

FIRST BANCORP /PR/  
Form 10-Q  
August 09, 2018

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

**Washington, DC 20549**

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**FORM 10-Q**

(Mark One)

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

For the quarterly period ended June 30, 2018

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

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

COMMISSION FILE NUMBER 001-14793

**First BanCorp.**

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

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(State or other jurisdiction of  
incorporation or organization)

(I.R.S. employer

identification number)

1519 Ponce de León Avenue, Stop 23

00908

Santurce, Puerto Rico

(Zip Code)

(Address of principal executive offices)

(787) 729-8200

(Registrant's telephone number, including area code)

Not applicable

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

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

Yes No

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

Yes No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer  
company

(Do not check if a smaller reporting company)

Smaller reporting

Emerging

growth company

If an emerging growth company, indicate by check mark if the registered has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13 (a) of the Exchange Act.

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

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

Common stock: 217,183,977 shares outstanding as of July 31, 2018.

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**SIGNATURES**

## Forward Looking Statements

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

First BanCorp. wishes to caution readers not to place undue reliance on any such “forward-looking statements,” which speak only as of the date made, and to advise readers that these forward-looking statements are not guarantees of future performance and involve certain risks, uncertainties, estimates, and assumptions by us that are difficult to predict. Various factors, some of which are beyond our control, could cause actual results to differ materially from those expressed in, or implied by, such forward-looking statements.

The two hurricanes that affected the Corporation’s service areas in 2017 are discussed below in Note 2 to the financial statements and in various sections of “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” These events caused significant uncertainties, the outcome of which will impact the Corporation’s future results.

Factors that could cause actual results to differ from those expressed in the Corporation’s forward-looking statements include, but are not limited to, risks described or referenced below in Part II, Item 1A. “Risk Factors” and the following:

- the actual pace and magnitude of economic recovery in the Corporation’s service areas that were affected by two hurricanes during 2017 compared to Management’s current views on the economic recovery;
- uncertainties about the effectiveness and the timing of the completion of the rebuilding taking place in the regions affected by the hurricanes, including the rebuilding of the public infrastructure, such as Puerto Rico’s power grid, how and the extent to which government, private or philanthropic funds will be invested in the affected communities, how many displaced individuals will return to their homes in both the short- and long-term, and what other demographic changes will take place, if any;

- uncertainty as to the ultimate outcomes of actions taken, or those that may be taken, by the Puerto Rico government, or the oversight board established by the Puerto Rico Oversight, Management, and Economic Stability Act (“PROMESA”) to address Puerto Rico’s financial problems, including the filing of a form of bankruptcy under Title III of PROMESA, which provides a court debt restructuring process similar to U.S. bankruptcy protection, and the effects of measures included in the Puerto Rico government fiscal plan, or any revisions to it, on our clients and loan portfolios;
- the ability of the Puerto Rico government or any of its public corporations or other instrumentalities to repay its respective debt obligations, including the effect of payment defaults on the Puerto Rico government general obligations, bonds of the Government Development Bank for Puerto Rico (the “GDB”) and certain bonds of government public corporations, and recent and any future downgrades of the long-term and short-term debt ratings of the Puerto Rico government, which could exacerbate Puerto Rico’s adverse economic conditions and, in turn, further adversely impact the Corporation;

- uncertainty about whether the Federal Reserve Bank of New York ( the “New York FED” or “Federal Reserve”) will continue to provide approvals for receiving dividends from the Corporation’s subsidiary, FirstBank Puerto Rico (“FirstBank” or the “Bank”), or making payments of dividends on non-cumulative perpetual preferred stock, or payments on trust preferred securities or subordinated debt, incurring, increasing or guaranteeing debt or repurchasing any capital securities, despite the consents that have enabled the Corporation to receive quarterly dividends from FirstBank since the second quarter of 2016, to pay quarterly interest payments on the Corporation’s subordinated debentures associated with its trust preferred securities since the second quarter of 2016, and to pay monthly dividends on the non-cumulative perpetual preferred stock since December 2016;
- a decrease in demand for the Corporation’s products and services and lower revenues and earnings because of the continued recession in Puerto Rico;
- uncertainty as to the availability of certain funding sources, such as brokered certificates of deposit (“brokered CDs”);
- the Corporation’s reliance on brokered CDs to fund operations and provide liquidity;
- the risk of not being able to fulfill the Corporation’s cash obligations or resume paying dividends to the Corporation’s common stockholders in the future due to the Corporation’s need to receive regulatory approvals to declare or pay any dividends and to take dividends or any other form of payment representing a reduction in capital from FirstBank or FirstBank’s failure to generate sufficient cash flow to make a dividend payment to the Corporation;
- the weakness of the real estate markets and of the consumer and commercial sectors and their impact on the credit quality of the Corporation’s loans and other assets, which have contributed and may continue to contribute to, among other things, high levels of non-performing assets, charge-offs and provisions for loan and lease losses, and may subject the Corporation to further risk from loan defaults and foreclosures;
- the ability of FirstBank to realize the benefits of its net deferred tax assets;
- adverse changes in general economic conditions in Puerto Rico, the United States (“U.S.”), the U.S. Virgin Islands (“USVI”), and the British Virgin Islands (“BVI”), including the interest rate environment, market liquidity, housing absorption rates, real estate prices, and disruptions in the U.S. capital markets, which reduced interest margins and affected funding sources, and have affected demand for all of the Corporation’s products and services and reduced the Corporation’s revenues and earnings and the value of the Corporation’s assets, and may continue to have these effects;

- an adverse change in the Corporation's ability to attract new clients and retain existing ones;
- the risk that additional portions of the unrealized losses in the Corporation's investment portfolio are determined to be other-than-temporary, including additional impairments on the Corporation's remaining \$8.1 million of the Puerto Rico government's debt securities;
- uncertainty about regulatory and legislative changes for financial services companies in Puerto Rico, the U.S., the USVI and the BVI, which could affect the Corporation's financial condition or performance and could cause the Corporation's actual results for future periods to differ materially from prior results and anticipated or projected results;



- changes in the fiscal and monetary policies and regulations of the U.S. federal government and the Puerto Rico and other governments, including those determined by the Board of the Governors of the Federal Reserve System (the “Federal Reserve Board”), the New York FED, the Federal Deposit Insurance Corporation (“FDIC”), government-sponsored housing agencies, and regulators in Puerto Rico, and the USVI and BVI;
- the risk of possible failure or circumvention of controls and procedures and the risk that the Corporation’s risk management policies may not be adequate;
- the risk that the FDIC may increase the deposit insurance premium and/or require special assessments to replenish its insurance fund, causing an additional increase in the Corporation’s non-interest expenses;
- the impact on the Corporation’s results of operations and financial condition of acquisitions and dispositions;
- a need to recognize impairments on the Corporation’s financial instruments, goodwill or other intangible assets relating to acquisitions;
- the risk that downgrades in the credit ratings of the Corporation’s long-term senior debt will adversely affect the Corporation’s ability to access necessary external funds;
- the effect on the Corporation’s businesses, business practices and results of operations of a potential higher interest rate environment;
- uncertainty as to whether FirstBank will be able to satisfy its regulators regarding, among other things, its asset quality, liquidity plans, maintenance of capital levels and compliance with applicable laws, regulations and related requirements; and
- general competitive factors and industry consolidation.

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

Investors should refer to the Corporation's Annual Report on Form 10-K for the year ended December 31, 2017, as well as "Part II, Item 1A, Risk Factors," in this Quarterly Report on Form 10-Q, for a discussion of such factors and certain risks and uncertainties to which the Corporation is subject.

