FIRST BANCORP /PR/
Form 10-K/A
September 26, 2006

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K / A
(Amendment No. 1)
ANNUAL REPORT PURSUANT TO SECTION 13 OR 15 (D) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Fiscal Year Ended December 31, 2004
Commission File No. 001-14793
First BanCorp.
(Exact name of registrant as specified in its charter)

Puerto Rico	**66-0561882**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1519 Ponce de León Avenue, Stop 23 Santurce, Puerto Rico	**00908**
(Address of principal office)	(Zip Code)

Registrant s telephone number, including area code:
(787) 729-8200
Securities registered under Section 12(b) of the Act:
Common Stock ($1.00 par value)
7.125% Noncumulative Perpetual Monthly Income Preferred Stock, Series A (Liquidation Preference $25 per share)
8.35% Noncumulative Perpetual Monthly Income Preferred Stock, Series B (Liquidation Preference $25 per share)
7.40% Noncumulative Perpetual Monthly Income Preferred Stock, Series C (Liquidation Preference $25 per share)
7.25% Noncumulative Perpetual Monthly Income Preferred Stock, Series D (Liquidation Preference $25 per share)
7.00% Noncumulative Perpetual Monthly Income Preferred Stock, Series E (Liquidation Preference $25 per share)
Securities registered under Section 12(g) of the Act:
NONE

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 o No þ

Indicate by check mark if disclosure of delinquent filer pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant s knowledge, in definite proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

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

Large accelerated filer o Accelerated filer þ Non-accelerated filer o

The aggregate market value of the voting common stock held by nonaffiliates of the registrant as of June 30, 2004 (the last day of the registrant s most recently completed second quarter) was $1,524,147,000 based on the closing price

of $40.75 per share of common stock on the New York Stock Exchange on June 30, 2004. (see Note 1 below)

The number of shares outstanding of the registrant s common stock, as of March 1, 2005 was:

Common stock, par value $1.00 40,390,655.

Documents Incorporated by Reference *

* PART III Items 10, 11, 12, 13 and 14 that were included in the Form 10-K filed with the Securities and Exchange Commission on March 16, 2005 have not been included herein.

Note 1-The registrant had no nonvoting common equity outstanding as of June 30, 2004. In calculating the aggregate market value of the common stock held by non affiliates of the registrant, registrant has treated as common stock held by affiliates only common stock of the registrant held by its principal executive officer and voting stock held by the registrant s employee benefit plans. The registrant s response to this item is not intended to be an admission that any person is an affiliate of the registrant for any purposes other than this response.

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12, 13 and 14, and the
Exhibit Index in
Part IV Item 15,

including certain Exhibits that were included in the Form 10-K filed with the Securities and Exchange Commission on March 16, 2005 have not been included herein because they have not been amended. Copies may be obtained electronically through First BanCorp s website at www.firstbankpr.com or from the Chief Accounting Officer, First BanCorp, 1519 Ponce de Leon Ave. PO Box 9146, San Juan, Puerto Rico 00908-0146. Part III Items 10, 11, 12, 13 and 14 were included in First BanCorp s Definitive Proxy Statement used in connection with First BanCorp s 2005 Annual Meeting of Stockholders.

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EXPLANATORY NOTE

This Amendment No. 1 to First BanCorp. s (the Corporation or First BanCorp) Annual Report on Form 10-K for the year ended December 31, 2004 (the Amended Form 10-K) is being filed to reflect the restatement of the Corporation s audited financial statements for the years ended December 31, 2004, 2003 and 2002, the unaudited selected quarterly financial information for each quarter in the fiscal years ended December 31, 2004 and 2003, and the five-year financial data in the Selected Financial Data included in the Form 10-K for fiscal year ended December 31, 2004 originally filed with the Securities and Exchange Commission (the SEC) on March 16, 2005 (the Original Filing). As previously announced on December 13, 2005, the Corporation determined that previously filed interim unaudited and annual audited financial statements should no longer be relied upon and that the Corporation needed to restate these previously issued financial statements. The need for the restatement was announced after the Corporation concluded that it was necessary to correct its accounting for all of the mortgage-related transactions in bulk (mortgage-related transactions) that it entered into with Doral Financial Corporation (Doral) and R&G Financial Corporation (R&G) and for interest rate swaps that it accounted for as hedges using the short-cut method. The mortgage-related transactions are comprised of previously classified purchases of mortgage loans and purchases of pass-through trust certificates.

Included in this Amended Form 10-K, in addition to corrections related to the accounting for the mortgage related transactions and the accounting for certain interest rate swaps, are corrections relating to other accounting practices. For a more detailed description of the financial impact of the restatement, see Note 1, Restatement of Previously Issued Financial Statements, to the accompanying audited consolidated financial statements and Restatement of Previously Issued Financial Statements under Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations, contained in this Amended Form 10-K.

This Amended Form 10-K amends and restates Items 1 and 3 of Part I, Items 5, 6, 7, 7A and 8 of Part II and Item 15 of Part IV of the Original Filing. In addition, the Corporation is amending Item 9A of Part II to restate its conclusions regarding the effectiveness of its disclosure controls and procedures and internal control over financial reporting as of December 31, 2004. These items have been amended to reflect the effects of the restatement and, unless otherwise indicated, have not been updated to reflect other events occurring after the filing of the Original Filing.

Following the filing of this Amended Form 10-K, the Corporation will file its Quarterly Reports on Form 10-Q for the quarters ended March 31, 2005, June 30, 2005, September 30, 2005, annual report on Form 10-K for the year ended December 31, 2005 and Quarterly Report on Form 10-Q for the quarters ended March 31, 2006 and June 30, 2006.

