| Equity Securities | \$ 10,800 | \$ 1,054 | \$ 79 | \$ 47 | \$ 10,879 | \$ 1,101 |

The Corporation's investment securities portfolio is comprised principally of (i) mortgage-backed securities issued or guaranteed by FNMA, GNMA or FHLMC and (ii) U.S. Treasury and agencies securities. Thus, payment of a substantial portion of these instruments is either guaranteed or secured by mortgages together with a U.S. government sponsored entity or is backed by the full faith and credit of the U.S. government. Principal and interest on these securities are therefore deemed recoverable. The Corporation's policy is to review its investment portfolio for possible other-than temporary impairment, at least quarterly. At March 31, 2006, 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 impairments are considered temporary. The increase in the net unrealized loss position during the first quarter of 2006 was principally due to increases in interest rates and the corresponding decrease in prices.

During the first quarter of 2006, the Corporation recorded other-than-temporary impairments of approximately \$2.1 million on certain equity securities held in its investment portfolio. Management concluded that the declines in value of the securities were other-than-temporary; as such, the cost basis of these securities was written down to the market value at the date of the analyses.

Total proceeds from the sale of securities available for sale during the three-month period ended March 31, 2006 amounted to approximately \$12.7 million (2005 - \$213.1 million; 2004-\$15.0 million). The Corporation realized gross gains of approximately \$1.6 million and gross losses of approximately \$0.2 million for the first quarter of 2006

(2005 \$9.5 million in gross realized gains; 2004-\$4.0 million in gross realized gains and approximately \$15,000 in gross realized losses).

Table of Contents**Investment Securities 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 at March 31, 2006, December 31, 2005, March 31, 2005 and March 31, 2004 were as follows:

| | March 31, 2006 | | | | | December 31, 2005 | | | | |
|--|-------------------|------------------------------|-----------------|---------------|--------------------------------|-------------------|------------------------------|-----------------|---------------|--------------------------------|
| | Amortized cost | Gross Unrealized gains | Gross losses | Fair value | Weighted average yield % | Amortized cost | Gross Unrealized gains | Gross losses | Fair value | Weighted average yield % |
| (Dollars in thousands) | | | | | | | | | | |
| U.S. Treasury Securities: Due within 1 year | \$ 145,211 | \$ 26 | \$ | \$ 145,237 | 4.41 | \$ 149,156 | \$ 48 | \$ | \$ 149,204 | 3.97 |
| Obligations of other U.S. Government Sponsored Agencies: After 10 years | 2,049,727 | | 106,462 | 1,943,265 | 5.83 | 2,041,558 | | 65,799 | 1,975,759 | 5.83 |
| Puerto Rico Government Obligations: After 1 to 5 years | 5,000 | 7 | | 5,007 | 5.00 | 5,000 | 20 | | 5,020 | 5.00 |
| After 5 to 10 years | 9,298 | 497 | 141 | 9,654 | 5.94 | | | | | |
| After 10 years | | | | | | 9,163 | 502 | 143 | 9,522 | 5.94 |
| United States and Puerto Rico Government obligations | 2,209,236 | 530 | 106,603 | 2,103,163 | 5.74 | 2,204,877 | 570 | 65,942 | 2,139,505 | 5.70 |
| Mortgage-backed securities: FHLMC certificates: After 5 to 10 years | 19,156 | | 1,017 | 18,139 | 3.68 | 20,211 | | 778 | 19,433 | 3.63 |
| FNMA certificates: After 5 to 10 years | 17,287 | | 874 | 16,413 | 3.79 | 18,418 | | 602 | 17,816 | 3.79 |
| After 10 years | 1,143,546 | | 49,884 | 1,093,662 | 4.38 | 1,195,082 | | 35,277 | 1,159,805 | 4.32 |
| | 1,179,989 | | 51,775 | 1,128,214 | 4.36 | 1,233,711 | | 36,657 | 1,197,054 | 4.30 |

Mortgage-backed
securities

Total Investment
Securities Held

| | | | | | | | | | | |
|-------------|--------------|--------|------------|--------------|------|--------------|--------|------------|--------------|------|
| to Maturity | \$ 3,389,225 | \$ 530 | \$ 158,378 | \$ 3,231,377 | 5.25 | \$ 3,438,588 | \$ 570 | \$ 102,599 | \$ 3,336,559 | 5.20 |
|-------------|--------------|--------|------------|--------------|------|--------------|--------|------------|--------------|------|

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| | March 31, 2005 (As Restated) | | | | | March 31, 2004 (As Restated) | | | | |
|--|---------------------------------|------------------------------|--------|---------------|--------------------------------|---------------------------------|------------------------------|--------|---------------|--------------------------------|
| | Amortized cost | Gross Unrealized gains | losses | Fair value | Weighted average yield % | Amortized cost | Gross Unrealized gains | losses | Fair value | Weighted average yield % |
| (Dollars in thousands) | | | | | | | | | | |
| U.S. Treasury Securities: Due within 1 year | \$ | \$ | \$ | \$ | | \$ 69,816 | \$ 9 | \$ | \$ 69,825 | 0.98 |
| Obligations of other U.S. Government Sponsored Agencies: Due within 1 year | 14,913 | | 15 | 14,898 | 2.83 | | | | | |
| After 10 years | 2,340,777 | 121 | 26,641 | 2,314,257 | 5.89 | 1,740,676 | 586 | 9,929 | 1,731,333 | 4.90 |
| Puerto Rico Government Obligations: After 1 to 5 years | 5,000 | 43 | | 5,043 | 5.00 | 5,000 | 163 | | 5,163 | 5.00 |
| After 10 years | 8,770 | 791 | | 9,561 | 5.94 | 4,716 | 706 | | 5,422 | 6.50 |
| United States and Puerto Rico Government obligations | 2,369,460 | 955 | 26,656 | 2,343,759 | 5.87 | 1,820,208 | 1,464 | 9,929 | 1,811,743 | 4.75 |
| Mortgage-backed securities: FHLMC certificates: After 5 to 10 years | 24,461 | | 797 | 23,664 | 3.52 | 33,370 | | 316 | 33,054 | 3.75 |
| After 10 years | 5,003 | | 169 | 4,834 | 4.88 | | | | | |
| GNMA certificates: After 10 years | 1,443 | 102 | | 1,545 | 7.56 | | | | | |
| FNMA certificates: After 5 to 10 years | 22,243 | | 560 | 21,683 | 3.81 | 28,228 | 191 | | 28,419 | 3.86 |
| After 10 years | 1,416,584 | | 30,933 | 1,385,651 | 4.31 | 1,825,206 | 13,974 | | 1,839,180 | 4.29 |

| | | | | | | | | | | |
|--|--------------|----------|-----------|--------------|------|--------------|-----------|-----------|--------------|------|
| Mortgage-backed securities | 1,469,734 | 102 | 32,459 | 1,437,377 | 4.29 | 1,886,804 | 14,165 | 316 | 1,900,653 | 4.27 |
| Corporate Bonds: | | | | | | | | | | |
| Within 1 year | 500 | | | 500 | 5.05 | 19,925 | 35 | | 19,960 | 2.64 |
| After 1 to 5 years | 2,484 | 133 | | 2,617 | 7.75 | | | | | |
| After 5 to 10 years | 3,018 | 29 | | 3,047 | 7.70 | | | | | |
| After 10 years | 22,903 | 80 | | 22,983 | 7.43 | | | | | |
| Corporate bonds | 28,905 | 242 | | 29,147 | 7.44 | 19,925 | 35 | | 19,960 | 2.64 |
| Total Investment Securities Held to Maturity | \$ 3,868,099 | \$ 1,299 | \$ 59,115 | \$ 3,810,283 | 5.28 | \$ 3,726,937 | \$ 15,664 | \$ 10,245 | \$ 3,732,356 | 4.50 |

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

Held to maturity investments as of March 31, 2005 includes a portfolio of approximately \$28.9 million in corporate bonds and \$6.4 million in mortgage-backed securities which were acquired as part of the purchase of Ponce General Corporation. These portfolios were reclassified to the available for sale category shortly after the acquisition.

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The following tables show the Corporation's held-to-maturity investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at March 31, 2006, December 31, 2005, March 31, 2005 and March 31, 2004.

| | Less than 12 months | | As of March 31, 2006 12 months or more | | Total | |
|--|---------------------|-------------------|---|-------------------|--------------|-------------------|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| (Dollars in thousands) | | | | | | |
| Debt Securities | | | | | | |
| Other U.S. Government Sponsored Agencies | \$ 1,449,824 | \$ 62,815 | \$ 493,441 | \$ 43,647 | \$ 1,943,265 | \$ 106,462 |
| Puerto Rico Government Obligations | | | 3,798 | 141 | 3,798 | 141 |
| Mortgage-Backed Securities | | | | | | |
| FHLMC | 2,499 | 132 | 15,640 | 885 | 18,139 | 1,017 |
| FNMA | | | 1,110,075 | 50,758 | 1,110,075 | 50,758 |
| | \$ 1,452,323 | \$ 62,947 | \$ 1,622,954 | \$ 95,431 | \$ 3,075,277 | \$ 158,378 |

| | Less than 12 months | | As of December 31, 2005 12 months or more | | Total | |
|--|---------------------|-------------------|--|-------------------|--------------|-------------------|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| (Dollars in thousands) | | | | | | |
| Debt Securities | | | | | | |
| Other U.S. Government Sponsored Agencies | \$ 1,585,810 | \$ 40,379 | \$ 389,949 | \$ 25,420 | \$ 1,975,759 | \$ 65,799 |
| Puerto Rico Government Obligations | 3,746 | 143 | | | 3,746 | 143 |
| Mortgage-Backed Securities | | | | | | |
| FHLMC | | | 19,433 | 778 | 19,433 | 778 |
| FNMA | 11,771 | 339 | 1,165,849 | 35,540 | 1,177,620 | 35,879 |
| | \$ 1,601,327 | \$ 40,861 | \$ 1,575,231 | \$ 61,738 | \$ 3,176,558 | \$ 102,599 |

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| | Less than 12 months | | As of March 31, 2005 (As restated) | | Total | |
|------------------------------------|------------------------|------------|---------------------------------------|------------|--------------|------------|
| | Fair Value | Unrealized | Fair Value | Unrealized | Fair Value | Unrealized |
| | | Losses | | Losses | | Losses |
| | (Dollars in thousands) | | | | | |
| Debt Securities | | | | | | |
| Other U.S. Government | | | | | | |
| Sponsored Agencies | \$ 874,198 | \$ 18,729 | \$ 861,380 | \$ 7,927 | \$ 1,735,578 | \$ 26,656 |
| Mortgage-Backed Securities | | | | | | |
| FHLMC | 5,415 | 185 | 23,083 | 781 | 28,498 | 966 |
| FNMA | 825,181 | 17,738 | 582,153 | 13,755 | 1,407,334 | 31,493 |
| | \$ 1,704,794 | \$ 36,652 | \$ 1,466,616 | \$ 22,463 | \$ 3,171,410 | \$ 59,115 |
| | | | | | | |
| | Less than 12 months | | As of March 31, 2004 (As restated) | | Total | |
| | Fair Value | Unrealized | Fair Value | Unrealized | Fair Value | Unrealized |
| | | Losses | | Losses | | Losses |
| | (Dollars in thousands) | | | | | |
| Debt Securities | | | | | | |
| Other U.S. Government | | | | | | |
| Sponsored Agencies | \$ 891,223 | \$ 8,371 | \$ 86,279 | \$ 1,558 | \$ 977,502 | \$ 9,929 |
| Mortgage- Backed Securities | | | | | | |
| FHLMC | 33,054 | 316 | | | 33,054 | 316 |
| | \$ 924,277 | \$ 8,687 | \$ 86,279 | \$ 1,558 | \$ 1,010,556 | \$ 10,245 |

Held-to-maturity securities in an unrealized loss position at March 31, 2006 are primarily mortgage-backed securities and U.S. agency securities. The vast majority of them are rated the equivalent of AAA by the major rating agencies. Management believes that the unrealized losses in the held-to-maturity portfolio at March 31, 2006 are substantially related to market interest rate fluctuations and not deterioration in the creditworthiness of the issuers; as a result, the impairment is considered temporary.

Table of Contents**6 OTHER EQUITY SECURITIES**

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

At March 31, 2006, December 31, 2005, March 31, 2005 and March 31, 2004, there were investments in FHLB stock with book value of \$28.9 million, \$40.9 million, \$66.4 million and \$52.2 million respectively. The estimated market value of such investments is its redemption value determined by the ultimate recoverability of its par value.

The Corporation has other equity securities that do not have a readily available fair value. The carrying value of such securities at March 31, 2006, December 31, 2005, March 31, 2005 and March 31, 2004 was \$1.4 million, \$1.4 million, \$1.4 million and \$0.3 million, respectively.

7 LOAN PORTFOLIO

The following is a detail of the loan portfolio:

| | March 31, | December | March 31, | March 31, |
|---|------------------|-------------------------------|------------------|------------------|
| | 2006 | 31, | 2005 | 2004 |
| | | 2005 | (As | (As |
| | | (Dollars in thousands) | Restated) | Restated) |
| Residential real estate loans, mainly secured by first mortgages | \$ 2,445,504 | \$ 2,245,272 | \$ 1,687,769 | \$ 1,005,487 |
| Commercial loans: | | | | |
| Construction loans | 1,432,255 | 1,137,118 | 478,429 | 358,070 |
| Commercial mortgage loans | 1,143,414 | 1,090,193 | 944,057 | 659,874 |
| Commercial loans | 2,443,455 | 2,421,219 | 2,000,741 | 1,713,532 |
| Loans to local financial institutions collateralized by real estate mortgages and pass-through trust certificates | 3,518,540 | 3,676,314 | 4,386,696 | 2,400,267 |
| Commercial loans | 8,537,664 | 8,324,844 | 7,809,923 | 5,131,743 |
| Finance leases | 306,633 | 280,571 | 226,923 | 172,073 |
| Consumer loans | 1,780,371 | 1,733,569 | 1,466,232 | 1,181,303 |
| Loans receivable | 13,070,172 | 12,584,256 | 11,190,847 | 7,490,606 |
| Allowance for loan and lease losses | (152,596) | (147,999) | (144,201) | (130,357) |
| Loans receivable, net | 12,917,576 | 12,436,257 | 11,046,646 | 7,360,249 |
| Loans held for sale | 73,327 | 101,673 | 26,360 | 1,345 |
| Total loans | \$ 12,990,903 | \$ 12,537,930 | \$ 11,073,006 | \$ 7,361,594 |

The Corporation's primary lending area is Puerto Rico. The Corporation's Bank subsidiary also lends in the U.S. and British Virgin Islands markets and in the state of Florida (USA). The Corporation has a significant lending concentration of \$2.9 billion in one mortgage originator in Puerto Rico at March 31, 2006. The Corporation has outstanding \$568.7 million with another mortgage originator in Puerto Rico for total loans granted to mortgage originators amounting to \$3.5 billion at March 31, 2006. These commercial loans were secured by individual residential and commercial mortgage loans. The mortgage originators have always paid the loans in accordance with the terms and conditions of the loan agreement.

Of the total gross loans receivable of \$13.1 billion as of March 31, 2006, approximately 82% have credit risk concentration in Puerto Rico, 12% in the state of Florida and 6% in the Virgin Islands.

Table of Contents**8 ALLOWANCE FOR LOAN AND LEASE LOSSES**

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

| | Quarter Ended March 31, 2005 (As Restated) | | |
|-------------------------------------|---|-------------|-------------|
| | 2006 | 2005 | 2004 |
| | (Dollars in thousands) | | |
| Balance at beginning of period | \$ 147,999 | \$ 141,036 | \$ 126,378 |
| Provision for loan and lease losses | 19,376 | 10,954 | 13,200 |
| Charge-offs | (16,449) | (10,599) | (10,696) |
| Recoveries | 1,670 | 1,447 | 1,475 |
| Other adjustments (1) | | 1,363 | |
| Balance at end of year | \$ 152,596 | \$ 144,201 | \$ 130,357 |

(1) Represents allowance for loan and lease losses from the acquisition of Ponce General Corporation.

The allowance for impaired loans is part of the allowance for loan and lease losses. These loans represent loans for which management has determined that it is probable that the debtor will be unable to pay all the amounts due, according to the contractual terms of the loan agreement, and do not necessarily represent loans for which the Corporation will incur a substantial loss. At March 31, 2006, December 31, 2005, March 31, 2005 and March 31, 2004, impaired loans had a related allowance as follows:

| | As of March 31, 2006 | As of December 31, 2005 | March 31, 2005 (As Restated) | March 31, 2004 (As Restated) |
|------------------------------|-------------------------------------|--|---|---|
| | (Dollars in thousands) | | | |
| Impaired loans | \$40,684 | \$ 59,801 | \$ 62,451 | \$ 68,946 |
| Allowance for impaired loans | \$ 6,059 | \$ 9,219 | \$ 17,573 | \$ 15,273 |

Interest income in the amount of approximately \$1.2 million, \$0.7 million and \$0.6 million was recognized on impaired loans for the quarters ended March 31, 2006, 2005 and 2004, respectively.

9 DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

The Corporation designates a derivative as either a fair value hedge, cash flow hedge or a derivative instrument not designated as a hedge when it enters into the derivative contract. Derivatives utilized by the Corporation include, among others, interest rate swaps, index options, and interest rate cap agreements.

The Corporation uses derivative instruments in the normal course of business to reduce its exposure to fluctuations in interest rates. The following table summarizes the notional amount of all derivative instruments as of March 31, 2006, December 31, 2005, March 31, 2005 and March 31, 2004.