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

	<b>June 30, 2018</b>	<b>December 31, 2017</b>
(In thousands, except for share information)		
<b>ASSETS</b>		
Cash and due from banks	\$ 790,809	\$ 705,980
Money market investments:		
Time deposits with other financial institutions	300	3,126
Other short-term investments	97,290	7,289
Total money market investments	97,590	10,415
Investment securities available for sale, at fair value:		
Securities pledged that can be repledged	241,378	350,123
Other investment securities	1,794,632	1,540,893
Total investment securities available for sale	2,036,010	1,891,016
Investment securities held to maturity, at amortized cost:		
Securities pledged that can be repledged	-	-
Other investment securities	150,486	150,627
Total investment securities held to maturity, fair value of \$135,430 (2017- \$131,032)	150,486	150,627
Other investment securities	43,400	43,119
Loans, net of allowance for loan and lease losses of \$222,035 (2017 - \$231,843)	8,418,256	8,618,633
Loans held for sale, at lower of cost or market	80,815	32,980
Total loans, net	8,499,071	8,651,613
Premises and equipment, net	144,507	141,895
Other real estate owned	143,355	147,940
Accrued interest receivable on loans and investments	47,171	57,172
Other assets	432,463	461,491
Total assets	\$ 12,384,862	\$ 12,261,268
<b>LIABILITIES</b>		
Non-interest-bearing deposits	\$ 2,317,149	\$ 1,833,665
Interest-bearing deposits	6,900,934	7,188,966
Total deposits	9,218,083	9,022,631
Securities sold under agreements to repurchase	200,000	300,000
Advances from the Federal Home Loan Bank (FHLB)	715,000	715,000
Other borrowings	184,150	208,635
Accounts payable and other liabilities	165,950	145,905
Total liabilities	10,483,183	10,392,171
<b>STOCKHOLDERS EQUITY</b>		

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Preferred stock, authorized, 50,000,000 shares:		
Non-cumulative Perpetual Monthly Income Preferred Stock: issued 22,004,000 shares, outstanding 1,444,146 shares, aggregate liquidation value of \$36,104	36,104	36,104
Common stock, \$0.10 par value, authorized, 2,000,000,000 shares; issued, 221,724,062 shares (2017 - 220,382,343 shares issued)	22,172	22,038
Less: Treasury stock (at par value)	(453)	(410)
Common stock outstanding, 217,185,449 shares outstanding (2017 - 216,278,040 shares outstanding)	21,719	21,628
Additional paid-in capital	937,919	936,772
Retained earnings, includes legal surplus reserve of \$59,693	958,044	895,208
Accumulated other comprehensive loss, net of tax of \$7,752	(52,107)	(20,615)
Total stockholders equity	1,901,679	1,869,097
Total liabilities and stockholders equity	\$ 12,384,862	\$ 12,261,268

The accompanying notes are an integral part of these statements.

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

	<b>Quarter Ended</b>		<b>Six-Month Pe</b>	
	<b>June 30,</b>		<b>Ended</b>	
	<b>2018</b>	<b>2017</b>	<b>2018</b>	<b>2017</b>
(In thousands, except per share information)				
<b>Interest and dividend income:</b>				
Loans	\$ 137,538	\$ 132,697	\$ 270,713	\$ 266,819
Investment securities	14,732	13,950	28,719	28,719
Money market investments and interest-bearing cash accounts	3,363	727	5,619	5,619
Total interest income	155,633	147,374	305,051	299,157
<b>Interest expense:</b>				
Deposits	16,974	16,348	33,945	33,945
Securities sold under agreements to repurchase	2,543	2,765	4,840	4,840
Advances from FHLB	3,410	2,292	6,782	6,782
Other borrowings	2,235	2,065	4,320	4,320
Total interest expense	25,162	23,470	49,887	49,887
Net interest income	130,471	123,904	255,164	249,270
<b>Provision for loan and lease losses</b>				
Net interest income after provision for loan and lease losses	110,935	105,808	215,084	209,383
<b>Non-interest income:</b>				
Service charges and fees on deposit accounts	5,344	5,803	10,432	10,432
Mortgage banking activities	4,835	4,846	9,000	9,000
Net gain on sale of investments	-	371	-	-
Other-than-temporary impairment (“OTTI”) losses on available-for-sale debt securities:				
Total OTTI losses	-	-	-	(12,316)
Portion of OTTI recognized in other comprehensive income (“OCI”)	-	-	-	-
Net impairment losses on available-for-sale debt securities	-	-	-	(12,316)
Gain on early extinguishment of debt	-	-	2,316	-
Insurance commission income	1,780	1,855	5,135	5,135
Other non-interest income	8,513	7,674	16,373	16,373
Total non-interest income	20,472	20,549	43,256	43,256
<b>Non-interest expenses:</b>				
Employees' compensation and benefits	39,555	38,409	80,239	79,117
Occupancy and equipment	13,746	13,759	28,851	28,851
Business promotion	4,016	3,192	6,592	6,592
Professional fees	10,193	11,800	20,253	20,253
Taxes, other than income taxes	3,637	3,745	7,493	7,493
Insurance and supervisory fees	3,701	4,855	7,556	7,556
Net loss on other real estate owned (“OREO”) and OREO operations	5,655	3,369	5,845	5,845
Credit and debit card processing expenses	3,766	3,566	7,303	7,303
Communications	1,582	1,628	3,064	3,064
Other non-interest expenses	4,365	4,746	9,047	9,047
Total non-interest expenses	90,216	89,069	176,243	176,243
<b>Income before income taxes</b>	<b>41,191</b>	<b>37,288</b>	<b>82,097</b>	<b>53,140</b>
<b>Income tax expense</b>	<b>(10,159)</b>	<b>(9,290)</b>	<b>(17,917)</b>	<b>(17,917)</b>

<b>Net income</b>	\$ 31,032	\$ 27,998	\$ 64,180	\$ 5
<b>Net income attributable to common stockholders</b>	\$ 30,363	\$ 27,329	\$ 62,842	\$ 5
<b>Net income per common share:</b>				
Basic	\$ 0.14	\$ 0.13	\$ 0.29	\$
Diluted	\$ 0.14	\$ 0.13	\$ 0.29	\$
<b>Dividends declared per common share</b>	\$ -	\$ -	\$ -	\$

The accompanying notes are an integral part of these statements.

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

	<b>Quarter Ended</b>		<b>Six-Month Period</b>	
	<b>June 30,</b>		<b>Ended</b>	
	<b>2018</b>	<b>2017</b>	<b>2018</b>	<b>2017</b>
(In thousands)				
Net income	\$ 31,032	\$ 27,998	\$ 64,180	\$ 53,539
Amount reclassified out of accumulated other comprehensive loss per Accounting Standards Update (“ASU”) 2016-01	-	-	6	-
Other comprehensive (loss) income:				
Unrealized (loss) gain on debt securities on which an OTTI has been recognized	(294)	1,127	202	(1,803)
Reduction of non-credit OTTI component on securities sold	-	5,678	-	5,678
Reclassification adjustments for net gain included in net income	-	(371)	-	(371)
Reclassification adjustment for other-than-temporary impairment on debt securities included in net income	-	-	-	12,231
All other unrealized holding (losses) gains on available-for-sale securities arising during the period	(7,151)	2,631	(31,700)	4,026
Other comprehensive (loss) income for the period	(7,445)	9,065	(31,492)	19,761
Total comprehensive income	\$ 23,587	\$ 37,063	\$ 32,688	\$ 73,300

The accompanying notes are an integral part of these statements.