Following the August 1, 2005 announcement of the review of accounting records, a number of significant events occurred. Refer to the *Subsequent Events* section for a detail of significant events.

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Forward Looking Statements

This Form 10-K/A and the information incorporated by reference into this Form 10-K/A contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. When used in this Form 10-K/A or future filings by First BanCorp with the Securities and Exchange Commission, 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 look forward , believes and similar expressions are meant to identify forward-look 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 affect the Corporation s financial performance and could cause actual results for future periods to materially differ from those contained in any forward looking statement. Such factors include, but are not limited to, the following:

- risks arising from material weaknesses in the Corporation s internal control over financial reporting;
- risks associated with the Corporation s inability to prepare and timely submit regulatory filings;
- risks associated with an adverse outcome of certain governmental inquiries, including the ongoing SEC inquiry;
- the Corporation s ability to attract new clients and retain existing ones;
- general economic conditions, including prevailing interest rates and performance of the financial markets, which may affect demand for the products and services and the value of the Corporation s assets, including the value of the undesignated portion of the interest rate swaps that hedge the interest rate risk mainly relating to brokered certificates of deposit, medium-term notes, and commercial loans or from the ineffectiveness of such hedges;
- credit and other risks of lending and investment activities;
- ability to fund operations and maintain liquidity;
- ability to return to normal financial reporting;
- changes in the Corporation s expenses associated with acquisitions and dispositions;
- developments in technology;
- risks associated with the ongoing shareholder litigation against the Corporation;
- 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 impact of possible special taxes imposed by the Puerto Rico government;
- regional and national economic conditions.

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.

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PART I

Item 1. Business

GENERAL

First BanCorp (the Corporation) is a publicly-owned financial holding corporation that is subject to regulation, supervision and examination by the Federal Reserve Board. The Corporation was incorporated under the laws of the Commonwealth of Puerto Rico to serve as the financial holding company for FirstBank Puerto Rico (FirstBank).

First BanCorp is engaged in the banking business and provides a wide range of financial services for retail, commercial and institutional clients. As of December 31, 2004, the Corporation offered its services through its two direct wholly-owned subsidiaries: FirstBank and FirstBank Insurance Agency, Inc. In addition, First BanCorp owned sixty percent of Grupo Empresas de Servicios Financieros (d/b/a PR Finance Group), an auto loan finance Corporation with focus on the used car market. As of December 31, 2004, First BanCorp had total assets of $15.6 billion, total deposits of $7.9 billion and total stockholder s equity of $1.2 billion.

FirstBank is a Puerto Rico-chartered commercial bank and FirstBank Insurance Agency is a Puerto Rico-chartered insurance agency. FirstBank is subject to the supervision, examination and regulation of both the Office of the Commissioner of Financial Institutions of the Commonwealth of Puerto Rico (the Commissioner) and the Federal Deposit Insurance Corporation (the FDIC). Deposits are insured through the Savings Association Insurance Fund. The Virgin Islands operations of FirstBank are subject to regulation and examination by the United States Virgin Islands Banking Board and by the British Virgin Islands Financial Services Commission. FirstBank s loan agency in the State of Florida is regulated by the Office of Financial Regulation of the State of Florida, the Federal Reserve Bank of Atlanta and Federal Reserve Bank of New York. FirstBank Insurance Agency, Inc. is subject to supervision, examination and regulation by the Office of the Insurance Commissioner of the Commonwealth of Puerto Rico.

As of December 31, 2004, FirstBank conducted its business through its main offices located in San Juan, Puerto Rico, forty-five full service banking branches in Puerto Rico, twelve branches in the United States Virgin Islands (USVI) and British Virgin Islands (BVI) and a loan agency in Coral Gables, Florida (USA). FirstBank had four wholly-owned subsidiaries with operations in Puerto Rico: First Leasing and Rental Corporation, a vehicle leasing and daily rental corporation with nine offices in Puerto Rico; First Federal Finance Corp. (d/b/a Money Express La Financiera), a finance corporation with thirty-one offices in Puerto Rico; FirstMortgage, Inc., a residential mortgage loan origination corporation with twenty-three offices in FirstBank branches and at stand alone sites and FirstBank Overseas Corporation, an international banking entity under the International Banking Entity Act of Puerto Rico. As of December 31, 2004, FirstBank had three subsidiaries with operations outside of Puerto Rico; First Insurance Agency, Inc., an insurance agency with three offices that sell insurance products in the USVI; First Trade, Inc., which provides foreign sales corporation management services with an office in the USVI and an office in Barbados; and First Express, Inc., a small loans corporation with three offices in the USVI.

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BUSINESS SEGMENTS

Based upon the Corporation s organizational structure and the information provided to the Chief Operating Decision Maker and to a lesser extent the Board of Directors, the operating segments are driven primarily by the legal entities.

The Corporation has four reportable segments: Consumer (Retail), Commercial and Corporate Banking, Mortgage Banking and Treasury and Investments. These segments are described below:

Consumer

The Consumer (Retail) segment consists of the Corporation s consumer lending and deposit-taking activities conducted mainly through its branch network and loan centers. Loans to consumers include auto, credit card and personal loans. Deposit products include checking and savings accounts, Individual Retirement Accounts (IRA), certificates of deposits. Retail deposits gathered through each branch of the FirstBank s retail network serve as one of the funding sources for the lending and investment activities.

Consumer lending growth has been mainly driven by auto loan originations. The growth of these portfolios has been achieved through a strategy of providing outstanding service to selected auto dealers who provide the channel for the bulk of the Corporation s auto loan originations. This strategy is directly linked to our commercial lending activities as the Corporation maintains strong and stable auto floor plan relationships, which is the foundation of a successful auto loan generation operation. The Corporation will continue to strengthen the commercial relations with floor plan dealers, which directly benefit the Corporation s consumer lending operation and which are managed as part of the consumer banking activities.