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| | Notional amounts | | | |
|--------------------------------------|-------------------------------------|--|---|---|
| | As of March 31, 2006 | As of December 31, 2005 | As of March 31, 2005 (As Restated) | As of March 31, 2004 (As Restated) |
| | (Dollars in thousands) | | | |
| Interest rate swap agreements: | | | | |
| Pay fixed versus receive floating | \$ 99,320 | \$ 109,320 | \$ 91,320 | \$ 113,165 |
| Received fixed versus pay floating | 5,540,529 | 5,751,128 | 4,481,858 | 2,970,078 |
| Embedded written options | 13,515 | 13,515 | 13,515 | |
| Purchased options | 13,515 | 13,515 | 13,515 | |
| Written interest rate cap agreements | 125,200 | 150,200 | 25,000 | 25,000 |
| Purchased interest rate caps | 357,841 | 386,750 | 471,541 | 25,000 |
| | \$ 6,149,920 | \$ 6,424,428 | \$ 5,096,749 | \$ 3,133,243 |

At March 31, 2006, derivatives not designated or not qualifying for hedge accounting with a positive fair value of \$20.2 million (December 31, 2005 \$15.8 million, March 31, 2005 \$19.7 million and March 31, 2004 \$7.7 million) and a negative fair value of \$227.2 million (December 31, 2005 \$158.1 million, March 31, 2005 \$121.3 million and March 31, 2004 \$27.0 million) were recorded as part of Other Assets and Accounts payable and other liabilities, respectively, in the Consolidated Statements of Financial Condition.

Interest rate swaps generally involve the exchange of fixed- and variable-rate interest payments between two parties, based on a common notional amount and maturity date. The Corporation uses interest rate swaps primarily to economically hedge brokered CDs and medium term notes. At March 31, 2006, these swaps were not qualified by the Corporation for hedge accounting treatment. The majority of the swaps used as economic hedges convert the long-term fixed interest rate payments to a floating rate. The Corporation receives a fixed payment and pays a floating payment based on LIBOR. Also, the Corporation receives a fixed-rate on certain assets (i.e., loans and corporate bonds) and converts the cash flows into a floating rate. Changes in the fair value of these derivatives and the interest payments exchanged are recognized in earnings as interest income or interest expense depending upon whether an asset or liability is being economically hedged.

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A summary of the types of swaps used at March 31, 2006, December 31, 2005, March 31, 2005 and March 31, 2004 follows:

| | As of March 31, 2006 | As of December 31, 2005 | As of March 31, 2005 (As Restated) | As of March 31, 2004 (As Restated) |
|---|-------------------------------------|--|---|---|
| | (Dollars in thousands) | | | |
| Pay fixed/receive floating: | | | | |
| Notional amount | \$ 99,320 | \$ 109,320 | \$ 91,320 | \$ 113,165 |
| Weighted average receive rate at period end | 6.76% | 6.41% | 4.52% | 3.17% |
| Weighted average pay rate at period end | 6.50% | 6.60% | 6.72% | 6.97% |
| Floating rates range from 187 to 251.5 basis points over 3-month LIBOR | | | | |
| Receive fixed/pay floating: | | | | |
| Notional amount | \$5,540,529 | \$5,751,128 | \$4,481,858 | \$2,970,078 |
| Weighted average receive rate at period end | 4.96% | 4.90% | 5.01% | 5.20% |
| Weighted average pay rate at period end | 4.79% | 4.37% | 2.85% | 1.15% |
| Floating rates range from 3.5 under to 19.5 basis points over 3-month LIBOR | | | | |

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

Interest rate caps are option-like contracts that require the writer, i.e. the seller, to pay the purchaser at specified future dates the amount, if any, by which a specified market interest rate exceeds the fixed cap rate, applied to a notional principal amount.

To satisfy the needs of its customers, the Corporation may enter into non-hedging transactions. These transactions are structured with the same terms and conditions and the Corporation participates as a buyer in one of the agreements and as the seller in the other agreements.

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

Table of Contents**10 GOODWILL AND OTHER INTANGIBLES**

Goodwill at March 31, 2006 amounted to \$28.7 million (December 31, 2005 \$28.7 million, March 31, 2005 \$27.3 million and March 31, 2004 \$0) and resulted primarily from the acquisition of Ponce General Corporation in 2005. No goodwill was written down during 2006, 2005 and 2004.

At March 31, 2006, the gross carrying amount and accumulated amortization of core deposit intangibles was \$41.2 million and \$12.5 million, respectively, recognized as part of Other Assets in the Consolidated Statements of Financial Condition (December 31, 2005 \$41.2 million and \$11.6 million, respectively ; March 31, 2005 \$41.2 million and \$8.5 million, respectively ; March 31, 2004 \$23.9 million and \$6.1 million, respectively). During the quarters ended March 31, 2006, 2005 and 2004, the amortization expense of core deposits amounted to \$0.9 million, \$0.6 million, and \$0.6 million, respectively.

11 DEPOSITS

The following table summarizes deposit balances:

| | As of March 31, 2006 | As of December 31, 2005 (Dollars in thousands) | As of March 31, 2005 (As Restated) | As of March 31, 2004 (As Restated) |
|--|----------------------------|--|--|--|
| Non-interest-bearing checking account deposits | \$ 806,469 | \$ 811,006 | \$ 744,765 | \$ 620,844 |
| Saving accounts | 1,028,722 | 1,034,047 | 1,147,249 | 782,028 |
| Interest-bearing checking accounts | 371,290 | 375,305 | 386,827 | 310,128 |
| Certificates of deposit | 1,759,755 | 1,664,379 | 1,734,991 | 1,343,050 |
| Brokered certificates of deposit | 9,383,540 | 8,579,015 | 5,383,945 | 3,514,002 |
| | \$ 13,349,776 | \$ 12,463,752 | \$ 9,397,777 | \$ 6,570,052 |

The interest expense on deposits includes the valuation to market of interest rate swaps that economically hedge brokered certificates of deposit, the related interest exchanged and the amortization of broker placement fees.

The following are the components of interest expense on deposits:

| | March 31, 2006 | Quarter ended March 31, 2005 (As Restated) | March 31, 2004 (As Restated) |
|--|----------------------|--|---------------------------------------|
| | | (Dollars in thousands) | |
| Interest expense on deposits | \$ 117,252 | \$ 46,601 | \$ 26,549 |
| Amortization of broker placement fees | 3,949 | 3,651 | 4,794 |
| Interest expense on deposits excluding unrealized loss (gain) on derivatives | 121,201 | 50,252 | 31,343 |
| Unrealized loss (gain) on derivatives | 65,637 | 43,730 | (44,723) |
| Total interest expense on deposits | \$ 186,838 | \$ 93,982 | \$ (13,380) |

Total interest expense on deposits includes interest exchanged on interest rate swaps that economically hedge brokered certificates of deposit that for the quarter ended March 31, 2006 amounted to net interest

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realized of \$3.5 million (2005 net interest realized of \$24.6 million; 2004 net interest realized of \$30.3 million).

12 NOTES PAYABLE

Notes payable consists of:

| | March 31, 2006 | December 31, 2005 | March 31, 2005 (As Restated) | March 31, 2004 |
|---|-------------------------------|----------------------------------|---|-------------------------------|
| Callable fixed rate notes, bearing interest at 6.00%, maturing on October 1, 2024 | \$ 149,460 | \$ 149,456 | \$ 149,445 | \$ |
| Callable step-rate notes, bearing step increasing interest from 5.00% to 7.00% maturing on October 18, 2019 | 15,248 | 15,245 | 15,235 | |
| Dow Jones Industrial Average (DJIA) linked principal protected notes: | | | | |
| Series A maturing on February 28, 2012 | 6,876 | 6,752 | 6,531 | |
| Series B maturing on May 27, 2011 | 7,443 | 7,240 | 6,971 | |
| | \$ 179,027 | \$ 178,693 | \$ 178,182 | \$ |
| | 40 | | | |

Table of Contents**13 OTHER BORROWINGS**

Other borrowings consist of:

| | March 31, | December | March 31, | March 31, |
|---|------------------|------------------------|------------------|------------------|
| | 2006 | 31, | 2005 | 2004 |
| | | 2005 | (As | (As |
| | | 2005 | Restated) | Restated) |
| | | (Dollars in Thousands) | | |
| Junior subordinated floating rate debentures due in 2034, interest bearing at a floating rate of 2.75% over 3-month LIBOR (7.67% at March 31, 2006, 7.25% at December 31, 2005 and 5.97% at March 31, 2005) | \$ 102,780 | \$ 102,756 | \$ 102,683 | \$ |
| Junior subordinated floating rate debentures due in 2034, interest bearing at a floating rate of 2.50% over 3-month LIBOR (7.43% at March 31, 2006, 7.00% at December 31, 2005 and 5.62% at March 31, 2005) | 128,866 | 128,866 | 128,866 | |
| Loan payable to local financial institution due on April 7, 2005 (2004 -April 30, 2004), interest bearing at 3.10% (2004 -1.34%) | | | 45,696 | 45,000 |
| Loan payable to local financial institution due on April 4, 2005, interest bearing at 3.095% | | | 196,520 | |
| | \$ 231,646 | \$ 231,622 | \$ 473,765 | \$ 45,000 |

14 SUBORDINATED NOTES

On December 20, 1995, the Corporation issued 7.63% subordinated capital notes in the amount of \$100 million maturing on December 20, 2005. The notes were issued at a discount. At March 31, 2006, there was no outstanding balance as the notes payable were paid at their maturity date of December 20, 2005 (carrying value of \$82.4 million as of March 31, 2005 and \$81.9 million as of March 31, 2004). Interest on the notes was paid semiannually and at maturity. The notes represented unsecured obligations of the Corporation ranking subordinate in right of payment to all existing and future senior debt including the claims of depositors and other general creditors. The notes could not be redeemed prior to their maturity.

15 INCOME TAXES

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

Under the Puerto Rico Internal Revenue Code of 1994, as amended (PR Code), First BanCorp is subject to a maximum statutory tax rate of 39%, except that in years 2005 and 2006, an additional transitory tax rate of 2.5% was

signed into law by the Governor of Puerto Rico. In August 2005, the Government of Puerto Rico approved a transitory tax rate of 2.5% that increased the maximum statutory tax rate from 39.0% to 41.5% for a two-year period. The additional tax related to the income earned from January 1 to the date of enactment of the law was

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fully recorded in the third quarter of 2005. On May 13, 2006, with an effective date of January 1, 2006, the Governor of Puerto Rico approved an additional transitory tax rate of 2.0% applicable only to companies covered by the Puerto Rico Banking Act as amended, such as First Bank Puerto Rico (First Bank or the Bank), which raised the maximum statutory tax rate to 43.5% for taxable years that commenced during calendar year 2006. For taxable years beginning after December 31, 2006, the maximum statutory tax rate will be 39%. The PR Code also includes an alternative minimum tax of 22% that applies if the Corporation's regular income tax liability is less than the alternative minimum tax requirements.

The Corporation has maintained an effective tax rate lower than the maximum statutory rate mainly by investing in government obligations and mortgage-backed securities exempt from U.S. and Puerto Rico income taxes and doing business through international banking units (IBEs) of the Corporation and the Bank and by the Bank's subsidiary, FirstBank Overseas Corporation. The IBEs and FirstBank Overseas Corporation were created under the International Banking Entity Act of Puerto Rico, which provides for total Puerto Rico tax exemption on net income derived by IBEs operating in Puerto Rico. Since 2004, IBEs that operate as a unit of a bank pay income taxes at normal rates to the extent that the IBEs' net income exceeds predetermined percentages of the bank's total net taxable income; such limitations were 30% of total net taxable income for a taxable year commencing between July 1, 2004 and July 1, 2005, and 20% of total net taxable income for taxable years commencing thereafter.

For the quarter ended March 31, 2006, the Corporation recognized an income tax benefit of \$11.6 million compared to a tax benefit of \$3.7 million and a tax expense of \$28.4 million for the same period in 2005 and 2004, respectively. The higher income tax benefit for the first quarter of 2006 as compared to the first quarter of 2005 and 2004 was mainly due to an increase in deferred tax benefits resulting principally from higher unrealized losses on derivative instruments, net of increases in the current tax provision. For the first quarter of 2006, the Corporation recognized a deferred tax benefit of \$28.6 million compared to \$17.7 million for the same period in 2005 and a deferred tax expense of \$13.0 million for the first quarter of 2004.

The Corporation evaluated its ability to realize the deferred tax asset and concluded, based on the evidence available, that it is more likely than not that some of the deferred tax assets will not be realized and thus, established a valuation allowance of \$2.9 million as of March 31, 2006. At March 31, 2006, the deferred tax asset, net of the valuation allowance, amounted to approximately \$164.3 million compared to \$93.1 million at March 31, 2005 and \$55.1 million at March 31, 2004. At March 31, 2005 and 2004, based on the Corporation's analysis and available evidence, the Corporation did not establish a valuation allowance.

16 SEGMENT INFORMATION

Based upon the Corporation's organizational structure and the information provided to the Chief Operating Decision Maker and to a lesser extent to the Board of Directors, the operating segments are driven primarily by the Corporation's legal entities. At March 31, 2006, the Corporation had four reportable segments: Commercial and Corporate Banking; Mortgage Banking; Consumer (Retail) Banking; and Treasury and Investments, as well as an Other category reflecting other legal entities reported separately on an aggregate basis. Management determined the reportable segments based on the internal reporting used to evaluate performance and to assess where to allocate resources. Other factors such as the Corporation's organizational chart, nature of the products, distribution channels and the economic characteristics of the products were also considered in the determination of the reportable segments.

The Commercial and Corporate Banking segment consists of the Corporation's lending and other services for large customers represented by the public sector and specialized and middle-market clients. The Commercial and Corporate Banking segment offers commercial loans, including commercial real estate and construction loans, and other products such as cash management and business management services. The Mortgage Banking segment's operations consist of the origination, sale and servicing of a variety of residential mortgage loans. The Mortgage

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Banking segment also acquires and sells mortgages in the secondary markets. Certain mortgage loans are purchased from other local banks or mortgage brokers. The Consumer (Retail) segment consists of the Corporation's consumer lending and deposit-taking activities conducted mainly through its branch network and loan centers. The Treasury and Investment segment is responsible for the Corporation's investment portfolio and treasury functions executed to manage and enhance liquidity. This segment loans funds to the Commercial and Corporate Banking; Mortgage Banking; and Consumer segments to finance their lending activities and borrows from those segments.

The Consumer segment also loans funds to other segments. The interest rates charged or credited by Treasury and Investments and the Consumer segment are allocated based on market rates. The difference between the allocated interest income or expense and the Corporation's actual net interest income from centralized management of funding costs is reported in the Treasury and Investments segment. The Other category is mainly composed of insurance, finance leases and other products.

The accounting policies of the business segments are the same as those described in Note 1 of the Corporation's financial statements for the year ended December 31, 2005 contained in the annual report of the Corporation on Form 10-K.

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

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

| | Mortgage Banking | Consumer | Commercial and Corporate | Treasury and Investments | Other | Total |
|--|-----------------------------|-----------------|---|---|--------------|---------------|
| For the quarter ended March 31, 2006: | | | | | | |
| Interest income | \$ 35,324 | \$ 49,973 | \$ 134,448 | \$ 80,956 | \$ 27,004 | \$ 327,705 |
| Net (charge) credit for transfer of funds | (23,537) | 25,071 | (89,131) | 92,026 | (4,429) | |
| Interest expense | | (16,031) | | (233,517) | (5,338) | (254,886) |
| Net interest income (loss) | 11,787 | 59,013 | 45,317 | (60,535) | 17,237 | 72,819 |
| Provision for loan and lease losses | (326) | (13,285) | (832) | | (4,933) | (19,376) |
| Other (loss) income | (554) | 5,836 | 918 | (910) | 5,298 | 10,588 |
| Direct operating expenses | (3,585) | (21,413) | (5,239) | (1,856) | (10,481) | (42,574) |
| Segment income (loss) | \$ 7,322 | \$ 30,151 | \$ 40,164 | \$ (63,301) | \$ 7,121 | \$ 21,457 |
| Average earnings assets | \$ 2,136,483 | \$ 1,936,044 | \$ 7,662,139 | \$ 6,391,152 | \$ 1,078,831 | \$ 19,204,649 |
| For the quarter ended March 31, 2005 (As Restated): | | | | | | |
| Interest income | \$ 22,728 | \$ 38,938 | \$ 79,516 | \$ 58,652 | \$ 12,543 | \$ 212,377 |
| Net (charge) credit for transfer of funds | (14,195) | 16,856 | (46,274) | 46,205 | (2,592) | |
| Interest expense | | (11,004) | | (136,097) | | (147,101) |
| Net interest income | 8,533 | 44,790 | 33,242 | (31,240) | 9,951 | 65,276 |
| Provision for loan and lease losses | (461) | (3,816) | (5,595) | | (1,082) | (10,954) |
| Other income | 512 | 4,758 | 1,283 | 9,602 | 4,096 | 20,251 |
| Direct operating expenses | (3,522) | (17,613) | (3,113) | (1,231) | (5,387) | (30,866) |
| Segment income (loss) | \$ 5,062 | \$ 28,119 | \$ 25,817 | \$ (22,869) | \$ 7,578 | \$ 43,707 |

| | | | | | | |
|--|--------------|--------------|--------------|--------------|------------|---------------|
| Average earnings assets | \$ 1,342,273 | \$ 1,541,563 | \$ 6,675,751 | \$ 4,878,107 | \$ 334,023 | \$ 14,771,717 |
| For the quarter ended March 31, 2004 (As Restated): | | | | | | |
| Interest income | \$ 18,490 | \$ 33,011 | \$ 41,396 | \$ 46,822 | \$ 11,098 | \$ 150,817 |
| Net (charge) credit for transfer of funds | (11,618) | 11,304 | (14,173) | 16,273 | (1,786) | |
| Interest expense | | (9,967) | | (12,064) | | (22,031) |
| Net interest income | 6,872 | 34,348 | 27,223 | 51,031 | 9,312 | 128,786 |
| Provision for loan and lease losses | (265) | (5,290) | (6,572) | | (1,073) | (13,200) |
| Other income | 1,576 | 10,049 | 1,329 | 5,214 | 2,796 | 20,964 |
| Direct operating expenses | (2,351) | (15,091) | (2,068) | (650) | (4,252) | (24,412) |
| Segment income | \$ 5,832 | \$ 24,016 | \$ 19,912 | \$ 55,595 | \$ 6,783 | \$ 112,138 |
| Average earnings assets | \$ 1,016,577 | \$ 1,243,618 | \$ 4,528,610 | \$ 4,667,888 | \$ 263,300 | \$ 11,719,993 |

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

| | | Quarter Ended | |
|---|---------------|----------------------|------------------|
| | | March 31, | |
| | | 2005 | 2004 |
| | | (As | (As |
| | 2006 | Restated) | Restated) |
| Net income: | | | |
| Total income for segments and other | \$ 21,457 | \$ 43,707 | \$ 112,138 |
| Other operating expenses | (29,164) | (22,141) | (18,318) |
| (Loss) Income before income taxes | (7,707) | 21,566 | 93,820 |
| Income tax benefit (expense) | 11,570 | 3,649 | (28,390) |
| Total consolidated net income | \$ 3,863 | \$ 25,215 | \$ 65,430 |
| Average assets: | | | |
| Total average earning assets for segments | \$ 19,204,649 | \$ 14,771,717 | \$ 11,719,993 |
| Average non-earning assets | 673,872 | 478,487 | 369,997 |
| Total consolidated average assets | \$ 19,878,521 | \$ 15,250,204 | \$ 12,089,990 |

17. COMMITMENTS AND CONTINGENCIES

The Corporation enters into financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments may include commitments to extend credit and commitments to sell and purchase mortgage loans at fair value. As of March 31, 2006, commitments to extend credit amounted to approximately \$1.8 billion and stand by letters of credit amounted to approximately \$118.7 million. Commitments to extend credit are agreements to lend to a customer as long as the conditions established in the contract are met. Commitments generally have fixed expiration dates or other termination clauses. Generally, the Corporation's mortgage banking activities do not enter into interest rate lock agreements with its prospective borrowers.