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

	<b>Six-Month Period Ended</b>	
	<b>June 30,</b>	<b>June 30,</b>
	<b>2018</b>	<b>2017</b>
(In thousands)		
<b>Cash flows from operating activities:</b>		
Net income	\$ 64,180	\$ 53,539
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	7,686	8,230
Amortization of intangible assets	1,868	2,242
Provision for loan and lease losses	40,080	43,538
Deferred income tax expense	11,479	728
Stock-based compensation	3,983	3,599
Gain on sale of investments	-	(371)
OTTI on debt securities	-	12,231
Unrealized loss (gain) on derivative instruments	103	(307)
Gain on early extinguishment of debt	(2,316)	-
Net gain on sales of premises and equipment and other assets	(840)	(133)
Net gain on sales of loans	(2,921)	(3,696)
Net amortization/accretion of premiums, discounts and deferred loan fees and costs	(3,937)	(4,235)
Originations and purchases of loans held for sale	(160,584)	(182,678)
Sales and repayments of loans held for sale	173,977	188,890
Loans held for sale valuation adjustments	558	-
Amortization of broker placement fees	676	1,007
Net amortization/accretion of premium and discounts on investment securities	1,090	40
Decrease in accrued interest receivable	9,948	10
Increase in accrued interest payable	115	567
Decrease in other assets	11,536	4,225
Increase in other liabilities	1,591	4,148
Net cash provided by operating activities	158,272	131,574
<b>Cash flows from investing activities:</b>		
Principal collected on loans	1,282,545	1,362,537
Loans originated and purchased	(1,217,117)	(1,498,967)
Proceeds from sales of loans held for investment	33,709	53,245
Proceeds from sales of repossessed assets	24,484	20,999
Proceeds from sales of available-for-sale securities	-	23,408
Purchases of available-for-sale securities	(352,576)	(12,440)
Proceeds from principal repayments and maturities of available-for-sale securities	174,574	119,664
Proceeds from principal repayments of held-to-maturity securities	141	141
Additions to premises and equipment	(10,305)	(5,269)
Proceeds from sale of premises and equipment and other assets	1,857	1,109
Net redemptions/purchase of other investment securities	132	(80)
Proceeds from the settlement of insurance claims	5,118	-
Net cash (used in) provided by investing activities	(57,438)	64,347
<b>Cash flows from financing activities:</b>		
Net increase (decrease) in deposits	196,687	(64,810)



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Repayment of securities sold under agreements to repurchase	(100,000)	-
Net FHLB advances proceeds	-	5,000
Repayment of junior subordinated debentures	(21,434)	-
Repurchase of outstanding common stock	(2,745)	(1,894)
Dividends paid on preferred stock	(1,338)	(1,338)
Net cash provided by (used in) financing activities	71,170	(63,042)
Net increase in cash and cash equivalents	172,004	132,879
Cash and cash equivalents at beginning of period	716,395	299,685
Cash and cash equivalents at end of period	\$ 888,399	\$ 432,564
Cash and cash equivalents include:		
Cash and due from banks	\$ 790,809	\$ 422,150
Money market instruments	97,590	10,414
	\$ 888,399	\$ 432,564

The accompanying notes are an integral part of these statements.

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

	<b>Six-Month Period Ended</b>	
	<b>June 30,</b>	<b>June 30,</b>
	<b>2018</b>	<b>2017</b>
(In thousands)		
<b>Preferred Stock</b>	\$ 36,104	\$ 36,104
<b>Common Stock outstanding:</b>		
Balance at beginning of period	21,628	21,745
Common stock issued as compensation	27	27
Common stock issued for exercised warrants	73	-
Common stock withheld for taxes	(42)	(33)
Restricted stock grants	34	95
Restricted stock forfeited	(1)	(238)
Balance at end of period	21,719	21,596
<b>Additional Paid-In-Capital:</b>		
Balance at beginning of period	936,772	931,856
Stock-based compensation	3,983	3,599
Common stock issued for exercised warrants	(73)	-
Common stock withheld for taxes	(2,703)	(1,861)
Restricted stock grants	(34)	(95)
Common stock issued as compensation	(27)	(27)
Restricted stock forfeited	1	238
Balance at end of period	937,919	933,710
<b>Retained Earnings:</b>		
Balance at beginning of period	895,208	830,928
Net income	64,180	53,539
Dividends on preferred stock	(1,338)	(1,338)
Amount reclassified from accumulated other comprehensive loss per ASU 2016-1	(6)	-
Balance at end of period	958,044	883,129
<b>Accumulated Other Comprehensive Income (Loss), net of tax:</b>		
Balance at beginning of period	(20,615)	(34,390)
Other comprehensive (loss) income, net of tax	(31,492)	19,761
Balance at end of period	(52,107)	(14,629)
 Total stockholders' equity	 \$ 1,901,679	 \$ 1,859,910

The accompanying notes are an integral part of these statements.

**FIRST BANCORP.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

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

The Consolidated Financial Statements (unaudited) of First BanCorp. (the “Corporation”) have been prepared in conformity with the accounting policies stated in the Corporation’s Audited Consolidated Financial Statements included in the Corporation’s Annual Report on Form 10-K for the year ended December 31, 2017 (the “2017 Annual Report on Form 10-K”). Certain information and note disclosures normally included in the financial statements prepared in accordance with generally accepted accounting principles in the United States of America (“GAAP”) have been condensed or omitted from these statements pursuant to the rules and regulations of the SEC and, accordingly, these financial statements should be read in conjunction with the Audited Consolidated Financial Statements of the Corporation for the year ended December 31, 2017, which are included in the 2017 Annual Report on Form 10-K. All adjustments (consisting only of normal recurring adjustments) that are, in the opinion of management, necessary for a fair presentation of the statement of financial position, results of operations and cash flows for the interim periods have been reflected. All significant intercompany accounts and transactions have been eliminated in consolidation.

The results of operations for the quarter and six-month period ended June 30, 2018 are not necessarily indicative of the results to be expected for the entire year.

## **Adoption of New Accounting Requirements and Recently Issued but Not Yet Effective Accounting Requirements**

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

### **Revenue Recognition**

In May 2014, the FASB updated the Accounting Standards Codification (the “Codification” or the “ASC”) to create a new, principles-based revenue recognition framework. This guidance requires entities to recognize revenues when they transfer promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This guidance describes a 5-step process that entities can apply to achieve the core principle of revenue recognition and requires disclosures sufficient to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from

contracts with customers and the significant judgments used in determining that information.

The Corporation adopted the guidance on January 1, 2018 using a modified retrospective method, in which the guidance applies to existing contracts in effect at January 1, 2018 and new contracts entered into after this date. Most of the Corporation's revenue, including net interest income, gain on sale of loans, and mortgage servicing fees is explicitly out of scope of the new revenue recognition guidance. The Corporation conducted an assessment of the revenue streams that were potentially affected by the new guidance and reviewed contracts in scope to ensure compliance with the new guidance.

The Corporation has identified service charges on deposits and related cash management services, insurance commissions, merchant-related income, and card interchange income as its most significant revenue streams within the scope of the standard. For the revenue streams that were found in scope, management reviewed in detail its most significant contracts with corresponding customers. The adoption of this guidance did not have a material effect on the Corporation's consolidated financial statements. However, additional disclosures required by the standard have been included in Note 23 – Revenue from Contracts with Customers, to the Corporation's consolidated financial statements.

## **Recognition and Measurement of Financial Assets and Liabilities**

In January 2016, the FASB updated the Codification to require an entity to: (i) measure equity investments at fair value through net income, with certain exceptions, thus, eliminating eligibility for the available-for-sale category; (ii) present in OCI the changes in instrument-specific credit risk for financial liabilities measured using the fair value option; (iii) present financial assets and financial liabilities by measurement category and form of financial asset; (iv) calculate the fair value of financial instruments for disclosure purposes based on an exit price; and (v) assess a valuation allowance on deferred tax assets related to unrealized losses of available-for-sale debt securities in combination with other deferred tax assets. The guidance provides an election to subsequently measure certain nonmarketable equity investments at cost less any impairment, adjusted for certain observable price changes. The guidance also requires a qualitative impairment assessment of such equity investments and amends certain fair value disclosure requirements. The adoption of this standard during the first quarter of 2018 did not have a material effect on the Corporation's consolidated financial statements.

## **Statement of Cash Flows Presentation – Restricted Cash**

In August 2016 and November 2016, the FASB updated the Codification to provide specific guidance on the classification and presentation of certain cash payments and cash receipts, including changes in restricted cash, in the statement of cash flows. This guidance is intended to reduce diversity in practice in how certain transactions are classified in the statement of cash flows. The amendments in this update must be applied using a retrospective transition method to each period presented. The Corporation adopted the provisions of this guidance during the first quarter of 2018 without any material effect on the Corporation's consolidated financial statements.