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

Commercial and Corporate Banking

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 industries such as healthcare, tourism, financial institutions, food and beverage, shopping centers 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. A substantial portion of this portfolio is collateralized by commercial real estate. Although commercial loans involve greater credit risk because they are larger in size and more risk is concentrated in a single borrower, the Corporation has and continues to develop an effective credit risk management infrastructure that mitigates potential losses associated with commercial lending, including strong underwriting and loan review functions, sales of loan participations and continuous monitoring of concentrations within portfolios.

Mortgage Banking

The Mortgage Banking segment conducts its operations mainly through FirstBank and its mortgage origination subsidiary, FirstMortgage. These operations consist of the origination, sale and servicing of a variety of residential mortgage loans products. Originations are sourced through different channels such as branches, mortgage brokers, real estate brokers, and in association with new project developers.

FirstMortgage focuses on originating residential real estate loans, some of which conform to Federal Housing Administration (FHA), Veterans Administration (VA) and Rural Development (RD) standards. Loans originated that meet FHA standards qualify for the federal agency s insurance program whereas loans that meet VA and RD standards are guaranteed by their respective federal agencies. Mortgage loans that do not qualify under these programs are commonly referred to as conventional loans. Conventional real estate loans could be conforming and non-conforming. Conforming loans are real estate loans that meet the standards for sale under the Fannie Mae and Freddie Mac programs whereas loans that do not meet the standards are referred to as non-conforming real estate loans. The Corporation s strategy is to penetrate markets by providing customers with a variety of high quality mortgage products to serve their financial needs faster, simpler and at competitive prices.

The Mortgage Banking segment also acquires and sells mortgages in the secondary markets. From time to time, conforming loans are typically sold to secondary buyers like Fannie Mae and Freddie Mac.

Treasury and Investments

The Treasury and Investment segment is responsible for the Corporation s investment portfolio and treasury functions executed to manage and enhance liquidity. This segment sells funds to Commercial and Corporate Banking, Mortgage Banking, and Consumer Lending segments to finance their lending activities and purchases funds gathered by those segments. The interest rates charged or credited by Treasury and Investments are based on market rates.

For information regarding First BanCorp s operating segments, please refer to note 31 - Segment Information to the Corporation s financial statements for the year ended December 31, 2004 included in Item 8 of this Form 10-K/A.

Employees

At December 31, 2004, the Corporation employed 2,237 persons. None of its employees are represented by a collective bargaining group. The Corporation considers its employee relations to be good.

SUBSEQUENT EVENTS

Audit Committee Review

As previously announced on August 1, 2005, the Audit Committee (the Committee) of the Corporation determined that the Committee should review the background and accounting for certain mortgage-related transactions that FirstBank had entered into between 1999 and 2005. 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 Committee in its review. Subsequent to the announcement of the review, a number of significant events occurred, including the announcement of the restatement and other events described below. In August 2006, the Committee completed its review.

Governmental Action

SEC

On August 11, 2005, the Corporation received an SEC comment letter (the Comment Letter) pertaining to the Corporation s Form 10-K for the fiscal year ended December 31, 2004 and its Form 10-Q for the fiscal quarter ended March 31, 2005. The Corporation

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will submit a response to the Comment Letter in connection with its filing of this Amended 10-K given that the majority of the comments relate to matters that were reviewed by management and the Audit Committee and are reflected in the financial statements set forth in this Amended Form 10-K.

On August 23, 2005, the Corporation received a letter from the SEC in which the SEC indicated that it was conducting an informal inquiry into the Corporation. The inquiry pertains to, among other things, the accounting for mortgage-related transactions with Doral and R&G during the calendar years 1999 through 2005.

On October 21, 2005, the Corporation announced that the SEC issued a formal order of investigation in its ongoing inquiry of the Corporation. The Corporation is cooperating with the SEC in connection with this investigation.

Banking Regulatory Matters

Beginning in the Fall of 2005, the Corporation received inquiries from federal banking regulators regarding the status and impact of the restatement and related safety and soundness concerns.

On December 6, 2005, the Commonwealth of Puerto Rico Commissioner of Financial Institutions (OCIF), determined that the Corporation was in violation of the lending limit requirements of Section 17(a) of the Puerto Rico Bank Act (the Act) which governs the amount a bank may lend to a single person, group or related entity. The Act also authorizes the OCIF to determine other components which may be considered as part of a bank s capital for purposes of establishing its lending limit. After consideration of other components, the OCIF authorized the Corporation to retain the secured loans of Doral and R&G as these loans are secured by sufficient collateral to diversify, disperse and significantly diffuse the risks connected to such loans thereby satisfying the safety and soundness considerations mandated by Section 28 of the Puerto Rico Bank Act.

On December 7, 2005, the Corporation was advised by the FDIC that the revised classification of the mortgage-related transactions for accounting purposes resulted in such transactions being viewed for regulatory capital purposes as loans to mortgage companies rather than loans secured by one-to-four family residential properties. FirstBank then advised the FDIC that pursuant to regulatory requirements, the revised classification of the mortgage transactions and the correction of the accounting for the interest rate swaps would cause FirstBank to be slightly below the well-capitalized level, within the meaning established by the FDIC. On March 17, 2006, the Corporation announced that FirstBank had returned to the well-capitalized level. The partial payment made by R&G (described below under Business Developments) contributed to the well-capitalized level.