As of March 31, 2006, First BanCorp and its subsidiaries were defendants in various legal proceedings arising in the ordinary course of business. Management believes, based on the opinion of legal counsel, that the final disposition of these matters will not have a material adverse effect on the Corporation's financial position or results of operations, except as described below.

On August 1, 2005, the Audit Committee of the Corporation determined that it should review the background and accounting for certain mortgage-related transactions that the Corporation had entered into with Doral Financial Corporation (Doral) and R&G Financial Corporation (R&G) between 1999 and 2005 that did not qualify as true sales for accounting purposes. The Committee retained the law firms of Clifford Chance U.S. LLP and Martínez Odell & Calabria and forensic accountants FTI Consulting Inc. to assist the Audit Committee in its review. On August 25, 2005, the Corporation announced the receipt of a letter from the SEC in which the SEC indicated that it was conducting an informal inquiry into the Corporation. On October 21, 2005, the Corporation announced that the SEC had issued a formal order of investigation into the accounting for the mortgage-related transactions with Doral and R&G. The Corporation announced on December 13, 2005 that management, with the concurrence of the Board of Directors, determined to restate its previously reported financial statements to correct its accounting for the mortgage-related transactions. The Corporation has fully cooperated with the SEC's investigation. In August 2006, the Audit Committee completed its review and the Corporation filed the Amended 2004 Form 10-K with the SEC on

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On August 7, 2007, First BanCorp announced that the SEC approved a final settlement with the Corporation, which resolves the previously disclosed SEC investigation of the Corporation. Under the settlement, the Corporation agreed, without admitting or denying any wrongdoing, to be enjoined from future violations of certain provisions of the securities laws. The Corporation also agreed to pay an \$8.5 million civil penalty and the disgorgement of \$1 to the SEC. The SEC may request that the civil penalty be subject to distribution pursuant to the Fair Fund provisions of Section 308(a) of the Sarbanes-Oxley Act of 2002. The monetary payment will have no impact on the Corporation's earnings or capital in 2007. As reflected in First BanCorp's previously filed audited Consolidated Financial Statements for 2005, the Corporation accrued \$8.5 million in 2005 for the potential settlement with the SEC. In connection with the settlement, the Corporation consented to the entry of a final judgment to implement the terms of the agreement. The United States District Court for the Southern District of New York must consent to the entry of the final judgment in order to consummate the settlement.

Following the announcement of the Audit Committee's review, the Corporation and certain of its current and former officers and directors were named as defendants in five separate securities class actions filed between October 31, 2005 and December 5, 2005, alleging violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934. At present, all securities class actions have been consolidated into one case named *In Re: First BanCorp Securities Litigations*. Subsequently, in 2007, the Corporation reached an agreement in principle and signed a memorandum of understanding with the lead plaintiff. The agreement specified a payment of \$74.25 million by the Corporation subject to the approval by the United States District Court for the District of Puerto Rico.

On August 1, 2007, the United States District Court for the District of Puerto Rico issued a Preliminary Order approving the stipulation of settlement filed in connection with the proposed settlement of the class action lawsuit brought on behalf of First BanCorp's shareholders against the Corporation in the amount of \$74.25 million.

The effectiveness of a final order to be issued by the Court is subject to:

The payment of \$61 million to be deposited by First BanCorp in a settlement fund within fifteen calendar days of the date of issuance of the Preliminary Order; and

The mailing of a notice to shareholders that describes the general terms of the settlement.

The court hearing for the final order of approval of the settlement has been set for October 15, 2007. First BanCorp intends to comply with the \$61 million payment requirement within the timeframe set forth in the terms of the settlement. The remaining amount of \$13,250,000 will be paid before December 31, 2007. The monetary payment will have no impact on the Corporation's earnings or capital in 2007. As reflected in First BanCorp's audited Consolidated Financial Statements, included in the Corporation's 2005 Annual Report on Form 10-K, the Corporation accrued \$74.25 million in 2005 for a possible settlement of the class action.

The Corporation expects to seek recovery of a total of approximately \$14.75 million from its insurance companies and from former executives of the Corporation. Since agreements with the insurance carriers have not been executed, the Corporation cannot provide assurances that the monies from the insurance carriers will be received and consequently, the Corporation has not made accruals for any potential payment from its insurance carriers.

Between November 8, 2005 and March 7, 2006, several shareholders of the Corporation commenced five separate derivative actions against certain current and former executive officers and directors of the Corporation. In these actions, the Corporation was included as a nominal defendant. These actions were filed pursuant to Section 304 of the Sarbanes-Oxley Act of 2002 and alleged, among other things, a breach of fiduciary duty on behalf of the defendants. All shareholder derivative actions were consolidated into one case

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named In Re: First BanCorp Derivative Litigation which was dismissed on November 30, 2006 before the U.S. District Court for the District of Puerto Rico.

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The following condensed financial information presents the financial position of the Holding Company only at March 31, 2006, December 31, 2005, March 31, 2005 and March 31, 2004 and the results of its operations for the quarters ended on March 31, 2006, 2005 and 2004.

| | As of March 31, 2006 | As of December 31, 2005 | As of March 31, 2005 (As Restated) | As of March 31, 2004 (As Restated) |
|--|----------------------------|----------------------------------|--|--|
| (Dollars in thousands) | | | | |
| Assets | | | | |
| Cash and due from banks | \$ 29,367 | \$ 2,772 | \$ 22,746 | \$ 18,482 |
| Money market instruments | 300 | 300 | 91,600 | 56,052 |
| Investment securities available for sale, at market: | | | | |
| Equity investments | 30,140 | 29,421 | 45,626 | 55,524 |
| Other equity securities | 1,425 | 1,425 | 1,375 | 375 |
| Loans receivable, net | 71,767 | 74,914 | 90,421 | 55,370 |
| Investment in FirstBank Puerto Rico, at equity | 1,276,837 | 1,316,380 | 1,132,837 | 987,551 |
| Investment in FirstBank Insurance Agency, at equity | 2,808 | 5,953 | 3,386 | 3,735 |
| Investment in Ponce General Corporation, at equity | 107,271 | 105,907 | 101,936 | |
| Investment in PR Finance, at equity | 3,026 | 3,005 | | |
| Accrued interest receivable | 328 | 363 | 332 | 25 |
| Investment in FBP Statutory Trust I | 3,093 | 3,093 | 3,093 | |
| Investment in FBP Statutory Trust II | 3,866 | 3,866 | 3,866 | |
| Other assets | 30,744 | 29,758 | 1,453 | 979 |
| Total assets | \$ 1,560,972 | \$ 1,577,157 | \$ 1,498,671 | \$ 1,178,093 |

Liabilities & Stockholders Equity

Liabilities:

| | | | | |
|--|---------------------|---------------------|---------------------|---------------------|
| Other borrowings | \$ 231,646 | \$ 295,446 | \$ 308,740 | \$ 45,000 |
| Accounts payable and other liabilities | 149,665 | 83,870 | 6,553 | 326 |
| Total liabilities | 381,311 | 379,316 | 315,293 | 45,326 |
| Stockholders equity | 1,179,661 | 1,197,841 | 1,183,378 | 1,132,767 |
| Total liabilities and stockholders equity | \$ 1,560,972 | \$ 1,577,157 | \$ 1,498,671 | \$ 1,178,093 |

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| | Quarter Ended March 31, 2006 | Quarter Ended March 31, 2005 (As Restated) (Dollars in thousands) | Quarter Ended March 31, 2004 (As Restated) |
|---|--|--|---|
| Income: | | | |
| Interest income on investment securities | \$ 178 | \$ 80 | \$ 151 |
| Interest income on other investments | 3 | 1,119 | 122 |
| Interest income on loans | 1,053 | 984 | 65 |
| Dividend from FirstBank Puerto Rico | 17,127 | 16,745 | 14,910 |
| Dividend from other subsidiaries | 4,000 | | |
| Other income | 124 | 203 | 49 |
| | 22,485 | 19,131 | 15,297 |
| Expense: | | | |
| Notes payable and other borrowings | 4,146 | 3,536 | 1 |
| Interest on funding to subsidiaries | 742 | | |
| (Recovery) provision for loan losses | (71) | | |
| Other operating expenses | 1,256 | 258 | 194 |
| | 6,073 | 3,794 | 195 |
| (Loss) gain on investments, net | (1,033) | 2,961 | 3,363 |
| Income before income tax provision and equity in undistributed (loss) earnings of subsidiaries | 15,379 | 18,298 | 18,465 |
| Income tax benefit (provision) | 1,088 | (8) | (45) |
| Equity in undistributed (loss) earnings of subsidiaries | (12,604) | 6,925 | 47,010 |
| Net income | \$ 3,863 | \$ 25,215 | \$ 65,430 |

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19. SUBSEQUENT EVENTS

Following the close of the first quarter of 2006, a number of events have occurred including:

Effective April 1, 2006, the majority of the Corporation's derivative instruments, which are mainly interest rate swaps, were designated as hedging relationships under SFAS 133. Most of the interest rate swaps were designated under the long-haul method to hedge the changes in fair value of brokered certificates of deposit and medium-term notes. Prospectively, the effective portion of the changes in value of the brokered certificates of deposit and medium-term notes (the hedge items) are 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 elected to early adopt SFAS 159 for the callable brokered CDs and a portion of the callable medium-term notes that were previously on a hedge accounting relationship with certain interest rate swaps under SFAS 133. Refer to Note 2 for additional information on the adoption of SFAS 159.

In May 2006, FirstBank Puerto Rico received a cash payment from Doral of approximately \$2.4 billion, substantially reducing the balance of the secured commercial loan to that institution. A loss of approximately \$10.6 million was recognized during 2006 as a result of this transaction. As part of the Cease and Desist Order imposed on the Corporation by its regulators the Corporation has continued working on the reduction of the Corporation's exposure to Doral.

In February 2007, the Corporation entered into various agreements with R&G relating to prior transactions originally treated as purchases of mortgages and pass-through trust certificates from R&G subsidiaries. First, through a mortgage payment agreement, R&G paid the Corporation approximately \$50 million to reduce the commercial loan that R&G Premier has outstanding with the Corporation. In addition, the remaining balance of approximately \$271 million was re-documented as a secured loan from the Corporation to R&G. Second, R&G and the Corporation amended various agreements involving approximately \$218 million of securities collateralized by loans that were originally sold through five grantor trusts. The modifications to the original agreements allow the Corporation to treat these transactions as true sales for accounting and legal purposes. The agreements enable First BanCorp to fulfill the remaining requirement of the Consent Order signed with banking regulators relating to the mortgage-related transactions with R&G that First BanCorp recharacterized for accounting and legal purposes as commercial loans secured by the mortgage loans and pass-through trust certificates.

During the first quarter of 2007, the Corporation announced that it had entered into a definitive agreement 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 approximately 10% of First BanCorp's currently outstanding common shares. The original agreement provided that the agreement may be terminated at any time prior to the closing by either the Corporation or Scotiabank if the closing did not occur by July 31, 2007 (the Termination Date). The agreement was subsequently amended to change the Termination Date to August 31, 2007. On August 9, 2007, First BanCorp announced the approval by the Federal Reserve Board of the private placement offering with Scotiabank.

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On August 1, 2007, the United States District Court for the District of Puerto Rico issued a Preliminary Order approving the stipulation of settlement filed in connection with the proposed settlement of the class action lawsuit brought on behalf of First BanCorp's shareholders against the Corporation in the amount of \$74.25 million.

The effectiveness of a final order to be issued by the Court is subject to:

The payment of \$61 million to be deposited by First BanCorp in a settlement fund within fifteen calendar days of the date of issuance of the Preliminary Order; and

The mailing of a notice to shareholders that describes the general terms of the settlement.

The court hearing for the final order of approval of the settlement has been set for October 15, 2007. First BanCorp intends to comply with the \$61 million payment requirement within the timeframe set forth in the terms of the settlement. The remaining amount of \$13,250,000 will be paid before December 31, 2007. The monetary payment will have no impact on the Corporation's earnings or capital in 2007. As reflected in First BanCorp's audited Consolidated Financial Statements, included in the Corporation's 2005 Annual Report on Form 10-K, the Corporation accrued \$74.25 million in 2005 for a possible settlement of the class action.

On August 7, 2007, First BanCorp announced that the SEC approved a final settlement with the Corporation, which resolves the previously disclosed SEC investigation of the Corporation. Under the settlement, the Corporation agreed, without admitting or denying any wrongdoing, to be enjoined from future violations of certain provisions of the securities laws. The Corporation also agreed to pay an \$8.5 million civil penalty and the disgorgement of \$1 to the SEC. The SEC may request that the civil penalty be subject to distribution pursuant to the Fair Fund provisions of Section 308(a) of the Sarbanes-Oxley Act of 2002. The monetary payment will have no impact on the Corporation's earnings or capital in 2007. As reflected in First BanCorp's previously filed audited Consolidated Financial Statements for 2005, the Corporation accrued \$8.5 million in 2005 for the potential settlement with the SEC. In connection with the settlement, the Corporation consented to the entry of a final judgment to implement the terms of the agreement. The United States District Court for the Southern District of New York must consent to the entry of the final judgment in order to consummate the settlement.

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

Restatement of Previously Issued Financial Statements

On September 26, 2006, First BanCorp filed with the SEC its amended 2004 Annual Report on Form 10-K/A, which included a restatement of the Corporation's audited financial statements for the years ended December 31, 2004, 2003 and 2002 and unaudited selected quarterly financial information for each of the four quarters of 2004, 2003 and 2002 (the 2004 restatement). This Quarterly Report on Form 10-Q includes financial information for the quarters ended March 31, 2005 and 2004, as restated. The restatement reflects adjustments necessary to correct accounting errors relating to the following:

Accounting for derivative instruments and broker placement fees;

Recharacterization of purchases of mortgage loans and pass-through trust certificates as commercial loans secured by mortgage loans;

Accounting for investment securities;

Accounting for deferral and recognition of origination fees and costs on loans; and

Other accounting adjustments and reclassifications, including adjustments to the gain on sale of credit card portfolios, accrual for rental expense on lease contracts, valuation of financial instruments and income from a loan origination subsidiary.

In addition, with the filing of its 2006 Annual Report on Form 10-K, First BanCorp restated its 2005 and 2004 Statements of Cash Flows due to some incorrect classifications. The classification errors related to three main items: 1) the treatment of discounts and the related accretion activity on certain investment securities, 2) the classification of cash flows from the disposition of repossessed assets, and 3) purchases of zero coupon bonds and agency discount notes amounts presented as part of investing activities (the 2006 restatement).

The filing of this Quarterly Report on Form 10-Q was delayed because of the time required to complete the 2004 restatement. For more information on the Corporation's 2004 restatement, refer to Item 8, Financial Statements and Supplementary Data, Note 1 Restatement of Previously Issued Financial Statements in the Corporation's amended 2004 Annual Report on Form 10-K. For more information on the Corporation's 2006 restatement, refer to Item 8, Financial Statements and Supplementary Data, Note 1 Restatement of 2005 and 2004 Consolidated Statements of Cash Flows to First BanCorp audited Consolidated Financial Statements, included in the Corporation's 2006 Annual Report on Form 10-K. For more information on the impact of the 2004 and 2006 restatements on the Corporation's financial statements for the quarters ended March 31, 2005 and 2004, refer to Note 1 to the accompanying unaudited interim consolidated financial statements contained in this Quarterly Report on Form 10-Q.