## **Income Tax Effect of Intra-Entity Transfers of Assets**

In October 2016, the FASB updated the Codification to improve the accounting for the income tax consequences of intra-entity transfers of assets other than inventory. With this update, entities are required to recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. Under prior GAAP, the recognition of current and deferred income taxes for an intra-entity asset transfer was prohibited until the assets are sold to an outside party. This Update does not include new disclosure requirements; however, existing disclosure requirements might be applicable when accounting for the current and deferred income taxes for an intra-entity transfer of an asset other than inventory. For example, GAAP requires an entity to disclose a comparison of income tax expense (benefit) with statutory expectations (a rate reconciliation for public entities or a description of the nature of each significant reconciling item for nonpublic entities) and also requires an entity to disclose the types of temporary differences and carryforwards that give rise to a significant portion of deferred income taxes. The Corporation adopted the provisions of this guidance during the first quarter of 2018 without any effect on the Corporation's consolidated financial statements.

## Clarifying what Changes Qualify as a Modification of a Share-Based Payment Award

In May 2017, the FASB updated the codification to reduce the cost and complexity when applying ASC Topic 718, “Compensation – Stock Compensation” (“ASC Topic 718”), and standardize the practice of applying ASC Topic 718 to financial reporting. ASC Topic 718 prescribes the accounting treatment of a modification in the terms or conditions of a share-based payment award. The guidance clarifies what changes would qualify as a modification. This was done by better defining what does not constitute a modification. In order for a change to a share-based arrangement to not require ASC Topic 718 modification treatment, all of the following must be met: (i) the fair value (or alternative measurement method used) of the modified award must equal the fair value (or alternative measurement method used) of the original award immediately before the original award is modified; (ii) the vesting conditions of the modified award must be the same as the vesting conditions of the original award immediately before the original award is modified; and (iii) the classification of the modified award as an equity instrument or a liability instrument must be the same as the classification of the original award immediately before the original award is modified. The current disclosure requirements in ASC Topic 718 apply regardless of whether an entity is required to apply modification accounting under this update. The amendments in this update must be applied prospectively to an award modified on or after the adoption date. The Corporation adopted the provisions of this guidance on January 1, 2018 without any effect on the Corporation’s consolidated financial statements. The Corporation’s Omnibus Plan provides for equity-based compensation incentives through the grant of stock options, stock appreciation rights, restricted stock, restricted stock units, performance shares, cash-based awards and other stock-based awards. If any change occurs in the future to awards issued under the Omnibus Plan, the Corporation will evaluate it under this guidance.

## Lease Accounting

In February 2016, the FASB updated the Codification to replace ASC 840, “Leases (Topic 840)” (“ASC Topic 840”), with new guidance for the financial reporting about leasing transactions. Under the new guidance, a lessee will be required to recognize assets and liabilities for leases with lease terms of more than 12 months. Consistent with current GAAP, the recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee primarily will depend on its classification as a finance or operating lease. However, unlike current GAAP, which requires the recognition of only capital leases on the balance sheet, the guidance will require both types of leases to be recognized on the balance sheet. The guidance will also require disclosures to help investors and other financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases. These disclosures include qualitative and quantitative information and additional information about the amounts recorded in the financial statements. The FASB issued an update in January 2018 providing an optional transition practical expedient to not evaluate under new ASC Topic 842, “Leases” (“ASC Topic 842”), land easements that exist or expired before the entity’s adoption of ASC Topic 842 and were not previously accounted for as leases. In addition, the FASB issued an update in July 2018 that makes 16 technical corrections to this guidance that alleviate the potential for unintended consequences from applying the new standard. The guidance on leases will take effect for public companies for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted. Entities are required to use a modified retrospective approach for leases that existed prior to, or are entered into after, the beginning of the earliest comparative period presented in the financial statements or they can elect an additional and optional transition method to adopt the new leases. Under the optional transition method, an entity applies the new standard at the adoption date and recognizes a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. Also, under the optional transition method, the entity’s reporting for comparative periods presented in the financial statements in which it adopts the new leases standard will continue to be in accordance with ASC Topic 840.

The update is expected to affect the Corporation’s consolidated financial statements since the Corporation has operating and lease arrangements for which it is a lessee. The Corporation has identified the population of its current leases and is in the process of obtaining the data necessary to estimate the amount of right-of-use assets (“ROU”) and lease liabilities that will be recognized upon adoption. Therefore, the Corporation is still evaluating the effect that the adoption of this accounting pronouncement will have on its consolidated financial statements and preliminarily expects that amounts to be recognized as ROU will not be material as a percentage of the Corporation’s total assets.

## Accounting for Financial Instruments – Credit Losses

In June 2016, the FASB updated the Codification to introduce new guidance for the accounting for credit losses. The guidance includes an impairment model (known as the current expected credit loss (“CECL”) model) that is based on expected losses rather than incurred losses. It also modifies the impairment model for available-for-sale debt securities and provides for a simplified accounting model for purchased financial assets with credit deterioration since their origination. The CECL model will apply to: (1) financial assets subject to credit losses and measured at amortized cost and (2) certain off-balance sheet credit exposures. This includes loans, held-to-maturity debt securities, loan commitments, financial guarantees, and net investments in leases, as well as reinsurance and trade receivables. Upon

initial recognition of the exposure, the CECL model requires an entity to estimate the credit losses expected over the life of an exposure (or pool of exposures). The estimate of expected credit losses (“ECL”) should consider historical information, current information, and reasonable and supportable forecasts, including estimates of prepayments. Financial instruments with similar risk characteristics should be grouped together when estimating ECL. The guidance does not prescribe a specific method to make the estimate, so its application will require significant judgment.

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

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



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

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

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

The guidance will be effective for public business entities that are SEC filers in fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption of the guidance will be permitted for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years.

The Corporation has developed a transition roadmap in order to comply on a timely basis with the implementation of this new accounting framework. The Corporation has created a working group with members from multiple areas across the organization that is responsible for assessing the effect of the standard, evaluating interpretative issues, and evaluating the current credit loss models against the new guidance to determine any necessary changes and other related implementation activities. The working group provides periodic updates to the Corporation’s CECL Management Committee, which has oversight responsibilities for the implementation efforts. The Corporation continues to evaluate the effect that this guidance, including the method of implementation, will have on its consolidated financial statements.

### **Subsequent Measurement of Goodwill**

In January 2017, the FASB updated the Codification to simplify the subsequent measurement of goodwill by eliminating Step 2 from the current two-step goodwill impairment test. This guidance provides that a goodwill impairment test be conducted by comparing the fair value of a reporting unit with its carrying amount. Entities are to recognize an impairment charge for goodwill equal to the excess of the carrying amount over the reporting unit's fair value. Entities have the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. This guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. The effect of this guidance will depend upon the performance of the reporting units that have goodwill and the market conditions affecting the fair value of each reporting unit going forward.

### **Amortization of Premiums and Discounts of Callable Debt Securities**

In March 2017, the FASB updated the Codification to shorten the amortization period for certain purchased callable debt securities held at a premium. Specifically, the amendments require the premium to be amortized to the earliest call date. With respect to securities held at a discount, the amendments do not require an accounting change; thus, the discount continues to be amortized to maturity. Under current GAAP, premiums and discounts on callable debt securities generally are amortized to the maturity date. An entity must have a large number of similar loans to consider estimates of future principal prepayments when applying the interest method. However, an entity that holds an individual callable debt security at a premium may not amortize that premium to the earliest call date. If that callable debt security is subsequently called, the entity records a loss equal to the unamortized premium. The amendments in this update more closely align the amortization period of premiums and discounts to expectations incorporated in market pricing on the underlying securities. In most cases, market participants price securities to the call date that produces the worst yield when the coupon is above current market rates (that is, the security is trading at a premium) and price securities to maturity when the coupon is below market rates (that is, the security is trading at a discount) in anticipation that the borrower will act in its economic best interest. As a result, the amendments more closely align interest income recorded on bonds held at a premium or a discount with the economics of the underlying instrument. For public business entities, the amendments in this update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The adoption of this guidance is not expected to have a material effect on the Corporation's consolidated statement of financial condition or results of operations. As of June 30, 2018, the Corporation had \$4.0 million of callable debt securities held at a premium (unamortized premium of \$32 thousand).