In February 2006, in an effort to isolate FirstBank Florida from the evaluation and examination of FirstBank, the Office of Thrift Supervision (the OTS) imposed restrictions on FirstBank Florida. Under these restrictions, FirstBank Florida cannot make any payments to the Corporation or its affiliates pursuant to a tax-sharing agreement nor can FirstBank Florida employ or receive consultative services from an executive officer of the Corporation or its affiliates without the prior written approval of the OTS Regional Director. Additionally, FirstBank Florida cannot enter into any agreement to sell loans or any portions of any loans to the Corporation or its affiliates nor can FirstBank Florida

make any payment to the Corporation or its affiliates via an intercompany account or arrangement unless pursuant to a pre-existing contractual agreement for services rendered in the normal course of business. Also, FirstBank Florida can not pay dividends to its parent, First BanCorp, without prior approval from the OTS.
On March 17, 2006, the Corporation announced that it had agreed with the Board of Governors of the Federal Reserve System to a Consent Order in which the Corporation consented to a Cease and Desist Order. The Consent Order is a result of certain concerns of banking regulators relating to the incorrect accounting for and documentation of mortgage-related transactions with Doral and R&G. The Corporation had initially reported those transactions as purchases of mortgage loans, however, they should have been accounted for as secured loans to the financial institutions because they were not sales from a legal standpoint. The Corporation also announced that FirstBank had entered into similar agreements with the FDIC and the Commissioner. The agreements, signed by all parties involved, did not impose any restrictions on the Corporation s day-to-day banking and lending activities.

The Consent Orders with banking regulators imposed certain restrictions and reporting requirements on the Corporation and FirstBank. Under its Consent Order, FirstBank may not directly or indirectly enter into, participate, or in any other manner engage in any various specified transactions with any affiliate without the prior written approval of the FDIC. The Consent Orders require First BanCorp and FirstBank to take various affirmative actions, including engaging an independent consultant to review mortgage portfolios, the documentation of the loans with Doral and R&G resulting from the need to classify the mortgage-related transactions as secured commercial loans, submitting capital and liquidity contingency plans, providing notice prior to the incurring of additional debt or of the restructuring or repurchasing of debt, obtaining approval prior to purchase or redeem stock, filing corrected regulatory reports upon completion of the restatement of financial statements, and obtaining regulatory approval prior to paying dividends after those payable in March 2006. The Cease and Desist Order deliverable requirements have been substantially completed and properly submitted to the Regulators as stated in the Order.

FirstBank received a letter dated May 24, 2006 from the FDIC regarding FirstBank s failure to file with the FDIC its Part 363 annual report for the fiscal year ended December 31, 2005. On June 12, 2006, FirstBank notified the FDIC that it intended to file an amended 2004 Part 363 annual report and its 2005 Part 363 annual report after the Corporation filed its 2005 Form 10-K with the SEC.

Subsequent to the effectiveness of the Consent Orders the Corporation and its subsidiary Bank have requested and obtained written approval from the Federal Reserve Board and the FDIC for the payments of dividends by FirstBank to its holding company, First BanCorp, and for the payment of dividends by First BanCorp to its preferred stock and common stock shareholders and trust preferred certificate holders. The written approvals have been obtained in accordance with the Consent Order requirements.

On August 29, 2006, the Corporation announced that its subsidiary, FirstBank, consented and agreed to the issuance of a Cease and Desist Order by the FDIC relating to the Bank s compliance with certain provisions of the Bank Secrecy Act (BSA). The BSA consent Order requires FirstBank to take various affirmative actions, including that FirstBank

operate with adequate management supervision and Board of Directors oversight on BSA related matters; implementing systems of internal controls, independent testing and training programs to ensure full compliance with BSA and OFAC; designating a BSA and OFAC Officer, and amending existing policies, procedures, and processes relating to internal and external audits to review compliance with BSA and OFAC provisions as part of routine auditing; engaging independent consultants to review account and transaction activity from June 1, 2005 to the effective date of the Order and to conduct a comprehensive review of FirstBank s actions to implement the consent Order in order to assess the effectiveness of the policies, procedures and processes adopted by FirstBank; and appointing a compliance committee of the Board of Directors.

Since the beginning of 2006, FirstBank has been refining core areas of its risk management and compliance systems, and to-date has instituted previous to this BSA Order, a significant number of measures required by the BSA consent Order. The BSA consent Order did not impose any civil or monetary penalties, and does not restrict FirstBank s business operations.

On April 13, 2006, the Corporation notified the NYSE that, given the delay in the filing of the Corporation s 2005 Form 10-K, which required the postponement of the 2006 Annual Meeting of Stockholders, the Corporation was not going to distribute its annual report to shareholders by April 30, 2006. As a result, the Corporation is not in compliance with Section Rule 203.01, *Annual Report Requirement*, of the NYSE Listed Company Manual, which requires a listed company to distribute its annual report within 120 days after its fiscal year end.

The NYSE s Section 802.01E procedures apply to the Corporation given its failure to file the Form 10-K for the fiscal year ended December 31, 2005, which the NYSE explained in a letter dated April 3, 2006. These procedures contemplate that the NYSE will monitor a company that has not timely filed a Form 10-K. If the company does not file its annual report within six months of the filing due date, the NYSE may, in its sole discretion, allow the company s securities to be traded for up to an additional six months depending on the company s specific circumstances. If the NYSE determines that an additional trading period of up to six months is not appropriate, suspension and delisting procedures will be commenced. If the NYSE determines that an additional trading period of up to six months is appropriate and the company fails to file its annual report by the end of that additional period, suspension and delisting procedures will generally commence. The procedures provide that the NYSE may commence delisting proceedings at any time. The Corporation expects to file its 2005 Form 10-K within the six months after its filing due date**.**

Recent Legislation

Act 41 of August 1, 2005 amended the Puerto Rico Internal Revenue Code by imposing a transitory additional tax of 2.5% on taxable income for all corporations. This transitory tax effectively increased the statutory tax rate from 39% to 41.5%. The Act is effective for taxable years commencing after December 31, 2004 and ending on or before December 31, 2006, therefore, effective for the 2005 and 2006 taxable years with a retroactive effect to January 1, 2005.