Table of Contents**SELECTED FINANCIAL DATA****(In thousands except for per share and financial ratios results)**

| | 2006 | Quarter ended March 31, 2005 (As Restated) | 2004 (As Restated) |
|---|-------------------------------------|--|---|
| Condensed Income Statements: | | | |
| Total interest income | \$ 327,705 | \$ 212,377 | \$ 150,817 |
| Total interest expense | 254,886 | 147,101 | 22,031 |
| Net interest income | 72,819 | 65,276 | 128,786 |
| Provision for loan and lease losses | 19,376 | 10,954 | 13,200 |
| Non-interest income | 10,588 | 20,251 | 20,964 |
| Non-interest expenses | 71,738 | 53,007 | 42,730 |
| (Loss) Income before income tax | (7,707) | 21,566 | 93,820 |
| Income tax benefit (provision) | 11,570 | 3,649 | (28,390) |
| Net income | 3,863 | 25,215 | 65,430 |
| Net (loss) income attributable to common stockholders | (6,206) | 15,146 | 55,361 |
| Per Common Share Results (1): | | | |
| Net (loss) income per share basic | \$ (0.08) | \$ 0.19 | \$ 0.69 |
| Net (loss) income per share diluted | \$ (0.08) | \$ 0.18 | \$ 0.67 |
| Cash dividends declared | \$ 0.07 | \$ 0.07 | \$ 0.06 |
| Average shares outstanding | 81,556 | 80,784 | 80,128 |
| Average shares outstanding diluted | 81,556 | 83,526 | 82,760 |
| Book value per common share | 7.56 | 7.84 | 7.24 |
| Selected Financial Ratios (In Percent): | | | |
| Profitability: | | | |
| Return on Average Assets | 0.08 | 0.66 | 2.16 |
| Interest Rate Spread | 2.66 | 2.99 | 2.94 |
| Net Interest Margin | 3.11 | 3.32 | 3.27 |
| Return on Average Total Equity | 1.28 | 8.42 | 23.77 |
| Return on Average Common Equity | (3.76) | 9.36 | 40.19 |
| Average Total Equity to Average Total Assets | 6.09 | 7.85 | 9.11 |
| Dividend payout ratio | (93.57) | 37.34 | 8.70 |
| Efficiency ratio (2) | 86.01 | 61.98 | 28.53 |
| Asset Quality: | | | |
| Allowance for loan and lease losses to loans receivable | 1.17 | 1.29 | 1.74 |
| Net charge-offs annualized to average loans | 0.46 | 0.36 | 0.51 |
| Provision for loan and lease losses to net charge-offs | 1.31 | 1.20 | 1.43 |
| Other Information: | | | |
| Common Stock Price: End of period | \$ 12.36 | \$ 21.13 | \$ 20.80 |
| | As of March 31, 2006 | As of December 31, 2005 | As of March 31, 2005 (As Restated) |
| | | | As of March 31, 2004 (As Restated) |

Balance Sheet Data:

| | | | | |
|--|---------------|---------------|---------------|--------------|
| Loans and loans held for sale | \$ 13,143,499 | \$ 12,685,929 | \$ 11,217,207 | \$ 7,491,951 |
| Allowance for loan and lease losses | 152,596 | 147,999 | 144,201 | 130,357 |
| Money market and investment securities | 6,824,988 | 6,653,925 | 5,855,957 | 5,583,989 |
| Total assets | 20,559,745 | 19,917,651 | 17,516,734 | 13,339,468 |
| Deposits | 13,349,776 | 12,463,752 | 9,397,777 | 6,570,052 |
| Borrowings | 5,440,338 | 5,750,197 | 6,093,771 | 5,042,474 |
| Total common equity | 629,561 | 647,741 | 633,278 | 582,667 |
| Total equity | 1,179,661 | 1,197,841 | 1,183,378 | 1,132,767 |

- 1- Adjusted to reflect two-for-one stock split effective June 30, 2005.
- 2- Non-interest expense to the sum of net interest income and non-interest income. The denominator includes non-recurring items and changes in the fair value of derivative instruments.

Table of Contents**OVERVIEW OF RESULTS OF OPERATIONS**

This discussion and analysis relates to the accompanying consolidated interim unaudited financial statements of First BanCorp (the Corporation or First BanCorp) and should be read in conjunction with the interim unaudited financial statements and the notes thereto.

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

As previously reported, 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. This acquisition will allow First BanCorp to build a larger platform in Florida from which to initiate further expansion into the United States. As of March 31, 2005, excluding the effects of purchase accounting entries, Ponce General had approximately \$546.2 million in assets and \$439.1 million in deposits. Ponce General assets were mainly comprised of \$476.0 million in loans (\$425.8 million commercial and residential mortgage loans; \$28.2 million commercial and construction loans; and \$22.1 million consumer loans). In connection with the purchase, the Corporation paid a cash premium of approximately \$36 million that was mainly allocated to core deposit intangibles and goodwill.

For the quarter ended March 31, 2006, the Corporation's net income was \$3.9 million, compared to \$25.2 million and \$65.4 million for the quarters ended March 31, 2005 and 2004, respectively. For the quarter ended March 31, 2006, loss per common share amounted to \$0.08, compared to diluted earnings per common share of \$0.18 and \$0.67 for the quarters ended March 31, 2005 and 2004, respectively. Return on average assets and return on average common equity were 0.08% and (3.76)% respectively, for the first quarter of 2006 as compared to 0.66% and 9.36% and 2.16% and 40.19%, for the same quarter of 2005 and 2004, respectively. The Corporation's financial performance for the first quarter of 2006, as compared to the first quarter of 2005, was principally impacted by: (1) higher unrealized losses in the valuation of derivative instruments, mainly interest rate swaps that economically hedge brokered certificates of deposits (CDs), (2) higher other-than-temporary impairment charges related to certain equity securities held in the Corporation's available for sale portfolio and lower gains on sales of investments, (3) higher non-interest expenses, primarily professional expenses associated with the Audit Committee's review and the restatement process coupled with share-based compensation expenses recognized according to the provisions of SFAS 123R adopted in 2006, and (4) a higher provision for loan and lease losses.

The highlights and key drivers of the Corporation's financial results for the quarter ended March 31, 2006 included the following:

For the quarter ended March 31, 2006, the Corporation's operations resulted in a net income of \$3.9 million, compared to \$25.2 million and \$65.4 million for the quarters ended March 31, 2005 and 2004, respectively. After payment of preferred stock dividends, the Corporation had a net loss attributable to common stockholders of \$6.2 million for the first quarter of 2006 compared to a net income attributable to

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common stockholders of \$15.1 million and \$55.4 million for the quarters ended March 31, 2005, and 2004, respectively.

Loss per common share for the quarter ended March 31, 2006 amounted to \$0.08 compared to diluted earnings per common share of \$0.18 and \$0.67 for the quarters ended March 31, 2005 and 2004, respectively.

Net interest income for the quarters ended March 31, 2006, 2005, and 2004 was \$72.8 million, \$65.3 million, and \$128.8 million, respectively. Net interest income was significantly impacted by changes in the valuation of derivatives instruments. For the quarter ended March 31, 2006, the Corporation recorded net unrealized losses of \$64.7 million in the valuation of derivative instruments, compared to net unrealized losses of \$42.2 million and net unrealized gains of \$44.6 million for the same periods in 2005 and 2004, respectively. Refer to the *Net Interest Income* discussion for further details. The figures for the first quarter of 2006 also include the results of Ponce General, acquired in March 31, 2005, which contributed approximately \$6.1 million to the consolidated net interest income.

On a tax equivalent basis (for definition and reconciliation of this non-GAAP measure, refer to the *Net Interest Income* discussion below), net interest income for the quarters ended March 31, 2006, 2005, and 2004 was \$148.4 million, \$121.8 million, and \$96.5 million, respectively. The increase in net interest income for 2006 was mainly driven by the increase in the average volume of interest-earnings assets of \$4.5 billion, or 30%, as compared to the same period a year ago, attributable primarily to the growth in the Corporation's loan and investment portfolios, in particular the commercial, construction and residential real estate loan portfolios as well as government agency securities, partially offset by a reduction in the net interest margin, which on a tax equivalent basis decreased by 21 basis points due to the flattening of the yield curve and fluctuations in net interest settlements on interest rate swaps. The decrease in the Corporation's net interest margin on a tax equivalent basis has been particularly significant with respect to the Corporation's portfolio of investment securities. The interest rate spread on the Corporation's portfolio of investment securities, (allocating a funding cost equal to the weighted-average cost of the Corporation's other borrowed funds), was approximately 1.32% for the quarter ended March 31, 2006 compared to 2.34% for the quarter ended March 31, 2005. Increases in short-term rates resulted in a change in net interest settlements on interest rate swaps included as part of interest expense. For the quarter ended March 31, 2006, the net interest settlements on such interest rate swaps resulted in a benefit of \$3.5 million recognized as a reduction to interest expense, compared to a benefit of \$24.6 million for the same period in 2005, as the rates paid by the Corporation under the variable portion of the swaps significantly increase during 2006.

The increase in tax equivalent net interest income for 2005 when compared with 2004 was mainly driven by higher average balance of loans receivable, particularly the residential and commercial loan portfolios, coupled with a slight increase in net interest rate margin.

For the quarter ended on March 31, 2006, the Corporation provided \$19.4 million for loan and lease losses, as compared to \$11.0 million and \$13.2 million for the quarters ended March 31, 2005 and 2004, respectively. The increase in the provision during 2006 principally reflects growth in the Corporation's commercial, construction and consumer loan portfolios coupled with increasing trends in delinquencies and changes to the Corporation's estimate of probable losses for residential real estate loans. The decrease in the provision during 2005 compared to 2004 was due in part to the stability experienced in non-performing loans and net charge-offs.

Non-interest income for the quarter ended March 31, 2006 amounted to approximately \$10.6 million as compared to \$20.3 million and \$21.0 million for the quarters ended March 31, 2005 and 2004, respectively. The decrease in non-interest income during 2006 compared to 2005 was principally due to a reduced volume of sales of investment securities coupled with other-than-temporary impairment charges of

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approximately \$2.1 million on certain equity securities as well as a \$1.0 million lower-of-cost-or-market negative valuation adjustment to the Corporation's loans held for sale portfolio. The decrease was partially offset by increases in insurance income and service charges on deposit accounts and loans. The decrease in non-interest income for 2005 compared to 2004 was principally due to reduced earnings in the Corporation's mortgage banking activities due to a lower volume of loan sales and to a decrease in other operating income offset in part by an increase in insurance income.

For the quarter ended March 31, 2006, non-interest expenses amounted to \$71.7 million, compared to \$53.0 million and \$42.7 million, for the same periods in 2005 and 2004, respectively. The increase in non-interest expenses for 2006 was mainly due to increases in employees' compensation and benefits (including share-based compensation expense of \$4.9 million according to the provisions of SFAS 123R and \$1.8 million associated with the operations of Ponce General Corporation), occupancy and equipment, and professional fees associated with the internal review conducted by the Corporation's Audit Committee, the restatement process and other related legal and regulatory matters. The increase in non-interest expenses for 2005 mainly reflects increases in employees' compensation and benefits, occupancy and equipment, professional fees, and other operating expenses.

For the quarter ended March 31, 2006, the Corporation recognized an income tax benefit of \$11.6 million compared to a tax benefit of \$3.6 million and a tax expense of \$28.4 million for quarters ended March 31, 2005 and 2004, respectively. The increase in income tax benefits for the first quarter of 2006 as compared to the first quarter of 2005 was mainly due to an increase in deferred tax benefits mainly as a result of higher unrealized losses on derivative instruments, partially offset by increases in the current tax provision coupled with an increase in non-qualifying IBE income that under current legislation was taxed at regular rates. The income tax benefit for 2005 compared to an income tax expense for 2004 was mainly due to a deferred tax benefit of \$17.4 million recognized during the first quarter of 2005 mainly as a result of unrealized losses on derivative instruments.

As of March 31, 2006, the Corporation's total assets amounted to \$20.6 billion compared to \$19.9 billion as of December 31, 2005. The increase in total assets was principally attributable to increases in the Corporation's construction and commercial loan portfolios. Total assets as of March 31, 2005 increased by \$4.2 billion or 31% over the prior year mainly due to the growth in the Corporation's loans portfolio coupled with the acquisition of Ponce General Corporation.

Total liabilities at March 31, 2006 were \$19.4 billion, an increase of \$0.7 billion, \$3.0 billion, and \$7.2 billion as compared to balances as of December 31, 2005, March 31, 2005, and March 31, 2004, respectively. The increase in total liabilities was mainly due to increases in interest-bearing deposits, mainly brokered CDs partially offset by decreases in FHLB advances. During 2005, the Corporation experienced a significant increase in brokered CDs as short-term brokered CDs were issued to fund the Corporation's growth and to replace advances from the Federal Home Loan Bank.

Total loan production for the quarter ended March 31, 2006 was \$1.4 billion compared to \$1.8 billion and \$1.1 billion for the quarters ended March 31, 2005 and 2004, respectively. The decrease in loan production for 2006 was mainly due to a decrease in commercial loan production, as the Corporation did not extend loans to local financial institutions in 2006, coupled with a decrease in residential mortgage loan production. The decrease in residential mortgage loan production for 2006 compared to 2005 was mainly attributable, among other things, to higher mortgage interest rates, adverse economic conditions in Puerto Rico, and stricter underwriting guidelines.

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Critical Accounting Policies and Practices

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

The Corporation's critical accounting policies are described in the Management Discussion and Analysis of Financial Condition and Results of Operations section of First BanCorp's 2005 Annual Report on Form 10-K.

For additional information and further details on the Corporation's recently adopted accounting pronouncements, refer to Note 2 of the accompanying unaudited interim consolidated financial statements.

Net Interest Income

Net interest income is the excess of interest earned by First BanCorp on its interest-earning assets over the interest incurred on its interest-bearing liabilities. First BanCorp's net interest income is subject to interest rate risk due to the re-pricing and maturity mismatch of the Corporation's assets and liabilities. Net interest income for the quarters ended March 31, 2006, 2005, and 2004 was \$72.8 million, \$65.3 million, and \$128.8 million, respectively. On a tax equivalent basis, excluding the changes in the fair values of derivative instruments, net interest income for the quarters ended March 31, 2006, 2005, and 2004 was \$148.4 million, \$121.8 million, and \$96.5 million, respectively.

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

Table of Contents**Part I****Quarter ended March 31,**

| | Average volume | | | Interest Income (1) / expense | | | Average rate (1) | | |
|------------------------------------|------------------------|--------------------------|--------------------------|-------------------------------|--------------------------|--------------------------|------------------|--------------------------|--------------------------|
| | 2006 | 2005 (As Restated) | 2004 (As Restated) | 2006 | 2005 (As Restated) | 2004 (As Restated) | 2006 | 2005 (As Restated) | 2004 (As Restated) |
| | (Dollars in thousands) | | | Dollars in thousands) | | | | | |
| Earning assets: | | | | | | | | | |
| Money market investments | \$ 959,644 | \$ 314,865 | \$ 323,849 | \$ 9,975 | \$ 1,867 | \$ 717 | 4.22% | 2.40% | 0.89% |
| Government obligations (2) | 2,752,308 | 1,953,561 | 1,182,421 | 42,669 | 33,953 | 14,802 | 6.29% | 7.05% | 5.02% |
| Mortgage-backed securities | 2,648,290 | 2,424,750 | 2,951,294 | 36,432 | 35,367 | 42,590 | 5.58% | 5.92% | 5.79% |
| Corporate bonds | 26,417 | 41,250 | 77,256 | 434 | 251 | (5) | 6.67% | 2.47% | -0.03% |
| FHLB stock | 34,984 | 74,624 | 43,544 | 782 | 485 | 156 | 9.07% | 2.64% | 1.44% |
| Equity securities | 31,333 | 34,186 | 49,771 | 213 | 215 | 151 | 2.75% | 2.55% | 1.22% |
| Total investments (3) | 6,452,976 | 4,843,236 | 4,628,135 | 90,505 | 72,138 | 58,411 | 5.69% | 6.04% | 5.06% |
| Residential real estate loans | 2,427,139 | 1,353,090 | 1,020,995 | 40,301 | 23,123 | 18,831 | 6.73% | 6.93% | 7.40% |
| Construction loans | 1,299,154 | 424,099 | 343,228 | 26,809 | 6,484 | 4,071 | 8.37% | 6.20% | 4.76% |
| Commercial loans | 7,138,251 | 6,635,716 | 4,479,393 | 116,386 | 74,795 | 39,683 | 6.61% | 4.57% | 3.55% |
| Finance leases | 292,304 | 220,859 | 164,571 | 6,712 | 4,852 | 4,090 | 9.31% | 8.91% | 9.97% |
| Consumer loans | 1,765,586 | 1,403,896 | 1,176,516 | 52,849 | 42,711 | 38,120 | 12.14% | 12.34% | 13.00% |
| Total loans (4) (5) | 12,922,434 | 10,037,660 | 7,184,703 | 243,057 | 151,965 | 104,795 | 7.63% | 6.14% | 5.85% |
| Total earning assets | \$ 19,375,410 | \$ 14,880,896 | \$ 11,812,838 | \$ 333,562 | \$ 224,103 | \$ 163,206 | 6.98% | 6.11% | 5.54% |
| Interest-bearing liabilities: | | | | | | | | | |
| Interest-bearing deposits | \$ 11,782,530 | \$ 7,643,437 | \$ 6,070,035 | \$ 121,201 | \$ 50,252 | \$ 31,343 | 4.18% | 2.67% | 2.07% |
| Other borrowed funds | 5,236,363 | 4,172,627 | 3,416,953 | 59,787 | 40,671 | 30,111 | 4.63% | 3.95% | 3.53% |
| FHLB advances | 373,389 | 1,468,844 | 797,885 | 4,178 | 11,425 | 5,300 | 4.54% | 3.15% | 2.66% |
| Total interest-bearing liabilities | \$ 17,392,282 | \$ 13,284,908 | \$ 10,284,873 | \$ 185,166 | \$ 102,348 | \$ 66,754 | 4.32% | 3.12% | 2.60% |
| Net interest income | | | | \$ 148,396 | \$ 121,755 | \$ 96,452 | | | |
| Interest rate spread | | | | | | | 2.66% | 2.99% | 2.94% |
| Net interest margin | | | | | | | 3.11% | 3.32% | 3.27% |

(1) On a tax equivalent basis. The tax equivalent yield was estimated by dividing the interest rate

spread on exempt assets by (1- Puerto Rico statutory tax rate (41.5% for 2006 and 39% for 2005 and 2004)) and adding to it the cost of interest bearing liabilities. When adjusted to a tax equivalent basis, yields on taxable and exempt assets are comparable. Changes in the fair value of derivative instruments are excluded from interest income and interest expense for average rate calculation purposes because the changes in valuation do not affect interest paid or received.

- (2) Government obligations include debt issued by government sponsored agencies.
- (3) Unrealized holding gains or losses in investments available-for-sale are excluded from average volumes.
- (4) Average loan balances include the average

balance of non-accruing loans, of which interest income is recognized when collected.