### **Derivatives and Hedging**

In August 2017, the FASB updated the Codification to: (i) expand hedge accounting for nonfinancial and financial risk components and amend measurement methodologies to more closely align hedge accounting with a company's risk management activities; (ii) decrease the complexity of preparing and understanding hedge results by eliminating the separate measurement and reporting of hedge ineffectiveness; (iii) enhance transparency, comparability, and understanding of hedge results through enhanced disclosures and a change in the presentation of hedge results to align the effects of the hedging instrument and the hedged item; and (iv) reduce the cost and complexity of applying hedge accounting by simplifying the manner in which assessments of hedge effectiveness may be performed. This update is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted. The guidance requires companies to apply requirements to existing hedging relationships on the date of adoption, and the effect of the adoption should be reflected as of the beginning of the fiscal year of adoption. As of June 30, 2018, all of the derivatives held by the Corporation were considered economic undesignated hedges. The adoption of this guidance is not expected to have a material effect on the Corporation's consolidated statement of financial condition or results of operations.

### **Reclassification of Certain Tax Effects From Accumulated Other Comprehensive Income**

In February 2018, the FASB updated the Codification to provide entities with an option to reclassify to retained earnings, tax effects that were stranded in accumulated other comprehensive income, pursuant to the Tax Cuts and Jobs Act of 2017 (the “Tax Act”). This guidance is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. This guidance may be early adopted in any interim or annual period for which financial statements have not yet been issued and applied either in the period of adoption or retrospectively to each period in which the effect of the change in the corporate tax rate in the Tax Act is recognized. The Corporation is currently evaluating whether it will adopt this guidance. If adopted, the Corporation does not expect a material effect on its consolidated financial statements.

### **Improvements to Nonemployee Share-Based Payment Accounting**

In June 2018, the FASB updated the Codification as part of a simplification initiative to expand the scope of Topic 718 to include share-based payment transactions for acquiring goods and services from non-employees and to address and improve aspects of the accounting for non-employee share-based payment transactions. The amendments will be effective for interim and annual reporting periods beginning after December 15, 2018. The adoption of this guidance is not expected to have an effect on the Corporation’s consolidated financial statements.

## NOTE 2 – UPDATE ON EFFECTS OF NATURAL DISASTERS

Two strong hurricanes affected the Corporation's service areas during September 2017. The following summarizes the more significant continuing financial repercussions of these natural disasters for the Corporation and for its major subsidiary, FirstBank.

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

Relationship officers continued to closely monitor the performance of hurricane-affected commercial loan customers during 2018. Information provided by these commercial loan officers and statistics on the performance of consumer and residential credits were factored into the determination of the allowance for loan and lease losses as of June 30, 2018. Although the identification and evaluation of hurricane-affected credits has been completed, management's assessment of the hurricanes' effect is still subject to uncertainties, both those specific to some individual customers, such as the resolution of insurance claims, and those applicable to the overall economic prospects of the hurricane-affected areas as a whole. During the second quarter and six-month period ended June 30, 2018, the Corporation recorded a net loan loss reserve release of approximately \$2.1 million and \$8.5 million, respectively, in connection with revised estimates associated with the effects of the hurricanes. The revised estimates were primarily attributable to updated assessments of financial performance and repayment prospects of certain individually-assessed commercial credits and, to a lesser extent, lower reserve requirements resulting from payments received during the first six-months of 2018 that reduced the balance of the consumer and residential mortgage loan portfolios outstanding on the dates of the hurricanes.

As of June 30, 2018, the hurricane-related qualitative allowance amounted to \$42.2 million (December 31, 2017 - \$55.6 million). With the future resolution of uncertainties and the ongoing collection of information on individual commercial customers and statistics on the consumer and residential loan portfolios, the loss estimate will be revised as needed. Refer to Note 7 – Loans Held for Investment, to the consolidated financial statements for information about non-performing loans and early delinquency statistics.

### *Disaster Response Plan Costs, Casualty Losses and Related Insurance*

The Corporation has incurred a variety of costs to operate in disaster response mode, and some facilities and their contents, including certain OREO properties, were damaged by the storms. The Corporation maintains insurance for casualty losses, as well as for reasonable and necessary disaster response costs and certain revenue lost through business interruption. Substantially all of the significant disaster response costs had been incurred by the end of the second quarter of 2018. Insurance claim receivables were established for some of the individual costs, when incurred, based on management's understanding of the underlying coverage and when realization of the claim was deemed probable. During the second quarter of 2018, the Corporation reached a final settlement on certain insurance claims arising from the hurricanes. With this settlement, the Corporation received proceeds of approximately \$4.3 million, primarily related to repairs and maintenance costs incurred on certain OREO properties, and \$0.8 million related to a loan receivable fully charged-off in prior periods. The insurance proceeds were recorded against incurred losses, previously-established accounts receivable, or loan recoveries, as applicable. Insurance recoveries are recorded in the same income statement caption as the incurred losses. Recoveries from insurance proceeds in excess of losses incurred, if any, are recognized as a gain from insurance proceeds and reported as part of "other non-interest income" in

the statement of income when the insurance proceeds are received, or when all contingencies related to the insurance claim are resolved. As of June 30, 2018, the Corporation still had an insurance claim receivable of \$6.3 million, included as part of “other assets” in the statement of financial condition. Management also believes that there is a possibility that some gains will be recognized with respect to casualty and lost revenue claims in future periods, but this is contingent on reaching agreement on the Corporation’s claims with the insurance carriers.

*Liquidity Management*

The Corporation experienced rapid accumulation of deposits after the hurricanes in the fourth quarter of 2017 and the first six months of 2018. Total deposits as of June 30, 2018, excluding brokered CDs, increased \$523.3 million from December 31, 2017 and \$884.8 million since September 30, 2017. The most significant increase was in non-interest-bearing demand deposits, which grew 26%, or \$483.5 million from December 31, 2017 and \$731.0 million, or 46%, since September 30, 2017. Hurricane-related factors, such as the effect of disaster relief funds and settlements of insurance claims, continue to contribute to this growth. Although management expects the balances accumulated by deposit customers in the hurricane-affected areas to reduce over time, it is difficult to predict when and to what degree, and there may be further growth as insurance claims are resolved and additional disaster-recovery funds are distributed.

**NOTE 3 – EARNINGS PER COMMON SHARE**

The calculations of earnings per common share for the quarters and six-month periods ended June 30, 2018 and 2017 are as follows:

	<b>Quarter Ended June 30,</b>		<b>Six-Month Period Ended June 30,</b>	
	<b>2018</b>	<b>2017</b>	<b>2018</b>	<b>2017</b>
(In thousands, except per share information)				
Net income	\$ 31,032	\$ 27,998	\$ 64,180	\$ 53,539
Less: Preferred stock dividends	(669)	(669)	(1,338)	(1,338)
Net income attributable to common stockholders	\$ 30,363	\$ 27,329	\$ 62,842	\$ 52,201
<b>Weighted-Average Shares:</b>				
Average common shares outstanding	215,737	213,900	215,194	213,621
Average potential dilutive common shares	929	2,932	1,289	3,482
Average common shares outstanding - assuming dilution	216,666	216,832	216,483	217,103
<b>Earnings per common share:</b>				
Basic	\$ 0.14	\$ 0.13	\$ 0.29	\$ 0.24
Diluted	\$ 0.14	\$ 0.13	\$ 0.29	\$ 0.24

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

Potential dilutive common shares consist of unvested shares of restricted stock that do not contain non-forfeitable dividend rights, performance units that do not contain non-forfeitable dividend rights if the performance condition is met as of the end of the reporting period, and warrants outstanding during the period using the treasury stock method. This method assumes that the potential dilutive common shares are issued and outstanding and the proceeds from the exercise, in addition to the amount of compensation cost attributable to future services, are used to purchase common stock at the exercise date. The difference between the numbers of potential dilutive shares issued and the shares purchased is added as incremental shares to the actual number of shares outstanding to compute diluted earnings per share. Unvested shares of restricted stock and performance units that do not contain non-forfeitable dividend rights, and warrants outstanding during the period that result in lower potential dilutive shares issued than shares purchased under the treasury stock method, are not included in the computation of dilutive earnings per share since their

inclusion would have an antidilutive effect on earnings per share.