Puerto Rico Internal Revenue Code Act 89 of May 13, 2006 imposes a 2% additional income tax on income subject to regular taxes of all corporations operating pursuant to Act

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55 of 1933 (The Puerto Rico Banking Act). The act will be effective for the taxable year commencing after December 31, 2005 and on or before December 31, 2006. Therefore, increasing the statutory tax for the 2006 taxable year to 43.5%.

Act 98 of May 16, 2006 imposed an extraordinary 5% tax on the taxable income reported in the corporate tax return of corporations whose gross income exceeded $10 million for the taxable year ended on or before December 31, 2005. Covered taxpayers are required to file a special return and pay the tax no later than July 31, 2006. The extraordinary tax paid will be taken as a credit against the income tax of the entity determined for taxable years commencing after July 31, 2006, subject to certain limitations. Any unused credit may be carried forward to subsequent taxable years, subject to certain limitations.

Private Litigation

Following the announcement of the Committee s review, the Corporation and certain of its officers and directors and former officer and directors were named as defendants in five (5) 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 currently pending before the U.S. District Court for the District of Puerto Rico.

Between November 8, 2005 and March 7, 2006 several shareholders of the Corporation commenced five (5) separate derivative actions against certain current and former executive officers and directors of the Corporation. In these actions, the Corporation is included as a nominal defendant. These actions were filed pursuant to Section 304 of the Sarbanes-Oxley Act of 2002 and allege, among other things, a breach of fiduciary duty on behalf of the defendants. At present, all shareholder derivative actions have been consolidated into one case named In Re: First BanCorp Derivative Litigation currently pending before the U.S. District Court for the District of Puerto Rico.

Restatement

On October 21, 2005, December 13, 2005, and March 17, 2006, the Corporation announced that it had concluded that the mortgage-related transactions that FirstBank entered into with Doral and R&G since 1999 do not qualify as sales for accounting purposes. As a consequence, the Corporation announced that management, with the concurrence of the Board, determined to restate its previously reported financial statements to correct its accounting for the mortgage-related transactions. In addition, the Corporation announced that it would also restate its financial statements to correct the accounting treatment used for certain interest rate swaps it accounted for as hedges using the short-cut method.

Management has identified various material weaknesses in the Corporation s internal controls over financial reporting. Refer to Item 9A Controls and Procedures in this Amended Form 10-K for additional information regarding the Corporation s remediation plan under Changes in Internal Control Over Financial Reporting.

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Corporate Governance Changes

Changes in Senior Management

In September 2005 following the announcement of the Audit Committee s review, the Corporation implemented changes to its senior management. Specifically, the Board of Directors asked that Angel Alvarez-Pérez, then President, Chief Executive Officer and Chairman of the Board (the Former CEO), Annie Astor-Carbonell, then Chief Financial Officer and Director of the Board (the Former CFO), and Carmen Szendrey-Ramos, then General Counsel and Secretary of the Board (the Former GC), to resign. On September 30, 2005, the Corporation announced that the Former CEO had resigned from his management positions and that the Former CFO had resigned from her position as CFO. In October 2005, the Corporation terminated the Former GC.

On September 30, 2005, Luis M. Beauchamp was appointed to serve as President and CEO of the Corporation; Aurelio Alemán to serve as Chief Operating Officer (COO) and Senior Executive Vice President; and Luis Cabrera-Marín to serve, on an interim basis, as CFO of the Corporation.

On February 22, 2006, the Corporation announced the retention of Lawrence Odell as Executive Vice President and General Counsel of the Corporation and its subsidiary, FirstBank.

On July 18, 2006, the Company s Board of Directors appointed Fernando Scherrer as Executive Vice President and Chief Financial Officer of the Company, effective July 24, 2006. Mr. Scherrer had been working with the Corporation since October 2005 as a consultant in its reassessment of accounting issues and preparation of restated financial statements and other consulting matters.

Changes in Board Structure

On September 30, 2005, the Corporation announced that the Former CEO retired from his positions as Chairman of the Board of Directors and a Director of the Corporation, effective December 31, 2005. Additionally, effective September 30, 2005, the Former CFO resigned from her position as a Director of the Corporation.

On September 30, 2005, Luis Beauchamp and Aurelio Alemán were elected to the Board of Directors of the Corporation.

On November 28, 2005, the Company announced that Fernando Rodríguez-Amaro was appointed as a Director and as an additional financial expert to serve in the Audit Committee. Thereafter, he was appointed Chairman of the Audit Committee effective January 1, 2006. In addition, the Board of Directors appointed José Menéndez-Cortada as Independent Lead Director effective February 15, 2006.

On March 28, 2006, José Julián Alvarez, 72, informed the Corporation that he would resign from his position as director of the Corporation, effective March 31, 2006. Mr. Alvarez s term as a director would have expired at the 2006 Annual Meeting of Stockholders and, given the Company s retirement policy for the Board of Directors, Mr. Alvarez would not have been eligible for reelection.

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Change in By-Laws

On March 14, 2006, the Board of Directors of the Company approved an amendment to the Corporation s By-Laws. As amended, Section 2 of Article I of the By-Laws provides that the Board of Directors will set a date and time for the annual meeting when the meeting cannot occur within 120 days after the Company s fiscal year end because the Company cannot submit an annual report with audited financial statements to stockholders. The Board will set such date and time within a reasonable period after the Company submits an annual report with audited financial statements to stockholders. Prior to adoption of this amendment, Section 2 of Article I did not provide that the Board of Directors could set the date and time of the annual meeting. The amendment was effective upon approval by the Board.