- (5) Interest income on loans includes \$3.6 million, \$2.5 million, and \$3.8 million for the first quarter of 2006, 2005, and 2004, respectively, of income from prepayment penalties and late fees related to the Corporation's loan portfolio.

Table of Contents**PART II****For the Quarter Ended March 31,**

| | 2006 compared to 2005 (As Restated) | | | 2005 (As Restated) compared to 2004 (As Restated) | | |
|---|--|--------------------|------------------|--|-----------------|------------------|
| | Increase (decrease) | | | Increase (decrease) | | |
| | Due to: | | | Due to: | | |
| | Volume | Rate | Total | Volume | Rate | Total |
| | (In thousands) | | | | | |
| Interest income on earning assets: | | | | | | |
| Money market investments | \$ 5,928 | \$ 2,180 | \$ 8,108 | \$ (49) | \$ 1,199 | \$ 1,150 |
| Government obligations | 13,255 | (4,539) | 8,716 | 11,827 | 7,324 | 19,151 |
| Mortgage-backed securities | 3,204 | (2,139) | 1,065 | (7,889) | 666 | (7,223) |
| Corporate bonds | (171) | 354 | 183 | | 256 | 256 |
| FHLB stock | (582) | 879 | 297 | 152 | 177 | 329 |
| Equity Securities | (18) | 16 | (2) | (75) | 139 | 64 |
| Total investments | 21,616 | (3,249) | 18,367 | 3,966 | 9,761 | 13,727 |
| Residential real estate loans | 18,226 | (1,048) | 17,178 | 5,813 | (1,521) | 4,292 |
| Construction loans | 17,379 | 2,946 | 20,325 | 1,055 | 1,358 | 2,413 |
| Commercial loans | 6,031 | 35,560 | 41,591 | 22,013 | 13,099 | 35,112 |
| Finance leases | 1,631 | 229 | 1,860 | 1,300 | (538) | 762 |
| Consumer loans | 10,997 | (859) | 10,138 | 6,957 | (2,366) | 4,591 |
| Total loans | 54,264 | 36,828 | 91,092 | 37,138 | 10,032 | 47,170 |
| Total interest income | 75,880 | 33,579 | 109,459 | 41,104 | 19,793 | 60,897 |
| Interest expense on interest-bearing liabilities: | | | | | | |
| Deposits | 34,736 | 36,213 | 70,949 | 8,967 | 9,942 | 18,909 |
| Other borrowed funds | 11,430 | 7,686 | 19,116 | 6,878 | 3,682 | 10,560 |
| FHLB advances | (10,483) | 3,236 | (7,247) | 5,025 | 1,100 | 6,125 |
| Total interest expense | 35,683 | 47,135 | 82,818 | 20,870 | 14,724 | 35,594 |
| Change in net interest income | \$ 40,197 | \$ (13,556) | \$ 26,641 | \$ 20,234 | \$ 5,069 | \$ 25,303 |

A portion of the Corporation's interest-earning assets, mostly investments in obligations of some U.S. Government agencies and sponsored entities, generate interest which is exempt from income tax, principally in Puerto Rico. Also, interest and gains on sale of investments held by the Corporation's international banking entities are tax-exempt under Puerto Rico tax law. To facilitate the comparison of all interest data related to these assets, the interest income has

been converted to a taxable equivalent basis. The tax equivalent yield was estimated by dividing the interest rate spread on exempt assets by (1 less the Puerto Rico statutory tax rate (41.5% for 2006, and 39% for all subsidiaries in 2005 and 2004)) and adding to it the average cost of interest-bearing liabilities. The computation considers the interest expense disallowance required by Puerto Rico tax law .

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

The following table reconciles interest income on a tax equivalent basis set forth in Part I above to interest income set forth in the Consolidated Statements of Income:

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| | Quarter ended March 31, | | |
|--|--------------------------------|--------------------------|--------------------------|
| | | 2005 | 2004 |
| | 2006 | (As Restated) | (As Restated) |
| | | (In thousands) | |
| Interest income on interest-earning assets on a tax equivalent basis | \$ 333,562 | \$ 224,103 | \$ 163,206 |
| Less: tax equivalent adjustments | (10,840) | (14,242) | (12,222) |
| Plus: net unrealized gains (losses) on derivatives (economic hedges) | 4,983 | 2,516 | (167) |
| Total interest income | \$ 327,705 | \$ 212,377 | \$ 150,817 |

The following table summarizes the components of the changes in fair values of interest rate swaps and interest rate caps, which are included in interest income.

| | Quarter ended March 31, | | |
|---|--------------------------------|--------------------------|--------------------------|
| | | 2005 | 2004 |
| | 2006 | (As Restated) | (As Restated) |
| | | (In thousands) | |
| Unrealized gains (losses) on derivatives (economic hedges): | | | |
| Interest rate caps | \$ 3,320 | \$ 1,535 | \$ |
| Interest rate swaps on corporate bonds | 30 | 468 | 127 |
| Interest rate swaps on loans | 1,633 | 513 | (294) |
| Net unrealized gains (losses) on derivatives (economic hedges) | \$ 4,983 | \$ 2,516 | \$ (167) |

The following table summarizes the components of interest expense for the quarters ended March 31, 2006, 2005 and 2004. As previously stated, the net interest margin analysis excludes the changes in the fair value of interest rate swaps.

| | Quarter ended March 31, | | |
|--|--------------------------------|--------------------------|--------------------------|
| | | 2005 | 2004 |
| | 2006 | (As Restated) | (As Restated) |
| | | (In thousands) | |
| Interest expense on interest-bearing liabilities | \$ 184,716 | \$ 123,329 | \$ 92,265 |
| Net interest realized on interest rate swaps | (3,506) | (24,638) | (30,305) |
| Amortization of placement fees on brokered CDs | 3,949 | 3,651 | 4,794 |
| Amortization of placement fees on medium-term notes | 7 | 6 | |
| Interest expense excluding unrealized losses (gains) on derivatives (economic hedges) | 185,166 | 102,348 | 66,754 |
| Net unrealized losses (gains) on derivatives (economic hedges) | 69,720 | 44,753 | (44,723) |

| | | | |
|------------------------|------------|------------|-----------|
| Total interest expense | \$ 254,886 | \$ 147,101 | \$ 22,031 |
|------------------------|------------|------------|-----------|

The following table summarizes the components of the unrealized loss (gain) on derivatives (economic hedges), which is included in interest expense:

| | Quarter ended March 31, | | |
|--|--------------------------------|-----------------------------------|-----------------------------------|
| | 2006 | 2005 (As Restated) | 2004 (As Restated) |
| | (In thousands) | | |
| Unrealized losses (gains) on derivatives (economic hedges): | | | |
| Interest rate swaps on brokered CDs | \$ 65,637 | \$ 43,730 | \$ (44,723) |
| Interest rate swaps on medium-term notes | 4,083 | 1,023 | |
| Net unrealized losses (gains) on derivatives (economic hedges) | \$ 69,720 | \$ 44,753 | \$ (44,723) |

Interest income on interest-earning assets primarily represents interest earned on loan receivables and investment securities.

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

Net interest incurred or realized on interest rate swaps primarily represents net interest exchanged on pay-float swaps that economically hedge brokered CDs and medium-term notes.

The amortization of broker placement fees represents the amortization of fees paid to brokers upon issuance of financial instruments (i.e., brokered CDs).

Unrealized gains or losses on derivatives (economic hedges) mainly represent changes in the fair value of interest rate swaps that economically hedge liabilities (i.e., brokered CDs and medium-term notes) or assets (i.e., loans and corporate bonds).

As shown on the tables above, the results of operations for the first quarter of 2006, 2005 and 2004 were significantly impacted by fluctuations in the valuation of interest rate swaps that economically hedge brokered CDs and medium-term notes; the change in the valuation of interest rate swaps recorded as part of interest expense resulted on an unrealized loss of \$69.7 million (2005- an unrealized loss of \$44.8 million, 2004- an unrealized gain of \$44.7 million). The increase in the unrealized loss position for 2006 and 2005 was principally due to increases in short-term interest rates.

Derivative instruments, such as interest rate swaps, are subject to market risk. While the Corporation does have certain trading derivatives to facilitate customer transactions, the Corporation does not utilize derivative instruments for speculative purposes. The Corporation's derivatives are mainly composed of interest rate swaps that are used to economically hedge brokered CDs and medium-term notes. Refer to the Risk Management Derivatives section below for further detail concerning the notional amounts of derivative instruments and additional information. As is the case with investment securities, the market value of derivative instruments is largely a function of the financial market's expectations regarding the future direction of interest rates. Accordingly, current market values are not necessarily indicative of the future impact of the values of derivative instruments on net interest income. This will depend, for the most part, on the shape of the yield curve as well as the level of interest rates.

2006 compared to 2005. First BanCorp's net interest income increased by \$7.5 million, or 12%, for the quarter ended March 31, 2006 compared to the same period in 2005. The increase in net interest income for the first quarter of 2006 was mainly driven by an increase in the average volume of interest earnings assets of \$4.5 billion or 30%, compared to 2005, attributable primarily to the growth in the Corporation's loan and investment portfolios, in particular construction, residential real estate and commercial loan portfolios as well as government agency securities. In addition to volume increases, higher yields on loans favorably impacted net interest income as a result of higher short-term interest rates experienced during 2006 as compared to 2005. A substantial portion of commercial and construction loans are variable rate loans tied to short-term-rates indexes, mainly LIBOR and Prime rate. These positive factors were partially offset by higher costs of funds, fluctuations in net interest settlements on interest rate swaps, and an increase in unrealized losses in the valuation of interest rate swaps that economically hedge brokered CDs and medium term notes. Increases in short-term rates resulted in a change in net interest settlements on interest rate swaps included as part of interest expense. For the quarter ended March 31, 2006, the net interest settlements on such interest rate swaps resulted in a benefit of \$3.5 million recognized as a reduction to interest expense, compared to benefits of \$24.6 million for the same period in 2005, as the rates paid under the variable leg of the swaps significantly increased during 2006. Net interest income for the quarters ended March 31, 2006 and 2005 was also impacted by unrealized losses in the valuation of derivative instruments. For the quarter ended March 31, 2006, the Corporation recorded \$64.7 million in net unrealized losses in the fair value of derivative instrument, compared to net unrealized losses of \$42.2 million for the same period in 2005.

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On a tax equivalent basis, the Corporation's net interest income, excluding the changes in the fair values of derivative instruments, increased by \$26.6 million, or 22%, for the first quarter of 2006 as compared to the same period in 2005. First BanCorp's net interest spread and margin, on a tax equivalent basis, for the quarter ended March 31, 2006 were 2.66% and 3.11%, respectively, compared to 2.99% and 3.32%, respectively, for the quarter ended March 31, 2005. The decrease in the net interest rate spread and margin during 2006 was due primarily to increases in short-term interest rates coupled with the re-pricing and maturity mismatch of the Corporation's assets and liabilities. On average, the Corporation's liabilities re-price and/or mature earlier than its assets. Thus, increases in short-term interest rates reduce net interest income, which is a significant component of the Corporation's earnings. The decrease in the Corporation's net interest margin has been particularly significant with respect to the Corporation's portfolio of investment securities. The interest rate spread on the Corporation's portfolio of investment securities, (allocating a funding cost equal to the weighted-average cost of the Corporation's other borrowed funds), was approximately 1.32% for the quarter ended March 31, 2006 compared to 2.34% for the quarter ended March 31, 2005. The tax equivalent yield on interest earning assets increased by 87 basis points from 6.11% for the first quarter of 2005 to 6.98% for the same period in 2006, mainly due to the re-pricing of variable rate commercial and construction loans and new commercial and construction loans originated at higher rates. The average rate paid by the Corporation on its interest-bearing liabilities increased by 120 basis points during the first quarter of 2006 when compared to same period in 2005, mainly due to the re-pricing of the Corporation's interest bearing deposits, principally from the issuance of brokered CDs at higher rates and from net interest incurred on the interest rate swaps that hedge these instruments, and increases in rates paid on FHLB advances, and other borrowed funds tied to 3-month LIBOR.

2005 compared to 2004. First BanCorp's net interest income decreased by \$63.5 million, or 49%, for the quarter ended March 31, 2005 compared to the same period in 2004. The decrease in net interest income for the first quarter of 2005 was mainly driven by changes in the valuation of interest rate swaps that economically hedge brokered CDs and medium-term notes offset in part by growth in the average volume of interest earnings assets of \$3.1 billion or 26%, as compared to 2004, attributable primarily to the growth in the Corporation's loan and investment portfolios, in particular commercial loan and residential real estate loan portfolios as well as government agency securities. For the first quarter of 2005, the change in the valuation of interest rate swaps recorded as part of interest expense resulted in an unrealized loss of \$44.8 million, compared to an unrealized gain of \$44.7 million for the same period in 2004.

On a tax equivalent basis, the Corporation's net interest income, excluding the changes in the fair values of derivative instruments, increased by \$25.3 million for the first quarter of 2005 as compared to the same period in 2004. First Bancorp's net interest spread and margin for the quarter ended March 31, 2005 were 2.99% and 3.32%, respectively, compared to 2.94% and 3.27%, respectively, for the quarter ended March 31, 2004. The slight increase in the net interest rate spread and margin during 2005 was due primarily to the re-pricing of the Corporation's assets and liabilities coupled with the purchase of agency obligations at higher rates. The tax equivalent yield on interest-earning assets increased by 57 basis points from 5.54% for the first quarter of 2004 to 6.11% for same period in 2005, mainly due to the re-pricing of variable rate commercial and construction loans, new commercial and construction loans originated at higher rates, and the purchase of agency obligations at higher rates. The average rate paid by the Corporation on its interest-bearing liabilities increased by 52 basis points during the first quarter of 2005 when compared to same period in 2004, mainly due to re-pricing of the Corporation's interest-bearing deposits, principally time deposits, as well as increases in rates paid on FHLB advances and other borrowed funds tied to 3-month LIBOR.

Table of Contents**Provision and Allowance for Loan and Lease Losses**

The provision for loan and lease losses is charged to earnings to maintain the allowance for loan and lease losses at a level that the Corporation considers adequate to absorb probable losses inherent in the loan and lease portfolio. 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, and the financial condition of the borrowers, and, as such, includes amounts based on judgments and estimates made by the Corporation. Although the Corporation believes that the allowance for loan and lease losses is adequate, factors beyond the Corporation's control, including factors affecting the Puerto Rico, Florida (USA), US Virgin Islands and British Virgin Islands economies may contribute to delinquencies and defaults, thus necessitating additional reserves.

For the quarter ended on March 31, 2006, the Corporation provided \$19.4 million for loan and lease losses, as compared to \$11.0 million and \$13.2 million for the quarters ended March 31, 2005 and 2004, respectively.

Refer to the discussions under *Non-accruing and Non-performing assets* and *Credit Risk Management* below for analysis of the allowance for loan and lease losses and non-performing assets and related ratios.

2006 compared to 2005. First BanCorp's provision for loan and lease losses for the quarter ended March 31, 2006 increased by \$8.4 million, or 77%, compared to the same period in 2005. The increase in the provision principally reflects growth in the Corporation's commercial and consumer portfolios coupled with increasing trends in non-performing loans and charge-offs experienced during 2006 compared to the first quarter of 2005 and stricter underwriting standards. The Corporation's trends in non-performing loans and net charge offs were affected 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 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 provision for loan and lease losses totaled 131% of net charge-offs for the first quarter of 2006, compared with 120% of net charge-offs for the same period in 2005. Net charge-offs were \$14.8 million (or 0.46% of average loans on an annualized basis) for the first quarter of 2006, compared to \$9.2 million (or 0.36% of average loans) for the first quarter of 2005. The increase of \$5.6 million in net charge-offs for the first quarter of 2006, compared with the same period in 2005, was mainly attributable to higher charge-offs in consumer loans, primarily auto loans, given higher delinquencies during 2006.

2005 compared to 2004. First BanCorp's provision for loan and lease losses for the quarter ended March 31, 2005 decreased by \$2.2 million, or 17%, compared to the same period in 2004. The decrease in the provision during 2005 was due in part to the stability experienced in non-performing loans coupled with the seasoning of the corporate commercial loan portfolio as well as a slight decrease in net charge-offs. The Corporation has not incurred significant losses as a percentage of its commercial loans receivable since it started emphasizing the corporate commercial lending activities in the late 1990s, therefore the provision for inherent losses in this portfolio has decreased.

The provision for loan and lease losses totaled 120% of net charge-offs for the first quarter of 2005, compared with 143% of net charge-offs for the same period in 2004. Net charge-offs were \$9.2 million (or 0.36% of average loans on an annualized basis) for the first quarter of 2005, compared to \$9.2 million (or 0.51% of

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average loans) for the first quarter of 2004. Recoveries made from previously written-off accounts were \$1.4 million in the first quarter of 2005, compared to \$1.5 million in 2004.

Non-Interest Income

| | Quarter ended March 31, | | |
|--|--------------------------------|-----------------------------------|-----------------------------------|
| | 2006 | 2005 (As Restated) | 2004 (As Restated) |
| | (In thousands) | | |
| Other service charges on loans | \$ 1,486 | \$ 1,121 | \$ 1,155 |
| Service charges on deposit accounts | 3,277 | 2,690 | 2,783 |
| Mortgage banking activities (loss) gain | (575) | 510 | 1,545 |
| Rental income | 773 | 866 | 617 |
| Insurance income | 3,057 | 2,079 | 1,486 |
| Other commissions and fees | 80 | 142 | 292 |
| Other operating income | 3,199 | 3,330 | 3,885 |
| Non-interest income before net gain on investments, impairment on investments, and gain on sale of credit card portfolio | 11,297 | 10,738 | 11,763 |
| Net gain on investments | 1,424 | 9,513 | 3,965 |
| Impairment on investments | (2,133) | | |
| Net (loss) gain on investments | (709) | 9,513 | 3,965 |
| Gain on sale of credit card portfolio | | | 5,236 |
| Total | \$ 10,588 | \$ 20,251 | \$ 20,964 |

Non-interest income primarily consists of other service charges on loans; service charges on deposit accounts; commissions derived from various banking, securities and insurance activities; gains and losses on mortgage banking activities; net gains and losses on investments and impairments; and gains and losses on certain derivatives that are designated non-economic hedges (non-economic derivatives).