On May 17, 2018, the U.S. Treasury exercised its warrant to purchase 1,285,899 shares of the Corporation's common stock on a cashless basis, resulting in the issuance of 730,571 shares of common stock.



**NOTE 4 – STOCK-BASED COMPENSATION.**

On May 24, 2016, the Corporation’s stockholders approved the amendment and restatement of the First BanCorp. Omnibus Incentive Plan, as amended (the “Omnibus Plan”), to, among other things, increase the number of shares of common stock reserved for issuance under the Omnibus Plan, extend the term of the Omnibus Plan to May 24, 2026 and re-approve the material terms of the performance goals under the Omnibus Plan for purposes of the then Section 162(m) of the U.S. Internal Revenue Code of 1986, as amended. The Omnibus Plan provides for equity-based compensation incentives (the “awards”) through the grant of stock options, stock appreciation rights, restricted stock, restricted stock units, performance shares, cash-based awards and other stock-based awards. The Omnibus Plan authorizes the issuance of up to 14,169,807 shares of common stock, subject to adjustments for stock splits, reorganizations, and other similar events. As of June 30, 2018, 6,956,802 authorized shares of common stock were available for issuance under the Omnibus Plan. The Corporation’s Board of Directors, based on the recommendation of the Corporation’s Compensation and Benefits Committee, has the power and authority to determine those eligible to receive awards and to establish the terms and conditions of any awards, subject to various limits and vesting restrictions that apply to individual and aggregate awards.

***Restricted Stock***

Under the Omnibus Plan, the Corporation may grant restricted stock to plan participants, subject to forfeiture upon the occurrence of certain events until the dates specified in the participant’s award agreement. While the restricted stock is subject to forfeiture and does not contain non-forfeitable dividend rights, restricted stock participants may exercise full voting rights. The restricted stock granted under the Omnibus Plan is typically subject to a vesting period. During the first six months of 2018, the Corporation awarded 342,439 shares of restricted stock to employees, fifty percent (50%) of those shares vest in two years from the grant date and the remaining (50%) vest in three years of the grant date. Included in those 342,439 shares of restricted stock were 20,447 shares granted to retirement-eligible employees at the grant date. The fair value of the shares of restricted stock granted in the first six months of 2018 was based on the market price of the Corporation’s outstanding common stock on the date of the grant.

The following table summarizes the restricted stock activity in the first six months of 2018 under the Omnibus Plan:

	<b>Six-Month Period Ended June 30, 2018</b>	
	<b>Number of shares of restricted stock</b>	<b>Weighted-Average Grant Date Fair Value</b>
Non-vested shares at beginning of year	1,816,968	\$ 2.76
Granted	342,439	6.30
Forfeited	(9,500)	2.99

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Vested	(1,086,822)		2.09
Non-vested shares at June 30, 2018	1,063,085	\$	4.59

For the quarter and six-month period ended June 30, 2018, the Corporation recognized \$0.8 million and \$1.9 million, respectively, of stock-based compensation expense related to restricted stock awards, compared to \$1.0 million and \$2.0 million for the same periods in 2017, respectively. As of June 30, 2018, there was \$3.2 million of total unrecognized compensation cost related to non-vested shares of restricted stock. The weighted average period over which the Corporation expects to recognize such cost is 1.5 years. The total expense determined for restricted stock awards granted to retirement-eligible employees was charged against earnings at the grant date.

During the first half of 2017, the Corporation awarded 3,644 shares of restricted stock subject to a one-year vesting period to an independent director appointed in the first quarter of 2017. In addition, during the first half of 2017, the Corporation awarded 951,332 shares of restricted stock to employees subject to a vesting period of two years. Included in those 951,332 shares of restricted stock were 838,332 shares granted in the first quarter of 2017 to certain senior officers consistent with the requirements of the Troubled Asset Relief Program (“TARP”) Interim Final Rule. On May 10, 2017, the United States Department of the Treasury (the “U.S. Treasury”) announced that it had sold all of its remaining 10,291,553 shares of the Corporation’s common stock. As a result of the sale by the U.S. Treasury, the Corporation is no longer subject to the compensation-related restrictions under TARP, which substantially limited the Corporation’s ability to award short-term and long-term incentives to the Corporation’s executives, and the Corporation’s senior officers are no longer subject to the transferability restrictions on their shares of restricted stock. However, since the U.S. Treasury did not recover the full amount of its original investment under TARP, the senior officers forfeited 2,370,571, or 50%, of their outstanding shares of restricted stock, resulting in a reduction in the number of common shares outstanding.

The fair value of the shares of restricted stock granted in the first quarter of 2017 was based on the market price of the Corporation’s outstanding common stock on the date of the grant. For the 838,332 shares of restricted stock granted under the TARP requirements, the market price was discounted assuming that 50% of the shares of restricted stock would become freely transferable and the remaining 50% would be forfeited, resulting in a fair value of \$2.71 for each share of restricted stock granted under TARP requirements.

Stock-based compensation accounting guidance requires the Corporation to reverse compensation expense for any awards that are forfeited due to employee or director turnover. Quarterly changes in the estimated forfeiture rate may have a significant effect on stock-based compensation, as the effect of adjusting the rate for all expense amortization is recognized in the period in which the forfeiture estimate is changed. If the actual forfeiture rate is higher than the estimated forfeiture rate, an adjustment is made to increase the estimated forfeiture rate, which will result in a decrease in the expense recognized in the financial statements. If the actual forfeiture rate is lower than the estimated forfeiture rate, an adjustment is made to decrease the estimated forfeiture rate, which will result in an increase in the expense recognized in the financial statements. The estimated forfeiture rate did not change as a result of the restricted shares forfeited in connection with the aforementioned U.S. Treasury’s sale of the Corporation’s common stock.



### *Performance Units*

Under the Omnibus Plan, the Corporation may award performance unit awards to Omnibus Plan participants. During the first six months of 2018, the Corporation granted 304,408 unit awards to executives, with each unit representing the value of one share of the Corporation's common stock. The performance unit awards granted are for the performance period beginning January 1, 2018 and ending on December 31, 2020 and are subject to a three-year requisite service period. These awards do not contain non-forfeitable rights to dividend equivalent amounts and can only be settled in shares of the Corporation's common stock. Included in those 304,408 performance unit awards were 29,171 units granted to retirement-eligible executives at the grant date. The performance unit will vest based on the achievement of a pre-established tangible book value per share target as of December 31, 2020. All of the performance units will vest if performance is at the pre-established performance target level or above. However, the participants may vest on 50% of the awards to the extent that performance is below the target but at 80% of the pre-established performance target level (the 80% minimum threshold) which is measured based upon the growth in the tangible book value during the performance cycle. If performance is between the 80% minimum threshold and the pre-established performance target level, the participants will vest on a proportional amount. No performance units will vest if performance is below the 80% minimum threshold.

The fair value of the performance unit awards granted during the first six months of 2018 was based on the market price of the Corporation's outstanding common stock on the date of the grant. For the quarter and the first six months of 2018, the Corporation recognized \$0.1 million and \$0.3 million, respectively, of stock-based compensation related to performance unit awards. As of June 30, 2018, there was \$1.6 million of total unrecognized compensation cost related to unvested performance units that the Corporation expects to recognize over the three-year requisite service period. The total expense determined for the performance unit awards granted to retirement-eligible executives was charged against earnings at the grant date. The total amount of compensation expense recognized reflects management's assessment of the probability that the pre-established performance goal will be achieved. A cumulative adjustment to compensation expense is recognized in the current period to reflect any changes in the probability of achievement of the performance goals.

### *Salary stock*

Also, effective April 1, 2013, the Corporation's Board of Directors determined to increase the salary amounts paid to certain executive officers, primarily by paying the increased salary amounts in the form of shares of the Corporation's common stock issued under the Omnibus Plan, instead of cash. During the first six months of 2018, the Corporation issued 268,709 shares of common stock (first six months of 2017 – 272,959 shares) with a weighted average market value of \$6.51 (first six months of 2017 – \$5.94) as salary stock compensation. This resulted in a compensation expense of \$1.7 million recorded in the first six months of 2018 (first six months of 2017 – \$1.6 million). Effective July 1, 2018, the payment of additional salary amounts in the form of stock was eliminated in accordance to the previously reported executive compensation program.