Business Developments

On March 13, 2005, the Corporation announced the closing of its acquisition of Ponce General Corporation, a Delaware corporation, and its subsidiaries, UniBank, a federal savings and loan association, and Ponce Realty Corporation, a Delaware corporation with real estate holdings in Florida. UniBank, which was headquartered in Miami, Florida, had 11 financial service facilities located in the Miami/Dade, Broward, Orange and Osceola counties of Florida. The Corporation subsequently changed the name of the acquired entities to FirstBank Florida.

Following the Corporation s announcement on October 21, 2005 that the SEC issued a formal order of investigation, Standard & Poors, a division of the McGraw-Hill Companies, Inc., Moody s Investor Service (Moody s) and Fitch Ratings, Ltd., a subsidiary of Fimalac, S.A. (Fitch) downgraded the Corporation s and FirstBank s ratings.

On March 17, 2006, the Corporation announced that in the fourth quarter of 2005, R&G made a partial payment, which released capital allocated to the loans secured by the mortgage loans to R&G and that First BanCorp made a capital contribution to FirstBank of $110 million at the end of 2005.

On May 31, 2006, the Corporation announced that its subsidiary, FirstBank, received a cash payment from Doral of approximately $2.4 billion, substantially reducing the balance in secured commercial loans resulting from the Corporation s previously-announced revised classification of several mortgage-related transactions with Doral. In addition, FirstBank and Doral entered into a sharing agreement with respect to certain profits or losses that Doral incurs as part of the sales of the mortgages that previously collateralized the commercial loans.

Disclosure Control and Procedures and Internal Control Over Financial Reporting

See Item 9A in this Amended Form 10-K for information concerning management s conclusion that, as of December 31, 2004, our disclosure controls and procedures were not effective as a result of the material weaknesses discussed in the restated Management s Report on Internal Control Over Financial Reporting and the Remediation Plan initiated to address identified material weaknesses in the Corporation s internal control over financial reporting and to enhance the Corporation s overall corporate governance.

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Certain of these and other subsequent events are addressed in the Corporation s Current Reports on Form 8-K filed with the SEC on August 25, 2005; October 5, 2005; October 26, 2005; November 29, 2005; December 13, 2005; February 22, 2006; March 20, 2006; June 1, 2006; July 24, 2006 and August 29, 2006.

WEBSITE ACCESS TO REPORT

We make our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports, filed or furnished pursuant to section 13(a) or 15(d) of the Securities Exchange Act of 1934 available free of charge on or through our internet website www.firstbankpr.com, (Sobre nosotros section, SEC Filings link), as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC.

We also make available the Corporation s corporate governance standards, the charters of the audit, compensation and benefits, corporate governance and nominating committees; and the codes mentioned below, free of charge on or through our internet website www.firstbankpr.com (Sobre nosotros, Governance Documents link):

- Code of Ethics for Senior Financial Officers
- Code of Ethics applicable to all employees
- Independence Principles for Directors

The corporate governance standards, and the aforementioned charters and codes may also be obtained free of charge by request to Mr. Lawrence Odell, Executive Vice President and General Counsel, PO Box 9146, San Juan, Puerto Rico 00908.

As previously announced on December 13, 2005, First BanCorp determined that previously filed interim unaudited and annual audited financial statements should no longer be relied upon and that it needed to restate previously issued financial statements. The Corporation is restating financial statements for the periods from January 1, 2000 through March 31, 2005. Other than this Annual Report on Form 10-K/A, the Corporation has not amended any of its previously filed reports. The consolidated financial statements and other financial information in First BanCorp s previously filed reports for the dates and periods referred to above should no longer be relied upon.

The public may read and copy any materials First BanCorp files with the SEC at the SEC s Public Reference Room at 100 F Street, NE, Washington, DC 20549. In addition, the public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site that contains reports, proxy, and information statements, and other information regarding issuers that file electronically with the SEC at its website (www.sec.gov).

MARKET AREA AND COMPETITION

Puerto Rico, where the banking market is highly competitive, is the main geographic service area of the Corporation. At December 31, 2004, the Corporation also had a presence through its subsidiaries in the United States and British Virgin Islands and through its loan agency in Coral Gables, Florida. Puerto Rico banks are subject to the same federal laws, regulations and supervision that apply to similar institutions in the United States mainland.

Competitors include other banks, insurance companies, mortgage banking companies, small loan companies, automobile financing companies, leasing companies, vehicle rental companies, brokerage

firms with retail operations, and credit unions, in Puerto Rico, the Virgin Islands and in the state of Florida. The Corporation s businesses compete with these other firms with respect to the range of products and services offered and the types of clients, customers, and industries served.

The Corporation s ability to compete effectively depends on the relative performance of its products, the degree to which the features of its products appeal to customers, and the extent to which the Corporation meets client s needs and expectations. The Corporation s ability to compete also depends on its ability to attract and retain professional and other personnel, and on its reputation.

The Corporation encounters intense competition in attracting and retaining deposits and in its consumer and commercial lending activities. The Corporation competes for loans with other financial institutions, some of which are larger and have available resources greater than those of the Corporation. Management believes that the Corporation has been able to compete effectively for deposits and loans by offering a variety of transaction account products and loans with competitive features, by pricing its products at competitive interest rates, by offering convenient branch locations, and by emphasizing the quality of its service. The Corporation s ability to originate loans depends primarily on the rates and fees charged and the service it provides to its borrowers in making prompt credit decisions. There can be no assurance that in the future the Corporation will be able to continue to increase its deposit base or originate loans in the manner or on the terms on which it has done so in the past.