Other service charges on loans include mainly fees generated on credit card-related activities.

Service charges on deposit accounts include monthly fees and other fees on deposit accounts.

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

The Corporation's subsidiary, First Leasing and Rental Corporation, generates income on the rental of various types of motor vehicles.

Other commissions and fees income is the result of an agreement with a major investment banking firm to participate in bond issues by the Government Development Bank for Puerto Rico, and an agreement with an international brokerage firm doing business in Puerto Rico to offer brokerage services in selected branches of the Corporation.

Insurance income consists of insurance commissions earned by the Corporation's subsidiary, FirstBank Insurance Agency, Inc., and the Bank's subsidiary in the US Virgin Islands, FirstBank Insurance V.I., Inc. These subsidiaries

offer a wide variety of insurance business.

The other operating income category is composed of miscellaneous fees such as debit and credit card interchange fees and check fees. Other operating income also includes unrealized gains and losses on certain non-economic derivatives.

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The net gain (loss) on investments reflects gains or losses as a result of sales that are consistent with the Corporation's investment policies as well as other-than-temporary impairment charges on the Corporation's investment portfolio.

2006 compared to 2005. First BanCorp's non-interest income for the quarter ended March 31, 2006 decreased by \$9.7 million, or 48%, compared to the same period in 2005. The decrease in non-interest income during 2006 was principally due to lower gains on the sale of investment securities, mainly due to a lower volume of sales, coupled with a \$2.1 million other-than-temporary impairment in the Corporation's investment portfolio related to certain equity securities and a loss in mortgage banking activities associated with lower-of-cost-or-market valuation adjustments to the Corporation's loans held for sale portfolio. Mortgage banking activities resulted in a loss of \$0.6 million for the first quarter of 2006 compared to income of \$0.5 million for the same period in 2005. The decrease in 2006 was principally due to a \$1.0 million lower-of-cost-or-market negative valuation adjustment to the Corporation's loans held for sale portfolio as a result of increases in long-term interest rates during the quarter. However, the Corporation experienced increases in insurance income and service charges on deposit accounts. Insurance income for the first quarter of 2006 increased by \$1.0 million, or 47%, compared to the same period in 2005. The increase for 2006 was due to an increase in the volume of business through cross selling strategies, marketing efforts and the strategic locations of the Corporation's insurance offices.

Service charges on deposit accounts and other service charges on loans for the first quarter of 2006 increased by \$0.6 million, or 22%, and \$0.4 million, or 33%, respectively, compared to the same period in 2005. The increase for 2006 primarily reflects a larger volume of accounts and transactions during 2006.

2005 compared to 2004. First BanCorp's non-interest income for the quarter ended March 31, 2005 decreased by \$0.7 million, or 3%, compared to the same period in 2004. The decrease in non-interest income during 2005 was principally due to decreases in mortgage banking activities and other operating income partially offset by an increase in insurance income. Also the Corporation recognized a non-recurring gain on sales of credit card portfolios during the first quarter of 2004 resulting from portfolios sold pursuant to a strategic alliance agreement reached with a US financial institution in 2003. The decrease in non-interest income, due to the aforementioned factors, was partially offset by higher gains on sale of investments due to an increased volume of sales during the first quarter of 2005 as compared to the same period in 2004. Income from mortgage banking activities during the first quarter of 2005 decreased by \$1.0 million compared to the same period in 2004. The decrease in income from mortgage banking activities in 2005 primarily reflects a lower volume of sales of mortgage loans in the secondary market.

Insurance income for first quarter of 2005 increased by \$0.6 million or 40% compared to the same period in 2004. The increase for 2005 was due to an increase in the volume of business through cross selling strategies, marketing efforts and the strategic locations of the Corporation's insurance offices.

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

| | Quarter ended March 31, | | |
|---|-------------------------|--------------------------|--------------------------|
| | 2006 | 2005 (As Restated) | 2004 (As Restated) |
| | (In thousands) | | |
| Employees compensation and benefits | \$ 34,125 | \$ 23,315 | \$ 19,736 |
| Occupancy and equipment | 12,706 | 10,639 | 9,378 |
| Deposit insurance premium | 399 | 269 | 241 |
| Other taxes, insurance and supervisory fees | 3,857 | 3,063 | 2,783 |
| Professional fees | 7,393 | 1,896 | 734 |
| Servicing and processing fees | 2,181 | 1,387 | 1,014 |
| Business promotion | 3,774 | 4,548 | 3,469 |
| Communications | 2,456 | 1,977 | 1,778 |
| Other | 4,847 | 5,913 | 3,597 |
| Total | \$ 71,738 | \$ 53,007 | \$ 42,730 |

For the quarter ended March 31, 2006, non-interest expenses amounted to \$71.7 million, compared to \$53.0 million and \$42.7 million for the quarters ended March 31, 2005 and 2004, respectively.

2006 compared to 2005. The Corporation's non-interest expenses for the first quarter of 2006 increased by \$18.7 million or 35% compared to the same period in 2005. The increase in non-interest expenses for 2006 was mainly due to increases in employees' compensation and benefits, occupancy and equipment, and professional fees. The increase in expenses also includes total non-interest expenses of \$3.6 million associated with the operations of Ponce General Corporation acquired in March 2005.

Employees' compensation and benefits expenses increased during the first quarter of 2006 by \$10.8 million or 46% compared to the same period in 2005. Nearly half the increase was associated with the expensing of the fair value of stock options granted to certain employees following the provisions of SFAS 123R. The Corporation recorded \$4.9 million during the first quarter of 2006 in stock-based compensation expense. The increase in compensation and benefits expenses was also attributable to increases in the average compensation and related fringe benefits paid to employees and an increase in the headcount for 2006. The increase in headcount was mostly attributable to increases associated with the Corporation's loan origination and deposit gathering efforts, in particular in FirstBank Puerto Rico, FirstBank Florida, FirstMortgage Inc. (First Mortgage), and the Corporation's small loan company (First Federal Finance), as well as increases in support areas, in particular audit and compliance, credit risk management, finance and accounting, information technology and banking operations.

Occupancy and equipment expenses increased during the first quarter of 2006 by \$2.1 million or 19% compared to the same period in 2005. The increase in occupancy and equipment expenses in 2006 as compared to 2005 is mainly attributable to increases in costs associated with the expansion of the Corporation's branch network and loan origination offices. The increase also reflects higher electricity costs and costs associated with Ponce General Corporation operations.

Professional fees increased during the first quarter of 2006 by \$5.5 million compared to the same period in 2005. The increase for 2006 was primarily due to legal, accounting, and consulting fees associated with the internal review conducted by the Corporation's Audit Committee, the restatement process, and other related legal and regulatory proceedings which increased professional fees by \$4.9 million in 2006 compared to 2005.

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2005 compared to 2004. The Corporation's non-interest expenses for the first quarter of 2005 increased by \$10.3 million or 24% compared to the same period in 2004. The increase in non-interest expenses mainly reflects increases in compensation and benefits, occupancy and equipment, professional fees, and other operating expenses.

Employees' compensation and benefits expenses increased during the first quarter of 2005 by \$3.6 million or 18% compared to the same period in 2004. The increase in compensation and benefits expenses was primarily attributable to increases in the average compensation and related fringe benefits paid to employees and an increase in the headcount for 2005. The increase in the headcount was mainly to support the growth in operations, primarily for new products and services, in particular related with the operations of First Mortgage, Inc.

Occupancy and equipment expenses increased during the first quarter of 2005 by \$1.3 million or 13% compared to the same period in 2004. The increase is mainly attributable to increases in costs associated with the expansion of the Corporation's branch network and loan origination offices.

Professional fees increased during the first quarter of 2005 by \$1.2 million compared to the same period in 2004. The increase was due to higher expenses related with Sarbanes-Oxley Act compliance.

The other non-interest expense category increased due to valuations of other real estate owned and increases in sundry losses.

Provision for Income Tax

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

Under the Puerto Rico Internal Revenue Code of 1994, as amended (PR Code), First BanCorp is subject to a maximum statutory tax rate of 39%, except that in years 2005 and 2006 an additional transitory tax rate of 2.5% was signed into law by the Governor of Puerto Rico. In August 2005, the Government of Puerto Rico approved a transitory tax rate of 2.5% that increased the maximum statutory tax rate from 39.0% to 41.5% for a two-year period. The additional tax related to the income earned from January 1 to the date of enactment of the law was recorded in the third quarter of 2005. On May 13, 2006, with an effective date of January 1, 2006, the Governor of Puerto Rico approved an additional transitory tax rate of 2.0% applicable only to companies covered by the Puerto Rico Banking Act, as amended, such as FirstBank, which raised the maximum statutory tax rate to 43.5% for taxable years commenced during calendar year 2006. The PR Code also includes an alternative minimum tax of 22% that applies if the Corporation's regular income tax liability is less than the alternative minimum tax requirements.

The Corporation has maintained an effective tax rate lower than the maximum statutory rate mainly by investing in government obligations and mortgage-backed securities exempt from U.S. and Puerto Rico income taxes and doing business through international banking units (IBEs) of the Corporation and the Bank and by the Bank's subsidiary FirstBank Overseas Corporation. The IBEs and FirstBank Overseas Corporation were created under the International Banking Entity Act of Puerto Rico, which provides for total Puerto Rico tax exemption on net income derived by IBEs operating in Puerto Rico. Since 2004, IBEs that operate as a unit of a bank pay income taxes at normal rates to the extent that the IBEs' net income exceeds predetermined percentages of the bank's total

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net taxable income; such limitations were 30% of total net taxable income for a taxable year commencing between July 1, 2004 and July 1, 2005, and 20% of total net taxable income for taxable years commencing thereafter.

2006 compared to 2005. For the quarter ended March 31, 2006, the Corporation recognized an income tax benefit of \$11.6 million compared to \$3.6 million for the same quarter of 2005. The increase in income tax benefit for the first quarter of 2006 was mainly due to an increase in deferred tax benefits, that itself was mainly the result of higher unrealized losses on derivative instruments, net of increases in the current tax provision. For the first quarter of 2006, the Corporation recognized a deferred tax benefit of \$28.6 million compared to \$17.7 million for the same period in 2005.

The Corporation evaluated its ability to realize the deferred tax asset and concluded, based on the evidence available, that it is more likely than not that some of the deferred tax assets will not be realized and thus, established a valuation allowance of \$2.9 million as of March 31, 2006. At March 31, 2006, the deferred tax asset, net of the valuation allowance, amounted to approximately \$164.3 million compared to \$93.1 million at March 31, 2005. At March 31, 2005, based on the Corporation's analysis and available evidence, the Corporation did not establish a valuation allowance.

The current provision for income taxes for the first quarter of 2006 amounted to \$17.1 million compared to \$14.0 million for the first quarter of 2005, an increase of \$3.1 million. The increase in the current provision for the first quarter of 2006, when compared to the first quarter of 2005, is attributable to a change in the proportion of exempt and taxable income as a result of increases in taxable income generated from the Corporation's loan portfolios and decreases in tax exempt income mainly from the Corporation's investment portfolios and by an increase in non-qualifying of IBEs income that under current legislation were taxed at regular rates. As discussed above, income from IBEs that operate as a unit of a bank that exceed certain thresholds are taxed at regular income tax rates.

2005 compared to 2004. For the quarter ended March 31, 2005, the Corporation recognized an income tax benefit of \$3.6 million compared to an expense of \$28.4 million for the same period in 2004. The income tax benefit for the first quarter of 2005 was mainly due to a deferred tax benefit of \$17.7 million recognized during the first quarter of 2005 as a result of unrealized losses on derivative instruments. In comparison, for the first quarter of 2004, the Corporation recognized a deferred tax expense of \$13.0 million mainly as a result of unrealized gains on derivative instruments due to decreases in interest rates.

Table of Contents**FINANCIAL CONDITION AND OPERATING DATA ANALYSIS****Loan Production**

First BanCorp relies primarily on its retail network of branches to originate residential and consumer loans. The Corporation supplements its residential mortgage loan originations with wholesale servicing released mortgage loan purchases from small mortgage bankers. The Corporation manages its construction and commercial loan originations through a centralized unit and most of its originations come from existing customers as well as through referrals and direct solicitations. For commercial loan originations, the Corporation also has regional offices to provide services to designated territories. For purposes of the following table, the Corporation separately presented commercial loans to local financial institutions because it believes this approach provides a better representation of the Corporation's commercial loan production capacity.

The following table sets the First BanCorp's loan production for the periods indicated:

| | Quarter ended March 31, | | |
|--|--------------------------------|--|-----------------------------------|
| | 2006 | 2005 (As Restated) (In thousands) | 2004 (As Restated) |
| Residential real estate | \$ 277,943 | \$ 303,776 | \$ 151,112 |
| Commercial and Construction | 847,853 | 593,816 | 321,861 |
| Finance Leases | 47,209 | 33,677 | 26,867 |
| Consumer | 222,078 | 224,522 | 158,847 |
| | 1,395,083 | 1,155,791 | 658,687 |
| Commercial loans to local financial institutions | | 681,407 | 435,034 |
| Total Loan Production | \$ 1,395,083 | \$ 1,837,198 | \$ 1,093,721 |

Residential Real Estate Loans

Residential mortgage loan production for the first quarter of 2006 decreased by \$25.8 million, compared to the same period in 2005, and increased by \$126.8 million, compared to the same period in 2004. The decrease in residential mortgage loan production for 2006 compared to 2005 was mainly attributable to higher rates, deteriorating economic conditions in Puerto Rico 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 the worsening economic 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 20% of total loans originated and purchased for the first quarter of 2006. The Corporation's strategy is to penetrate markets by providing customers with a variety of high quality mortgage products. The Corporation's originations of residential mortgage loans continued to be driven by FirstMortgage, the mortgage loan origination subsidiary. The Corporation continues 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. 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 and small mortgage bankers 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 them, and to assist real estate brokers in building their individual businesses and closing transactions. FirstMortgage multi-channel strategy has proven to be effective in capturing business.

Table of Contents*Commercial and Construction Loans*

For the quarter ended March 31, 2006, total commercial loans originated amounted to \$847.9 million, compared to \$593.8 million and \$321.9 million for the same periods in 2005 and 2004, respectively. The Corporation's subsidiary bank loan agency in Coral Gables, Florida accounted for a substantial portion of the increase in commercial loans during 2006. Loans originated by the agency for the first quarters of 2006 and 2005 amounted to \$294.1 million and \$37.5 million, respectively.

Commercial and construction 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.

Consumer Loans

Consumer loan originations are principally driven through the Corporation's retail network. For the first quarter of 2006, consumer loan originations decreased by \$2.4 million and increased \$63.2 million compared to the same periods in 2005 and 2004, respectively. The Corporation's consumer loan originations are primarily composed of auto and personal loan originations. Auto loan originations come primarily through referrals from the Corporation's network of auto dealers. Personal loan originations come primarily through advertising campaigns, walk-in customers and referrals.

Finance Leases

During the first quarter of 2006, finance lease originations, which are mostly composed of loans to individuals to finance the acquisition of motor vehicles, increased by \$13.5 million and \$20.3 million compared to the same periods in 2005 and 2004, respectively.

Assets

Total assets as of March 31, 2006 amounted to \$20.6 billion, an increase of \$0.6 billion as compared to total assets as of December 31, 2005. The increase was mainly the result of an increase of approximately \$453.0 million in total loans and an increase of approximately \$320.7 million in money market instruments, partially offset by a decrease of \$149.6 million in the Corporation's investment portfolio. The decrease in investment securities resulted mainly from prepayments and maturities received from the Corporation's investment portfolio, principally mortgage-backed securities, and the Corporation's decision to deleverage its investment portfolio. The deleverage of the investment portfolio was influenced, among other things, by the flat to inverted yield curve.

On March 31, 2005, the Corporation completed the acquisition of Ponce General, the holding company of First Bank Florida. Total assets acquired amounted to approximately \$546.2 million, of which loans amounted to approximately \$476.0 million and deposits \$439.1 million. The purchase price resulted in a premium of approximately \$36 million. The Corporation recognized goodwill of \$19 million and core deposit intangibles of \$17 million as part of the purchase price allocation.

Table of Contents**Loan portfolio**

The composition of the Corporation's total loan portfolio for the periods indicated is as follows:

| | March 31, 2006 | December 31, 2005 | March 31, 2005 (As Restated) | March 31, 2004 (As Restated) |
|---|-------------------|-------------------------|---------------------------------------|---------------------------------------|
| <i>(In thousands)</i> | | | | |
| Residential real estate loans | \$ 2,518,831 | \$ 2,346,945 | \$ 1,714,129 | \$ 1,006,832 |
| Commercial real estate loans | 1,143,414 | 1,090,193 | 944,057 | 659,874 |
| Construction loans | 1,432,255 | 1,137,118 | 478,429 | 358,070 |
| Commercial loans | 2,443,455 | 2,421,219 | 2,000,741 | 1,713,532 |
| Loans to local financial institutions collateralized by real estate mortgages and pass-through trust certificates | 3,518,540 | 3,676,314 | 4,386,696 | 2,400,267 |
| Total commercial loans | 8,537,664 | 8,324,844 | 7,809,923 | 5,131,743 |
| Finance leases | 306,633 | 280,571 | 226,923 | 172,073 |
| Consumer and other loans | 1,780,371 | 1,733,569 | 1,466,232 | 1,181,303 |
| Total | \$ 13,143,499 | \$ 12,685,929 | \$ 11,217,207 | \$ 7,491,951 |

For the first quarter of 2006, the Corporation's total loans increased by \$0.5 billion, \$1.9 billion, and \$5.7 billion when compared with balances as of December 31, 2005, March 31, 2005 and March 31, 2004, respectively. The increase in the Corporation's total loans primarily relates to the growth in the Corporation's loan originations. Refer to the *Loan Production* section of this discussion for further details on the Corporation's originations by product.