For the first six months of 2018, the Corporation withheld 96,377 shares (first six months of 2017 – 90,973 shares) from the common stock paid to certain senior officers as additional compensation and 328,433 shares of restricted stock that vested during the first six months of 2018 (first six months of 2017 – 235,680) to cover employees' payroll and income tax withholding liabilities; these shares are held as treasury shares. The Corporation paid in cash any fractional share of salary stock to which the officer was entitled. In the consolidated financial statements, the Corporation treats shares withheld for tax purposes as common stock repurchases.

**NOTE 5 – INVESTMENT SECURITIES*****Investment Securities Available for Sale***

The amortized cost, non-credit loss component of OTTI recorded in OCI, gross unrealized gains and losses recorded in OCI, estimated fair value, and weighted-average yield of investment securities available for sale by contractual maturities as of June 30, 2018 and December 31, 2017 were as follows:

	Amortized cost	Noncredit Loss Component of OTTI Recorded in OCI	June 30, 2018		Fair value	Weighted- average yield%
			Gross Unrealized gains	losses		
(Dollars in thousands)						
U.S. Treasury securities:						
Due within one year	\$ 57,464	\$ -	\$ 2	\$ 67	\$ 57,399	1.52
U.S. government-sponsored agencies obligations:						
Due within one year	74,962	-	-	326	74,636	1.18
After 1 to 5 years	311,675	-	-	5,481	306,194	1.51
After 5 to 10 years	186,269	-	87	3,675	182,681	2.94
After 10 years	36,702	-	-	211	36,491	2.28
Puerto Rico government obligations:						
After 5 to 10 years	4,032	-	43	-	4,075	3.14
After 10 years	4,054	-	-	1,286	2,768	6.97
United States and Puerto Rico government obligations	675,158	-	132	11,046	664,244	1.95
Mortgage-backed securities:						
Freddie Mac (“FHLMC”) certificates:						
After 5 to 10 years	89,235	-	23	3,378	85,880	2.01
After 10 years	265,350	-	295	8,379	257,266	2.49

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	354,585	-	318	11,757	343,146	2.37
Ginnie Mae (“GNMA”) certificates:						
After 1 to 5 years	142	-	2	-	144	3.10
After 5 to 10 years	61,136	-	540	25	61,651	3.03
After 10 years	135,599	-	3,746	1,102	138,243	3.81
	196,877	-	4,288	1,127	200,038	3.57
Fannie Mae (“FNMA”) certificates:						
Due within one year	801	-	11	-	812	1.90
After 1 to 5 years	11,606	-	-	260	11,346	2.38
After 5 to 10 years	148,799	-	63	5,335	143,527	2.10
After 10 years	618,975	-	1,965	16,416	604,524	2.65
	780,181	-	2,039	22,011	760,209	2.54
Collateralized mortgage obligations guaranteed by the FHLMC and GNMA:						
After 1 to 5 years	7,588	-	5	11	7,582	2.74
After 10 years	45,385	-	367	22	45,730	2.57
	52,973	-	372	33	53,312	2.59
Other mortgage pass-through trust certificates:						
After 10 years	20,590	5,529	-	-	15,061	4.51
Total mortgage-backed securities	1,405,206	5,529	7,017	34,928	1,371,766	2.67
Total investment securities available for sale	\$ 2,080,364	\$ 5,529	\$ 7,149	\$ 45,974	\$ 2,036,010	2.44



	Amortized cost	Noncredit Loss Component of OTTI Recorded in OCI	December 31, 2017		Fair value	Weighted- average yield%
			Gross Unrealized gains	losses		
(Dollars in thousands)						
U.S. Treasury securities:						
After 1 to 5 years	\$ 7,458	\$ -	\$ -	\$ 57	\$ 7,401	1.29
U.S. government-sponsored agencies obligations:						
Due within one year	122,471	-	-	319	122,152	1.06
After 1 to 5 years	309,472	-	28	3,735	305,765	1.42
After 5 to 10 years	133,451	-	117	319	133,249	2.72
After 10 years	40,769	-	1	149	40,621	1.84
Puerto Rico government obligations:						
After 5 to 10 years	4,071	-	47	-	4,118	3.14
After 10 years	3,972	-	-	1,277	2,695	6.97
United States and Puerto Rico government obligations						
	621,664	-	193	5,856	616,001	1.70
Mortgage-backed securities:						
FHLMC certificates:						
After 5 to 10 years	18,658	-	14	63	18,609	2.14
After 10 years	297,733	-	217	4,853	293,097	2.23
	316,391	-	231	4,916	311,706	2.23

GNMA						
certificates:						
After 1 to 5 years	81	-	1	-	82	3.23
After 5 to 10 years	69,661	-	1,244	-	70,905	3.05
After 10 years	145,067	-	5,910	334	150,643	3.81
	214,809	-	7,155	334	221,630	3.56
FNMA certificates:						
After 1 to 5 years	20,831	-	294	109	21,016	2.69
After 5 to 10 years	49,934	-	-	818	49,116	1.83
After 10 years	613,129	-	3,180	6,401	609,908	2.43
	683,894	-	3,474	7,328	680,040	2.39
Collateralized mortgage obligations issued or guaranteed by the FHLMC and GNMA:						
After 1 to 5 years	5,918	-	14	-	5,932	2.21
After 5 to 10 years	2,556	-	11	-	2,567	2.23
After 10 years	35,331	-	231	-	35,562	2.22
	43,805	-	256	-	44,061	2.22
Other mortgage pass-through trust certificates:						
After 10 years	22,791	5,731	-	-	17,060	2.44
Total mortgage-backed securities	1,281,690	5,731	11,116	12,578	1,274,497	2.54
Other						
Due within one year	100	-	-	-	100	1.48
Equity securities (1)	424	-	-	6	418	2.11
Total investment securities						
available for sale	\$ 1,903,878	\$ 5,731	\$ 11,309	\$ 18,440	\$ 1,891,016	2.27

- (1) As of January 1, 2018, the Corporation adopted ASU 2016-01, resulting in the reclassification of equity securities from available-for-sale investment securities to other investment securities.

Maturities of mortgage-backed securities (“MBS”) are based on the period of final contractual maturity. Expected maturities of investments might differ from contractual maturities because they may be subject to prepayments and/or call options. The weighted-average yield on investment securities available for sale is based on amortized cost and, therefore, does not give effect to changes in fair value. The net unrealized gain or loss on securities available for sale and the noncredit loss component of OTTI are presented as part of OCI.

The following tables show the Corporation’s available-for-sale investments’ fair value and gross unrealized losses, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, as of June 30, 2018 and December 31, 2017. The tables also include debt securities for which an OTTI was recognized and only the amount related to a credit loss was recognized in earnings. For unrealized losses for which OTTI was recognized, the related credit loss was charged against the amortized cost basis of the debt security.