SUPERVISION AND REGULATION

On March 17, 2006, the Corporation announced that the Corporation and FirstBank consented to cease and desist orders with the Federal Reserve Board and the FDIC. For more information regarding these orders, see Subsequent Events Governmental Action, Banking Regulators.

Bank Holding Company Activities and Other Limitations

The Corporation is subject to ongoing regulation, supervision, and examination by the Federal Reserve Board, and is required to file with the Federal Reserve Board periodic and annual reports and other information concerning its own business operations and those of its subsidiaries. In addition, under the provisions of the Bank Holding Company Act, a bank holding company must obtain Federal Reserve Board approval before it acquires directly or indirectly ownership or control of more than 5% of the voting shares of a second bank. Furthermore, Federal Reserve Board approval must also be obtained before such a company acquires all or substantially all of the assets of a second bank or merges or consolidates with another bank holding company. The Federal Reserve Board also has authority under certain circumstances to issue cease and desist orders against bank holding companies and their non-bank subsidiaries.

A bank holding company is prohibited under the Bank Holding Company Act, with limited exceptions, from engaging, directly or indirectly, in any business unrelated to the business of banking or of managing or controlling banks. One of the exceptions to these prohibitions permits ownership by a bank holding company of the shares of any corporation if the Federal Reserve Board, after due notice and opportunity for hearing, by regulation or order has determined that the activities of the corporation in question are so closely related to the business of banking or of managing or controlling banks as to be a proper incident thereto.

Under the Federal Reserve Board policy, a bank holding company such as the Corporation is expected to act as a source of financial strength to its banking subsidiaries and to commit support to them. This support may be required at times when, absent such policy, the bank holding company might not otherwise provide such support. In the event of a bank holding company s bankruptcy, any commitment

by the bank holding company to a federal bank regulatory agency to maintain capital of a subsidiary bank will be assumed by the bankruptcy trustee and be entitled to a priority of payment. In addition, any capital loans by a bank holding company to any of its subsidiary banks must be subordinated in right of payment to deposits and to certain other indebtedness of such subsidiary bank. At December 31, 2004, FirstBank was the only depository institution subsidiary of the Corporation**.** On March 31, 2005, the Corporation announced the acquisition, in an all-cash consideration merger transaction, of Ponce General Corporation, a Delaware corporation, and its subsidiaries, UniBank, a federal savings and loan association, and Ponce Realty Corporation, a Delaware corporation with real estate holdings in Florida. The Corporation subsequently changed the name of the acquired entities to FirstBank Florida. For additional information, see Subsequent Events Business Developments.

The Gramm-Leach-Bliley Act revised and expanded the provisions of the Bank Holding Company Act by including a section that permits a bank holding company to elect to become a financial holding company to engage in a full range of financial activities. The Gramm-Leach-Bliley Act requires that in the event that the bank holding company elects to become a financial holding company, the election must be made by filing a written declaration with the appropriate Federal Reserve Bank and complying with the following (and such compliance must continue while the entity is treated as a financial holding company): (i) state that the bank holding company elects to become a financial holding company**;** (ii) provide the name and head office address of the bank holding company and each depository institution controlled by the bank holding company**;** (iii) certify that all depository institutions controlled by the bank holding company are well capitalized as of the date the bank holding company files for the election; (iv) provide the capital ratios for all relevant capital measures as of the close of the previous quarter for each depository institution controlled by the bank holding company**;** and (v) certify that all depository institutions controlled by the bank holding company are well managed as of the date the bank holding company files the election. All insured depository institutions controlled by the bank holding company must have also achieved at least a rating of satisfactory record of meeting community credit needs under the Community Reinvestment Act during the depository institution s most recent examination. In April of 2000, the Corporation filed an election with the Federal Reserve Board and became a financial holding company.

Financial holding companies may engage, directly or indirectly, in any activity that is determined to be (i) financial in nature, (ii) incidental to such financial activity, or (iii) complementary to a financial activity and does not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally. The Gramm-Leach-Bliley Act specifically provides that the following activities have been determined to be financial in nature : (a) Lending, trust and other banking activities; (b) Insurance activities; (c) Financial or economic advice or services; (d) Pooled investments; (e) Securities underwriting and dealing; (f) Existing bank holding company domestic activities; (g) Existing bank holding company foreign activities; and (h) Merchant banking activities. The Corporation offers insurance agency services through its wholly-owned subsidiary, FirstBank Insurance Agency, Inc. and through First Insurance Agency V. I., Inc., a subsidiary of FirstBank.

In addition, the Gramm-Leach-Bliley Act specifically gives the Federal Reserve Board the authority, by regulation or order, to expand the list of financial or incidental activities, but requires consultation with the U.S. Treasury, and gives the Federal Reserve Board authority to allow a financial holding company to engage in any activity that is complementary to a financial activity and does not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally.

Under the Gramm-Leach-Bliley Act, if the Corporation fails to meet any of the requirements for being a financial holding company and is unable to cure such deficiencies within certain prescribed periods of time, the Federal Reserve Board could require the Corporation to divest control of one or more

of its depository institution subsidiaries or alternatively cease conducting financial activities that are not permissible for bank holding companies that are not financial holding companies.

Sarbanes-Oxley Act

On July 20, 2002, President Bush signed into law the Sarbanes-Oxley Act of 2002 (SOA), which implemented legislative reforms intended to address corporate and accounting fraud. SOA contains reforms of various business practices and numerous aspects of corporate governance. Most of these requirements have been implemented by regulations issued by the SEC. The following is a summary of certain key provisions of SOA.