During the first quarter of 2005, the Corporation entered into an arrangement with another unrelated financial institution (the Counterparty) in which, in substance, the parties agreed to sell and purchase similar mortgage loan portfolios. Pursuant to this arrangement, the Corporation purchased mortgage loans with an aggregate unpaid principal balance of \$87.2 million for \$88.9 million in March 2005. In April and May of 2005, the Corporation sold to the Counterparty mortgage loans with aggregate unpaid principal balances of \$60.0 million and \$29.7 million, for \$61.1 million and \$30.3 million, respectively, resulting in gains on the sales of \$1.3 million and \$0.6 million, respectively. Since the Corporation retained the servicing on the mortgage loans sold to the Counterparty, it also recognized a servicing asset of \$1.2 million. The Corporation entered into these transactions because, among other reasons, they were consistent with its business objectives of developing a mortgage-banking business that would provide its liquidity as well as new sources for its acquisition of mortgage loans. Notwithstanding that the transactions were in substance the purchase and sale of similar mortgage loan portfolios, generally accepted accounting principles require that the transactions be treated as a separate purchase and a separate sale.

Residential Real Estate Loans

As of March 31, 2006, the Corporation's residential real estate loan portfolio increased by \$0.2 billion, \$0.8 billion and \$1.5 billion as compared to balances as of December 31, 2005, March 31, 2005, and March 31, 2004, respectively. The Corporation has diversified its loan portfolio by increasing the concentration of residential real estate loans. The residential real estate loans as a percentage of total loans has increased over time from 13% at March 31, 2004 to 19% at March 31, 2006.

Commercial and Construction Loans

As of March 31, 2006, the Corporation's commercial and construction loans portfolio increased by \$0.2 billion, \$0.7 billion and \$3.4 billion as compared to balances as of December 31, 2005, March 31, 2005, and March 31, 2004, respectively. The Corporation's strategy focuses on growing its commercial loans portfolio principally

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through commercial real estate and construction loans. A substantial portion of this portfolio is collateralized by real estate. The Corporation's commercial loans are primarily variable- and adjustable-rate loans.

The Corporation had a significant lending concentration of \$2.9 billion in one mortgage originator in Puerto Rico, Doral Financial Corporation (Doral), at March 31, 2006. The Corporation had outstanding \$568.7 million with another mortgage originator in Puerto Rico, R&G Financial Corporation (R&G), for total loans to mortgage originators amounting to \$3.5 billion at March 31, 2006. These commercial loans are secured by individual mortgage loans on residential and commercial real estate. 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 (Office of the Commissioner) with respect to the statutory limit for individual borrowers (loans-to-one borrower limit). For additional information concerning events that occurred after the close of the first quarter of 2006 and that are related with loans to local financial institutions, refer to Note 19 Subsequent Events in the accompanying unaudited interim consolidated financial statements and to the Current Report on Form 8-K First BanCorp filed with the SEC on February 16, 2007.

During the fourth quarter of 2005, First BanCorp received a partial payment from R&G of \$137 million for its secured commercial loans.

Consumer Loans

As of March 31, 2006, the Corporation's consumer loans portfolio increased by \$46.8 million, \$314.1 million, and \$599.1 million as compared to the portfolio balances at December 31, 2005, March 31, 2005, and March 31, 2004, respectively. The increase is mainly driven by increases in the Corporation's auto loan portfolio. The growth of this portfolio has been achieved through a strategy of providing outstanding service to selected auto dealers who provide 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.

Finance Leases

As of March 31, 2006, finance leases, which are mostly composed of loans to individuals to finance the acquisition of a motor vehicle, increased by \$26.1 million, \$79.7 million and \$134.6 million as compared to portfolio balances as of December 31, 2005, March 31, 2005, and March 31, 2004, respectively. 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 (extended to individuals) portfolio.

Investment Activities

As part of its strategy to diversify its revenue sources and maximize its net interest income, First BanCorp maintains an investment portfolio that is classified as available for sale or held-to-maturity. The Corporation's investment portfolio at March 31, 2006 amounted to \$5.3 billion, a decrease of \$149.6 million and \$187.2 million when compared with the investment portfolio at December 31, 2005 and March 31, 2005, respectively. The decrease in investment securities was due to the Corporation's decision to deleverage its balance sheet by not reinvesting maturities and prepayments received from the Corporation's investment portfolio, mainly mortgage-backed securities. The deleverage of the investment portfolio was influenced, among other things, by the flat-to-inverted yield curve. As a result, the Corporation decided to repay during the second half of 2006

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higher rate maturing liabilities, in particular brokered CDs, rather than investing the proceeds at an interest yield lower than the Corporation's cost of funds.

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

| | March 31, | December | March 31, | March 31, |
|---|------------------|-----------------|------------------|------------------|
| | 2006 | 31, | 2005 | 2004 |
| <i>(In thousands)</i> | | 2005 | (As | (As |
| | | | Restated) | Restated) |
| Money market investments | \$ 1,545,446 | \$ 1,224,791 | \$ 389,172 | \$ 621,039 |
| Investment securities held-to-maturity: | | | | |
| US Government and agencies obligations | 2,194,938 | 2,190,714 | 2,355,690 | 1,810,492 |
| PR Government obligations | 14,298 | 14,163 | 13,770 | 9,716 |
| Mortgage-backed securities | 1,179,989 | 1,233,711 | 1,469,734 | 1,886,804 |
| Corporate Bonds | | | 28,905 | 19,925 |
| | 3,389,225 | 3,438,588 | 3,868,099 | 3,726,937 |
| Investment securities available-for-sale: | | | | |
| US Government and agencies obligations | 388,411 | 389,650 | 288,330 | |
| PR Government obligations | 24,963 | 25,006 | 24,941 | 16,264 |
| Mortgage-backed securities | 1,402,631 | 1,478,720 | 1,124,347 | 1,063,650 |
| Corporate bonds | 13,900 | 25,381 | 44,025 | 48,050 |
| Equity securities | 30,140 | 29,421 | 49,235 | 55,524 |
| | 1,860,045 | 1,948,178 | 1,530,878 | 1,183,488 |
| Other equity securities | 30,272 | 42,368 | 67,808 | 52,525 |
| Total Investments | \$ 6,824,988 | \$ 6,653,925 | \$ 5,855,957 | \$ 5,583,989 |

Mortgage-backed securities at the indicated dates consist of:

| | March 31, | December | March 31, | March 31, |
|-----------------------|------------------|-----------------|------------------|------------------|
| | 2006 | 31, | 2005 | 2004 |
| <i>(In thousands)</i> | | 2005 | (As | (As |
| | | | Restated) | Restated) |
| Held-to-maturity | | | | |
| FHLMC certificates | \$ 19,156 | \$ 20,211 | \$ 29,464 | \$ 33,370 |
| FNMA certificates | 1,160,833 | 1,213,500 | 1,438,827 | 1,853,434 |
| GNMA certificates | | | 1,443 | |
| | 1,179,989 | 1,233,711 | 1,469,734 | 1,886,804 |

Available-for-sale

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| | | | | |
|------------------------------------|--------------|--------------|--------------|--------------|
| FHLMC certificates | 9,081 | 9,962 | 7,168 | 10,414 |
| GNMA certificates | 418,273 | 438,881 | 93,275 | 153,879 |
| FNMA certificates | 974,883 | 1,029,474 | 1,023,447 | 898,675 |
| Mortgage pass-through certificates | 394 | 403 | 457 | 682 |
| | 1,402,631 | 1,478,720 | 1,124,347 | 1,063,650 |
| Total mortgage-backed securities | \$ 2,582,620 | \$ 2,712,431 | \$ 2,594,081 | \$ 2,950,454 |

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The carrying values of investment securities (excluding other equity securities) at March 31, 2006, by contractual maturity (excluding mortgage-backed securities, equity securities and money market investments) are shown below:

| <i>(Dollars in thousands)</i> | Carrying amount | Weighted average yield % |
|---|----------------------------|---|
| US Government and agencies obligations | | |
| Due within one year | \$ 145,211 | 4.41 |
| Due after five years through ten years | 380,549 | 4.29 |
| Due after ten years | 2,057,589 | 5.83 |
| | 2,583,349 | 5.52 |
| PR Government obligations | | |
| Due after one year through five years | 9,793 | 5.57 |
| Due after five years through ten years | 24,128 | 5.26 |
| Due after ten years | 5,340 | 5.88 |
| | 39,261 | 5.42 |
| Corporate bonds | | |
| Due after one year through five years | 1,013 | 7.30 |
| Due after ten years | 12,887 | 7.56 |
| | 13,900 | 7.54 |
| | 2,636,510 | 5.53 |
| Mortgage-backed securities | 2,582,620 | 4.82 |
| Equity securities | 30,140 | 2.31 |
| Total investment securities available-for-sale and held-to-maturity | \$ 5,249,270 | 5.16 |

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 securities purchased at a premium, as the amortization of premiums paid upon acquisition of these securities would accelerate. Conversely, acceleration in the prepayments of mortgage-backed securities would increase yields on securities purchased at a discount, as the amortization of the discount would accelerate. Also, net interest income in future periods might be affected by the Corporation's substantial investments in callable securities. 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. These risks are directly linked to future period market interest rate fluctuations. Refer to the Risk Management discussion below 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.

Sources of Funds

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

As of March 31, 2006, total liabilities amounted to \$19.4 billion, an increase of \$0.7 billion, \$3.0 billion, and \$7.2 billion as compared to balances as of December 31, 2005, March 31, 2005, and March 31, 2004, respectively. The net increase in total liabilities was mainly due to increases in interest-bearing deposits, mainly brokered CDs, partially offset by decreases in FHLB advances. 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, as financial institutions are at a competitive disadvantage since the income generated on other investment products available to investors in Puerto Rico has been taxed at lower rates than tax rates for income generated on deposit products. The brokered CDs market is very competitive and liquid and the Corporation has been able to obtain substantial amounts of funding in short periods of time. This strategy enhances the

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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 by entering into interest rate swap agreements.

During 2005, the Corporation's brokered CDs increased significantly. Significant amounts of short-term brokered CDs were issued to fund the Corporation's growth and to replace advances from the Federal Home Loan Bank as these matured since the collateral for these funds was under evaluation by the FHLB. During 2005, the FHLB evaluated the eligibility of collateral that secured the commercial loans to local financial institutions and concluded that such collateral was not eligible to secure advances from the FHLB. The rate of the short-term brokered CDs approximated long-term rates given the flat-to-inverted yield curve. As a result, the Corporation decided to repay during the second half of 2006 higher-rate maturing liabilities, in particular brokered CDs, rather than investing the proceeds at an interest yield lower than the Corporation's cost of funds.

CDs with denominations of \$100,000 or higher, including brokered CDs, amounted to \$10.3 billion at March 31, 2006. At March 31, 2006, brokered CDs amounted to \$9.4 billion. Brokered CDs are sold through third-party intermediaries in denominations of \$100,000 or less. The following table presents a maturity schedule of brokered CDs at March 31, 2006:

| | Total |
|---------------------------------|---------------------|
| | (In thousands) |
| Three months or less | \$ 1,322,131 |
| Over three months to six months | 1,606,934 |
| Over six months to one year | 1,754,082 |
| Over one year to five years | 852,533 |
| Over five years | 3,847,860 |
| Total | \$ 9,383,540 |

The Corporation maintains unsecured lines of credit with other banks. At March 31, 2006, the Corporation's total outstanding lines of credit with these banks amounted to \$335.0 million. At March 31, 2006, the Corporation had an available line of credit with the FHLB, guaranteed with excess collateral in the amount of \$287.9 million.

The Corporation's deposit products include regular savings accounts, demand deposit accounts, money market accounts, CDs, and brokered CDs. Refer to Note 11 Deposits in the accompanying notes to the unaudited interim consolidated financial statements for further details. Total deposits amounted to \$13.3 billion at March 31, 2006, as compared to \$12.5 billion, \$9.4 billion and \$6.6 billion at December 31, 2005, March 31, 2005 and 2004, respectively. The increase in total deposits was mainly due to increases in brokered CDs.

Refer to the Net Interest Income discussion above for information about the average balances of interest-bearing deposits and the average interest rate paid on deposits, for the period ended March 31, 2006, 2005 and 2004.

Capital

The Corporation's stockholders' equity amounted to \$1.18 billion at March 31, 2006, \$1.20 billion at December 31, 2005, \$1.18 billion at March 31, 2005 and \$1.13 billion at March 31, 2004. Total capital decreased by \$18.2 million and \$3.7 million compared to amounts at December 31, 2005 and March 31, 2005, respectively. The decrease was primarily due to the low level of earnings recognized during 2006 and the accrual by the Corporation during the fourth quarter of 2005 of approximately \$74.25 million for the potential settlement of the class action lawsuits coupled with higher common stock dividends paid during the period.

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On August 1, 2007, the United States District Court for the District of Puerto Rico issued a Preliminary Order approving the stipulation of settlement filed in connection with the proposed settlement of the class action lawsuit brought on behalf of First BanCorp's shareholders against the Corporation in the amount of \$74.25 million.

The effectiveness of a final order to be issued by the Court is subject to:

The payment of \$61 million to be deposited by First BanCorp in a settlement fund within fifteen calendar days of the date of issuance of the Preliminary Order; and

The mailing of a notice to shareholders that describes the general terms of the settlement.

The court hearing for the final order of approval of the settlement has been set for October 15, 2007. First BanCorp intends to comply with the \$61 million payment requirement within the timeframe set forth in the terms of the settlement. The remaining amount of \$13,250,000 will be paid before December 31, 2007. The monetary payment will have no impact on the Corporation's earnings or capital in 2007. As reflected in First BanCorp's audited Consolidated Financial Statements, included in the Corporation's 2005 Annual Report on Form 10-K, the Corporation accrued \$74.25 million in 2005 for a possible settlement of the class action.

On August 7, 2007, First BanCorp announced that the SEC approved a final settlement with the Corporation, which resolves the previously disclosed SEC investigation of the Corporation. Under the settlement, the Corporation agreed, without admitting or denying any wrongdoing, to be enjoined from future violations of certain provisions of the securities laws. The Corporation also agreed to pay an \$8.5 million civil penalty and the disgorgement of \$1 to the SEC. The SEC may request that the civil penalty be subject to distribution pursuant to the Fair Fund provisions of Section 308(a) of the Sarbanes-Oxley Act of 2002. The monetary payment will have no impact on the Corporation's earnings or capital in 2007. As reflected in First BanCorp's previously filed audited Consolidated Financial Statements for 2005, the Corporation accrued \$8.5 million in 2005 for the potential settlement with the SEC. In connection with the settlement, the Corporation consented to the entry of a final judgment to implement the terms of the agreement. The United States District Court for the Southern District of New York must consent to the entry of the final judgment in order to consummate the settlement.

During the first quarter of 2007, the Corporation agreed to issue, subject to regulatory approval, 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 that ended January 30, 2007. After the investment, Scotiabank will hold approximately 10% of First BanCorp's currently outstanding common shares. The original agreement provided that the agreement may be terminated at any time prior to the closing by either the Corporation or Scotiabank if the closing did not occur by July 31, 2007 (the Termination Date). The agreement was subsequently amended to change the Termination Date to August 31, 2007. On August 9, 2007, First BanCorp announced the approval by the Federal Reserve Board of the private placement offering with Scotiabank.

On March 17, 2006, First BanCorp and its banking subsidiary FirstBank Puerto Rico 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 and R&G. For additional information of these orders, please refer to the Current Report on Form 8-K filed with the SEC on March 20, 2006.

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Effective January 1, 2007, the Corporation early adopted the provision of SFAS 157 and SFAS 159. Refer to Note 2 of the accompanying unaudited consolidated financial statement for additional information. Regulatory capital increased by the positive adjustment to retained earnings recognized as part of the adoption of SFAS 159, exceeding by higher margins the capital levels required to be classified as well-capitalized and strengthening the Corporation's current regulatory capital ratios.

As of March 31, 2006, First BanCorp, FirstBank Puerto Rico and FirstBank Florida were in compliance with the 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 Puerto Rico and FirstBank Florida's regulatory capital ratios as of March 31, 2006 based on existing Federal Reserve, Federal Deposit Insurance Corporation and the Office of Thrift Supervision guidelines.

| | First Bancorp | Banking subsidiaries | | |
|---|------------------|----------------------|---------|---------------------------|
| | | FirstBank | Florida | To be well capitalized |
| REGULATORY CAPITAL RATIOS | | | | |
| Total Capital (Total capital to risk-weighted assets) | 10.60% | 10.43% | 11.19% | 10.00% |
| Tier 1 Capital Ratio (Tier I capital to risk-weighted assets) | 9.60% | 9.39% | 10.85% | 6.00% |
| Leverage Ratio (1) | 6.76% | 6.59% | 7.88% | 5.00% |

(1) Tier 1 capital to average assets in the case of First BanCorp and First Bank and Tier 1 capital to adjusted total assets in the case of First Bank Florida.

Dividends

During the period ended March 31, 2006 and March 31, 2005, the Corporation declared a quarterly cash dividend of \$0.07 per common share representing a 16.7% increase over the quarterly cash dividend of \$0.06 per common share declared for the same period in 2004. Total dividends declared per common share for the three-month periods ended on March 31, 2006, 2005 and 2004 amounted to approximately \$5.8 million, \$5.7 million, and \$4.8 million, respectively. Dividends declared on preferred stock amounted to approximately \$10.1 million for each of quarters ended on March 31, 2006, 2005, and 2004.

Off-Balance Sheet Arrangements

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

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

in excess of the amount recognized in the statements of financial position. At March 31, 2006, commitments to extend credit and commercial and financial standby letters of credit amounted to approximately \$1.8 billion and \$118.7 million, respectively. Commitments to extend credit are agreements to lend to customers as long as the conditions established in the contract are met. Generally, the Corporation's mortgage banking activities do not enter into interest rate lock agreements with its prospective borrowers.