	Less than 12 months		As of June 30, 2018 12 months or more		Total	
	Unrealized		Unrealized		Unrealized	
	Fair Value	Losses	Fair Value	Losses	Fair Value	Losses
(In thousands)						
<b>Debt securities:</b>						
Puerto Rico-government obligations	\$ -	\$ -	\$ 2,768	\$ 1,286	\$ 2,768	\$ 1,286
U.S. Treasury and U.S. government agencies obligations	237,349	4,448	355,093	5,312	592,442	9,760
<b>Mortgage-backed securities:</b>						
FNMA	343,390	9,315	262,712	12,696	606,102	22,011
FHLMC	155,213	4,011	150,268	7,746	305,481	11,757
GNMA	65,966	1,109	601	18	66,567	1,127
Collateralized mortgage obligations issued or guaranteed by FHLMC and GNMA	17,196	33	-	-	17,196	33
Other mortgage pass-through trust certificates	-	-	15,061	5,529	15,061	5,529
	\$ 819,114	\$ 18,916	\$ 786,503	\$ 32,587	\$ 1,605,617	\$ 51,503

	Less than 12 months		As of December 31, 2017 12 months or more		Total	
	Unrealized		Unrealized		Unrealized	
	Fair Value	Losses	Fair Value	Losses	Fair Value	Losses
(In thousands)						
<b>Debt securities:</b>						
Puerto Rico-government obligations	\$ -	\$ -	\$ 2,695	\$ 1,277	\$ 2,695	\$ 1,277
U.S. Treasury and U.S. government agencies obligations	136,459	494	362,050	4,085	498,509	4,579
<b>Mortgage-backed securities:</b>						

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FNMA	189,699	1,705	274,963	5,623	464,662	7,328
FHLMC	91,174	590	166,331	4,326	257,505	4,916
GNMA	39,145	334	-	-	39,145	334
Other mortgage pass-through trust certificates	-	-	17,060	5,731	17,060	5,731
<b>Equity securities (1)</b>	-	-	407	6	407	6
	\$ 456,477	\$ 3,123	\$ 823,506	\$ 21,048	\$ 1,279,983	\$ 24,171

(1) As of January 1, 2018, the Corporation adopted ASU 2016-01, resulting in the reclassification of equity securities from available-for-sale investment securities to other investment securities.

**Assessment for OTTI**

Debt securities issued by U.S. government agencies, U.S. government-sponsored entities, and the U.S. Treasury accounted for approximately 99% of the total available-for-sale portfolio as of June 30, 2018, and no credit losses are expected, given the explicit and implicit guarantees provided by the U.S. federal government. The Corporation's OTTI assessment was concentrated mainly on private label MBS, and on Puerto Rico government debt securities, for which credit losses are evaluated on a quarterly basis. The Corporation considered the following factors in determining whether a credit loss exists and the period over which the debt security is expected to recover:

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

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

	Quarter Ended		Six-Month Period Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
(In thousands)				
Total OTTI losses	\$ -	\$ -	\$ -	\$ (12,231)
Portion of OTTI recognized in OCI	-	-	-	-
Net impairment losses recognized in earnings (1)	\$ -	\$ -	\$ -	\$ (12,231)

(1) Credit losses on Puerto Rico government debt securities, recorded in the first quarter of 2017.

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

	<b>Cumulative OTTI credit losses recognized in earnings on securities still held</b>			
	<b>March 31,</b>	<b>Credit impairments</b>	<b>Credit loss</b>	<b>June 30,</b>
	<b>2018</b>	<b>recognized in</b>	<b>reductions for</b>	<b>2018</b>
	<b>Balance</b>	<b>earnings on</b>	<b>securities sold</b>	<b>Balance</b>
		<b>securities that have</b>	<b>during the</b>	
		<b>been</b>	<b>period</b>	
		<b>previously impaired</b>		
(In thousands)				
Available-for-sale securities				
Private label MBS	\$ 6,792	\$ -	\$ -	\$ 6,792

	<b>Cumulative OTTI credit losses recognized in earnings on securities still held</b>			
	<b>December 31,</b>	<b>Credit</b>	<b>Credit loss</b>	<b>June 30,</b>
	<b>2017</b>	<b>impairments</b>	<b>reductions for</b>	<b>2018</b>
	<b>Balance</b>	<b>recognized in</b>	<b>securities sold</b>	<b>Balance</b>
		<b>earnings on</b>	<b>during the period</b>	
		<b>securities that</b>		
		<b>have been</b>		
		<b>previously</b>		
		<b>impaired</b>		
(In thousands)				
Available-for-sale securities				
Private label MBS	\$ 6,792	\$ -	\$ -	\$ 6,792

	<b>Cumulative OTTI credit losses recognized in earnings on securities still held</b>			
	<b>March 31,</b>	<b>Credit impairments</b>	<b>Credit loss</b>	<b>June 30,</b>
	<b>2017</b>	<b>recognized in</b>	<b>reductions</b>	<b>2017</b>
	<b>Balance</b>	<b>earnings</b>	<b>for securities sold</b>	<b>Balance</b>
		<b>on securities that have</b>	<b>during the period</b>	
		<b>been</b>		
		<b>previously</b>		
		<b>impaired</b>		
(In thousands)				
Available-for-sale securities				
Puerto Rico government obligations	\$ 34,420	\$ -	\$ (34,420)	\$ -
Private label MBS	6,792	-	-	6,792

Total OTTI credit losses for available-for-sale debt securities	\$	41,212	\$	-	\$	(34,420)	\$	6,792
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**Cumulative OTTI credit losses recognized in earnings on securities still held**

	<b>December 31,</b>		<b>Credit impairments</b>		<b>Credit loss</b>		<b>June 30,</b>	
	<b>2016</b>		<b>recognized in</b>		<b>reductions</b>		<b>2017</b>	
	<b>Balance</b>		<b>earnings</b>		<b>for securities sold</b>		<b>Balance</b>	
			<b>on securities that</b>		<b>during the period</b>			
			<b>have been</b>					
			<b>previously impaired</b>					
(In thousands)								
Available-for-sale securities								
Puerto Rico government obligations	\$	22,189	\$	12,231	\$	(34,420)	\$	-
Private label MBS		6,792		-		-		6,792
Total OTTI credit losses for available-for-sale debt securities	\$	28,981	\$	12,231	\$	(34,420)	\$	6,792



During the second quarter of 2017, the Corporation sold for an aggregate of \$23.4 million three Puerto Rico government available-for-sale debt securities, specifically bonds of the Government Development Bank for Puerto Rico (the "GDB") and the Puerto Rico Public Buildings Authority, carried on its book at an amortized cost at the time of sale of \$23.0 million (net of \$34.4 million in cumulative OTTI impairment charges). Approximately \$12.2 million of the cumulative OTTI charges on these securities was recorded in the first quarter of 2017.

For the OTTI charge recorded on the Puerto Rico government debt securities in the first quarter of 2017, the Corporation considered the latest available information about the Puerto Rico government's financial condition, including but not limited to credit ratings downgrades, revised estimates of recovery rates, and other relevant developments such as government actions, including debt exchange proposals and the fiscal plan published by the Puerto Rico government in March 2017, as applicable. The Corporation applied a discounted cash flow analysis to its Puerto Rico government debt securities in order to calculate the cash flows expected to be collected and to determine if any portion of the decline in market value of these securities was considered a credit-related OTTI. The analysis derived an estimate of value based on the present value of risk-adjusted cash flows of the underlying securities and included of the following components:

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

The discounted risk-adjusted cash flow analysis for the three Puerto Rico government bonds mentioned above assumed a default probability of 100%, as these three non-performing bonds had been in default since the third quarter of 2016. Based on this analysis, the Corporation recorded in the first quarter of 2017 credit-related OTTI amounting to \$12.2 million, assuming recovery rates ranging from 15% to 80% (with a weighted average of 41%).

In addition, the Corporation performed an OTTI assessment on its private label MBS, which are collateralized by fixed-rate mortgages on single-family residential properties in the United States. The interest rate on these private-label MBS is variable, tied to 3-month LIBOR and limited to the weighted-average coupon on the underlying collateral. The underlying mortgages are fixed-rate, single-family loans with original high FICO scores (over 700) and

moderate loan-to-value ratios (under 80%), as well as moderate delinquency levels.

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

	<b>As of June 30, 2018</b>		<b>As of December 31, 2017</b>	
	<b>Weighted Average</b>	<b>Range</b>	<b>Weighted Average</b>	<b>Range</b>
Discount rate	14.6%	14.6%	14.0%	14.0%
Prepayment rate	12.6%	5.0% - 23.0%	16.4%	12.0% - 29.0%
Projected Cumulative Loss Rate	4%	0% - 8.7%	3%	0% - 6.8%

No OTTI charges on private label MBS were recorded in either the first half of 2018 or the first half of 2017.

*Investments Held to Maturity*

The amortized cost, gross unrecognized gains and losses, estimated fair value, weighted-average yield and contractual maturities of investment securities held to maturity as of June 30, 2018 and December 31, 2017 were as follows:

<b>Amortized cost</b>	<b>June 30, 2018</b>
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