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

| <i>(In thousands)</i> | Contractual Obligations and Commitments March 31, 2006 | | | | |
|--|---|-----------------------------|---------------------|---------------------|--------------------------|
| | Total | Less than 1 year | 1-3 years | 3-5 years | After 5 years |
| Contractual obligations: | | | | | |
| Certificates of deposit | \$ 11,143,295 | \$ 6,092,694 | \$ 692,228 | \$ 506,712 | \$ 3,851,661 |
| Federal funds purchased and securities sold under agreements to repurchase | 4,801,666 | 1,845,706 | 700,000 | 580,960 | 1,675,000 |
| Advances from FHLB | 228,000 | 110,000 | 39,000 | 79,000 | |
| Notes payable | 179,027 | | | | 179,027 |
| Other borrowings | 231,646 | | | | 231,646 |
| Total contractual obligations | \$ 16,583,634 | \$ 8,048,400 | \$ 1,431,228 | \$ 1,166,672 | \$ 5,937,334 |
| | | | | | |
| Commitments to sell mortgage loans | \$ 145,930 | \$ 145,930 | | | |
| | | | | | |
| Standby letters of credit | \$ 118,743 | \$ 118,743 | | | |
| | | | | | |
| Commitments to extend credit: | | | | | |
| Lines of credit | \$ 1,091,326 | \$ 1,091,326 | | | |
| Letters of credit | 59,032 | 59,032 | | | |
| Commitments to originate loans | 659,053 | 659,053 | | | |
| | | | | | |
| Total commercial commitments | \$ 1,809,411 | \$ 1,809,411 | | | |

The Corporation has obligations and commitments to make future payments under contracts, such as outstanding debt securities, and under other commitments to sell mortgage loans at fair value and commitments 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. Since certain commitments are expected to expire without being drawn upon, the total commitment amount does not necessarily represent future cash requirements. In the case of credit cards and personal lines of credit, the Corporation can at any time and without cause cancel the unused credit facility. In the ordinary course of business, the Corporation enters into operating leases and other commercial commitments. There have been no significant changes in such contractual obligations since the end of 2005.

RISK MANAGEMENT

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, (2) market risk, (3) credit risk, (4) liquidity risk, (5) operational risk, (6) legal and compliance risk, (7) reputation risk, and (8) contingency risk. First BanCorp has adopted policies and procedures which have been designed to

identify and manage risks to which the Corporation is exposed, specifically those relating to interest rate risk, credit risk, liquidity risk, and operational 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

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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 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. There have been no significant changes in the Corporation's interest rate risk profile since the end of 2005.

Derivatives. First Bancorp uses derivative instruments and other strategies to manage its exposure to interest rate risk caused by changes in interest rates beyond management's control. The following summarizes major strategies, including derivatives activities, used by the Corporation in managing interest rate risk:

Interest rate swaps Interest rate swap agreements generally involve the exchange of fixed- and floating-rate interest payment obligations without the exchange of the underlying principal. 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 CDs (liabilities) to a variable-rate to better match the variable-rate nature of these loans.

Interest rate cap agreements Interest rate cap agreements provide the right to receive cash if a reference interest rate rises above a contractual rate. The value increases as the reference interest rate rises. The Corporation enters into interest rate cap agreements to protect against rising interest rates. Specifically, the interest rate of the Corporation's commercial loans to other financial institutions is generally a variable rate

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limited to the weighted-average coupon of the referenced residential mortgage collateral, less a contractual servicing fee. The Corporation utilizes interest rate cap agreements to protect against rising interest rates.

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

The following table summarizes the notional amount of all derivative instruments as of March 31, 2006, December 31, 2005, March 31, 2005, and March 31, 2004:

| | Notional amounts | | | |
|--------------------------------------|-------------------------------------|---|-------------------------------------|-------------------------------------|
| | As of March 31, 2006 | As of December 31, 2005 (Dollars in thousands) | As of March 31, 2005 | As of March 31, 2004 |
| Interest rate swap agreements: | | | | |
| Pay fixed versus receive floating | \$ 99,320 | \$ 109,320 | \$ 91,320 | \$ 113,165 |
| Received fixed versus pay floating | 5,540,529 | 5,751,128 | 4,481,858 | 2,970,078 |
| Embedded written options | 13,515 | 13,515 | 13,515 | |
| Purchased options | 13,515 | 13,515 | 13,515 | |
| Written interest rate cap agreements | 125,200 | 150,200 | 25,000 | 25,000 |
| Purchased interest rate caps | 357,841 | 386,750 | 471,541 | 25,000 |
| | \$ 6,149,920 | \$ 6,424,428 | \$ 5,096,749 | \$ 3,133,243 |

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

| (In thousands) | Quarter ended March 31, 2006 |
|--|---|
| Fair value of contracts outstanding at the beginning of the period | \$ (142,347) |
| Contracts realized or otherwise settled during the period | 1,078 |
| Changes in fair value during the period | (65,815) |
| Fair value of contracts outstanding at March 31, 2006 | \$ (207,084) |

Source of Fair Value

| (In thousands) | Payments Due by Period | | | | |
|-------------------------------------|-----------------------------------|-----------------------|-----------------------|-------------------------------------|---------------------|
| | Maturity Less Than One Year | Maturity 1-3 Years | Maturity 3-5 Years | Maturity In Excess of 5 Years | Total Fair Value |
| As of March 31, 2006 | | | | | |
| Prices provided by external sources | \$(3,032) | \$(4,865) | \$(8,888) | \$(190,299) | \$(207,084) |

The use of derivatives involves market and credit risk. The market risk of derivatives stems principally from the potential for changes in the value of 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.

Table of Contents***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 represent 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 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.

Non-performing Assets and Allowance for Loan and Lease Losses***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, and 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, the state of Florida, US VI or British VI economies may contribute to delinquencies and defaults, thus necessitating additional reserves.

For small, homogeneous 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 No. 5, *Accounting for Contingencies*.

Commercial and construction loans in amounts of over \$1.0 million are individually evaluated on a quarterly basis for impairment following the provisions of SFAS No. 114, *Accounting by Creditors of a Loan*. A loan is

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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 generally measured based on the present value of expected cash flows discounted at the loan's effective interest rate. 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:

| | 2006 | Quarter Ended March 31, 2005 (As Restated) | 2004 (As Restated) |
|---|-------------|---|-----------------------------------|
| <i>(Dollars in thousands)</i> | | | |
| Allowance for loan and lease losses, beginning of period | \$ 147,999 | \$ 141,036 | \$ 126,378 |
| Provision for loan and lease losses | 19,376 | 10,954 | 13,200 |
| Loans charged off: | | | |
| Residential real estate | (213) | (65) | (26) |
| Commercial and Construction | (1,987) | (1,483) | (1,536) |
| Finance leases | (694) | (433) | (548) |
| Consumer | (13,555) | (8,618) | (8,586) |
| Recoveries | 1,670 | 1,447 | 1,475 |
| Net charge-offs | (14,779) | (9,152) | (9,221) |
| Other adjustments | | 1,363 | |
| Allowance for loan and lease losses, end of period | \$ 152,596 | \$ 144,201 | \$ 130,357 |
| Allowance for loan and lease losses to period end total loans receivable | 1.17% | 1.29% | 1.74% |
| Net charge-offs annualized to average loans outstanding during the period | 0.46% | 0.36% | 0.51% |
| Provision for loan and lease losses to net charge-offs during the period | 1.31x | 1.20x | 1.43x |

The provision for loan and lease losses for the first quarter of 2006 amounted to \$19.4 million, compared to \$11.0 million and \$13.2 million for the corresponding periods in 2005 and 2004, respectively. The increase in this provision for 2006 was mainly due to growth in the Corporation's loans portfolio, in particular residential real estate, commercial, construction and consumer portfolios, coupled with increasing trends in non-performing loans and charge-offs experienced and changes to the Corporation's estimate of probable losses for residential real estate loans. The Corporation's net charge-offs were affected by the fiscal and economic situation of Puerto Rico. According to the Puerto Rico Planning Board, Puerto Rico is currently in a midst of a recession. 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 decrease in the provision during 2005 as compared to 2004 was primarily attributable to the seasoning of the commercial loans portfolio, trends in net charge-offs experienced during 2005, and the stability of non-performing loans.

The provision for loan losses totaled 131% of net charge-offs for the first quarter of 2006, compared with 120% of net charge-offs for the same period in 2005 and 143% for the first quarter of 2004. The increase of \$5.6 million in net charge-offs for the first quarter of 2006, compared with same period in 2005, was mainly composed of \$4.9 million of

higher charge-offs in consumer loans, primarily auto loans, given higher delinquencies during 2006. Auto loans are collateralized by the underlying automobile units. Commercial loans, including construction loans, charged-offs during the first quarter of 2006 amounted to \$2.0 million, an increase of \$0.5 million when

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compared to the same period in 2005. The commercial loans portfolio includes the secured loans to local financial institutions; these institutions have always paid the loans in accordance with the terms and conditions. Further, these commercial loans are mainly secured by residential real estate collateral. Due to the trend of increasing home values, losses in the residential mortgage loan portfolio have been minimal; therefore, reserves allocated to the loans to local financial institutions secured by residential mortgages and to the Corporation's residential real estate portfolios are not significant. Recoveries made from previously written-off accounts were \$1.7 million in the first quarter of 2006 compared to \$1.4 million in 2005 and \$1.5 million in 2004.

Non-accruing and Non-performing Assets

Total non-performing assets are the sum of non-accruing loans, foreclosed real estate, other repossessed properties and investment securities. Non-accruing loans and investments are loans and investments on 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.

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 in 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 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 for 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 at the dates indicated:

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| | March 31, 2006 | December 31, 2005 | March 31, 2005 (As Restated) | March 31, 2004 (As Restated) |
|--|-------------------------------|----------------------------------|---|---|
| <i>(Dollars in thousands)</i> | | | | |
| Non-accruing loans: | | | | |
| Residential real estate | \$ 65,788 | \$ 54,777 | \$ 34,447 | \$ 26,275 |
| Commercial, commercial real estate and construction | 61,599 | 35,814 | 29,794 | 40,168 |
| Finance leases | 4,519 | 3,272 | 2,458 | 3,185 |
| Consumer | 40,379 | 40,459 | 22,219 | 16,025 |
| | 172,285 | 134,322 | 88,918 | 85,653 |
| Other real estate owned | 4,825 | 5,019 | 8,257 | 5,839 |
| Other repossessed property | 11,987 | 9,631 | 7,287 | 5,914 |
| Investment securities | | | | 3,750 |
| Total non-performing assets | \$ 189,097 | \$ 148,972 | \$ 104,462 | \$ 101,156 |
| Past due loans | \$ 31,748 | \$ 27,501 | \$ 31,237 | \$ 22,515 |
| Non-performing assets to total assets | 0.92% | 0.75% | 0.60% | 0.76% |
| Non-accruing loans to total loans receivable | 1.32% | 1.06% | 0.79% | 1.14% |
| Allowance for loan and lease losses | \$ 152,596 | \$ 147,999 | \$ 144,201 | \$ 130,357 |
| Allowance to total non-accruing loans | 89% | 110% | 162% | 152% |
| Allowance to total non-accruing loans, excluding residential real estate loans | 143% | 186% | 265% | 220% |

Due to deteriorating economic conditions in Puerto Rico, increased delinquencies, and overall growth of the Corporation's loan portfolio, First BanCorp increased its allowance for loan losses from \$130.4 million as of March 31, 2004 to \$152.6 million as of March 31, 2006.

As a result of the increase in delinquencies, the Corporation's non-accruing loans to total loans receivable ratio has increased over time from 1.14% at March 31, 2004 to 1.32% at March 31, 2006. The increase was mainly due to increases in non-accruing loans in the residential real estate and commercial real estate portfolios. Historically, the Corporation has experienced the lowest rates of losses for its portfolio of residential real estate loans. As a consequence, the provision and allowance for loan and lease losses did not increase proportionately with the increase in non-accruing loans. As of March 31, 2006, the Corporation's ratio of the allowance for loan and lease losses to non-accruing loans decreased by 63 basis points from 152% as of March 31, 2004 to 89%. Excluding residential real estate loans, the ratio of the allowance for loan and lease losses to non-performing loans decreased by 77 basis points from 220% at March 31, 2004 to 143% at March 31, 2006.

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

Liquidity Risk Management

Liquidity refers to the level of cash and eligible 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 as well as other unsecured lines established with financial institutions. MIALCO reviews credit availability on a regular basis. In the past, the Corporation has

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securitized and sold auto and mortgage loans as supplementary sources of funding. Additional funding is provided by the sale of commercial paper as well as long-term funding through the issuance of notes and long-term brokered CDs. The cost of these different alternatives, among other things, is taken into consideration. The Corporation's principal uses of funds are the origination of loans and the repayment of maturing deposit accounts and borrowings.

A large portion of the Corporation's funding is retail brokered CDs issued by the banking subsidiaries. In the event that the Corporation's bank subsidiaries are not well-capitalized institutions, they might not be able to replace this source of funding. The banking subsidiaries currently comply with the minimum requirements ratios for well-capitalized institutions and the Corporation does not foresee any risks to their ability to issue brokered deposits. In addition, the average life of the retail brokered CDs was approximately 5.9 years at March 31, 2006. Approximately 49% of these certificates are callable, but only at the Corporation's option.

Refer to the *Sources of Funds* section above for further details on the Corporation's brokered CDs.

Operational Risk

The Corporation faces ongoing and emerging risk and regulatory pressures 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, its potential for operational and reputational loss has increased. In order to mitigate and control operational risk, the Corporation has developed, and continues to enhance, specific internal controls, policies and procedures that are designated to identify and manage operational risk at appropriate levels throughout the organization. The purpose of these mechanisms is to provide reasonable assurance that the Corporation's business operations are functioning within the policies and limits established by management.

The Corporation classifies operational risk into two major categories: business specific and corporate-wide affecting all business lines. For business specific risks, a risk assessment group works with the various business units to ensure consistency in policies, processes and assessments. With respect to corporate wide risks, such as information security, business recovery, 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.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

For information regarding market risk to which the Corporation is exposed, see the information contained under the caption Management's Discussion and Analysis of Financial Condition and Results of Operations Risk Management.

ITEM 4. CONTROLS AND PROCEDURES

Disclosure Control and Procedures

First BanCorp's management, with the participation of its Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of First BanCorp's disclosure controls and procedures as of March 31, 2006. Disclosure controls and procedures are defined under SEC rules as controls and other procedures that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within required time periods. Disclosure controls and procedures include controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits

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under the Securities Exchange Act of 1934 is accumulated and communicated to the issuer's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate, to allow timely decisions regarding required disclosure. As a result of this evaluation, First BanCorp's Chief Executive Officer and its current Chief Financial Officer have concluded that the Corporation's disclosure controls and procedures were not effective as of March 31, 2006 due to the existence of the material weaknesses discussed below.

A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected on a timely basis by management or employees in the normal course of their assigned functions.

As reported in the Corporation's 2005 Annual Report on Form 10-K dated February 9, 2007, management previously concluded that its internal control over financial reporting was not effective as of December 31, 2005. Such conclusion resulted from the identification of the following material weaknesses:

1. Ineffective Control Environment
2. Ineffective controls over the documentation and communication of relevant terms of certain mortgage loans bulk purchase transactions.
3. Ineffective controls over communications to the Audit Committee.
4. Ineffective controls over communication to the Corporation's independent registered public accounting firm.
5. Ineffective anti-fraud controls and procedures.
6. Insufficient accounting resources and expertise.
7. Ineffective controls over the accounting for mortgage-related transactions.
8. Ineffective controls over the accounting for derivative financial instruments.
9. Ineffective controls over the valuation of premiums and discounts on mortgage-backed securities.

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

Remediation of previously disclosed material weakness

During the first quarter of 2006, First BanCorp completed the implementation of the following remediation steps to fully remediate material weakness number 9 *Ineffective controls over the valuation of premiums and discounts on mortgage-backed securities* as of March 31, 2006. The remediation steps taken by management were to adjust 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.

Changes in Internal Control over Financial Reporting

In addition to the remediation of the material weakness in the valuation of premiums and discounts on mortgage-based securities described above, the following are changes in the Corporation's internal control over financial reporting that occurred during the period ended March 31, 2006 that materially affected, or are reasonably likely to materially affect, the Corporation's internal control over financial reporting.

1. Changes in Management and Clarification of the Role, Responsibilities and Authority of Management. In addition to the previous appointments of a new CEO and COO, in February 15, 2006 the Board appointed a new General Counsel, who reports to the CEO.
- 2.

Board Membership Changes. In November 2005, the Board elected Fernando Rodriguez-Amaro as a new independent director to serve as an additional audit committee financial expert, and thereafter

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appointed him Chairman of the Audit Committee as of January 1, 2006. Also, in the first quarter of 2006, the Board appointed Jose Menendez Cortada as the Lead Independent Director of the Board.

3. Risk Management Program. During the first quarter of 2006, the Board reviewed the Corporation's risk management program with the assistance of outside consultants and legal counsel and began a process of realigning the risk management functions and the adoption of an enterprise risk management process.
4. 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 effort is expected to result in a 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.
5. Accounting for derivative financial instruments. The Corporation 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 analyses/computations. As discussed in First BanCorp's 2006 Annual Report on Form 10-K filed with the SEC on July 9, 2007 as of December 31, 2006, First BanCorp completed the execution 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 had been remediated.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The Corporation is subject to various legal proceedings arising as a result of the restatement of the Corporation's financial statements for the years 2004, 2003 and 2002. For information on these proceedings, please refer to Note 17 to the unaudited interim financial statements included in Item 1, Financial Statements, of this Quarterly Report on Form 10-Q.

ITEM 1A. RISK FACTORS

For a detailed discussion of certain risk factors that could affect First BanCorp's operations, financial condition or results for future periods see Item 1A, Risk Factors, in First BanCorp's 2005 Annual Report on Form 10-K.

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

Not applicable.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

ITEM 5. OTHER INFORMATION

Not applicable.

ITEM 6. EXHIBITS

31.1 CEO Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 CFO Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 CEO Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 CFO Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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SIGNATURES

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

First BanCorp.

Registrant

Date: August 20, 2007

By: /s/ Luis M. Beauchamp

Luis M. Beauchamp
Chairman, President and Chief
Executive Officer

Date: August 20, 2007

By: /s/ Fernando Scherrer

Fernando Scherrer
Executive Vice President
and Chief Financial Officer
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