In addition to the establishment of an accounting oversight board that enforces auditing, quality control and independence standards and is funded by fees from all publicly traded companies, SOA places restrictions on the scope of services that may be provided by accounting firms to their public corporation audit clients. Any non-audit services being provided to a public corporation audit client requires pre-approval by the corporation s audit committee. In addition, SOA makes certain changes to the requirements for partner rotation after a period of time. SOA requires chief executive officers and chief financial officers, or their equivalent, to certify to the accuracy of periodic reports filed with the SEC, subject to civil and criminal penalties if they knowingly or willingly violate this certification requirement. In addition, counsel is required to report evidence of a material violation of the securities laws or a breach of fiduciary duties to the corporation s chief executive officer or its chief legal officer, and, if such officer does not appropriately respond, to report such evidence to the audit committee or other similar committee of the board of directors or the board itself.

Under SOA, longer prison terms may apply to corporate executives who violate federal securities laws; the period during which certain types of suits can be brought against a corporation or its officers is extended**;** and bonuses issued to top executives prior to restatement of a corporation s financial statements are now subject to disgorgement if such restatement was due to corporate misconduct. Executives are also prohibited from insider trading during retirement plan blackout periods, and loans to corporations executives (other than loans by financial institutions permitted by federal rules or regulations) are restricted. In addition, the legislation accelerates the time frame for disclosures by public companies, as they must immediately disclose any material changes in their financial condition or operations. Directors and executive officers required to report changes in ownership in a corporation s securities must now report within two business days of the change.

SOA increases responsibilities and codifies certain requirements related to audit committees of public companies and how they interact with the corporation s registered public accounting firm. Audit committee members must be independent and are barred from accepting consulting, advisory or other compensatory fees from the issuer. In addition, companies are required to disclose whether at least one member of the committee is a financial expert (as such term is defined by the SEC) and if not, why not. A corporation s registered public accounting firm is prohibited from performing statutorily mandated audit services for a corporation if the corporation s chief executive officer, chief financial officer, controller, chief accounting officer or any person serving in equivalent positions had been employed by such firm and participated in the audit of such corporation during the one-year period preceding the audit initiation date. SOA also prohibits any officer or director of a corporation or any other person acting under their direction from taking any action to fraudulently influence, coerce, manipulate, or mislead any independent public or certified accountant engaged in the audit of the corporation s financial statements for the purpose of rendering the financial statements materially misleading.

SOA also has provisions relating to inclusion of certain internal control reports and assessments by management in the annual report on Form 10-K. The law also requires a corporation s independent registered public accounting firm that issues the audit report to attest to and report on management s assessment of the corporation s internal controls and on the effectiveness of internal control over financial reporting. Commencing with the Original Filing, the Corporation has been required to include an internal control report containing management s assessment regarding the effectiveness of the Corporation s internal control structure and procedures over financial reporting. The internal control report includes a statement of management s responsibility for establishing and maintaining adequate internal control over financial reporting for the Corporation; management s assessment as to the effectiveness of the Corporation s internal control over financial reporting based on management s evaluation of it, as of year-end; and the framework used by management as criteria for evaluating the effectiveness of the Corporation s internal control over financial reporting. In addition, Section 404 of SOA requires the Corporation s independent registered public accounting firm to attest to, and report on, management s assessment of the Corporation s internal control over financial reporting and on the effectiveness of internal control over financial reporting in accordance with standards established and adopted by the Public Corporation Accounting Oversight Board (PCAOB). Both reports by Management and of the Independent Registered Public Accounting Firm, as restated, are being filed as part of the Annual Report on this Form 10-K/A.

USA Patriot Act

Under Title III of the USA Patriot Act, also known as the International Money Laundering Abatement and Anti-Terrorism Financing Act of 2001, all financial institutions, including the Corporation and FirstBank, are required to, among other things, identify their customers, adopt formal and comprehensive anti-money laundering programs, scrutinize or prohibit altogether certain transactions of special concern, and be prepared to respond to inquiries from U.S. law enforcement agencies concerning their customers and their transactions. Additional information-sharing among financial institutions, regulators, and law enforcement authorities is encouraged by the presence of an exemption from the privacy provisions of the Gramm-Leach-Bliley Act for financial institutions that comply with this provision and the authorization of the Secretary of the Treasury to adopt rules to further encourage cooperation and information-sharing.

The U.S. Treasury Department (Treasury) has issued a number of regulations implementing the USA Patriot Act that apply certain of its requirements to financial institutions. The regulations impose new obligations on financial institutions to maintain appropriate policies, procedures, and controls to detect, prevent and report money laundering and terrorist financing. Treasury is expected to issue a number of additional regulations that will further clarify the USA Patriot Act s requirements.

Failure of a financial institution to comply with the USA Patriot Act s requirements could have serious legal and reputational consequences for the institutions. The Corporation and FirstBank have adopted appropriate policies, procedures and controls to address compliance with the USA Patriot Act under existing regulations, and will continue to revise and update their policies, procedures and controls to reflect changes required by the USA Patriot Act and Treasury s regulations. See Subsequent Events Governmental Action for information regarding recent issues relating to compliance with the Bank Secrecy Act.

Privacy Policies

Under the Gramm-Leach-Bliley Act, all financial institutions are required to adopt privacy policies, restrict the sharing of nonpublic customer data with nonaffiliated parties at the customer s

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request and establish policies and procedures to protect customer data from unauthorized access. The Corporation and its subsidiaries have adopted policies and procedures in order to comply with the privacy provisions of the Gramm-Leach-Bliley Act and the regulations issued thereunder.

State Chartered Non-Member Bank; Banking Laws and Regulations in General.

FirstBank is subject to extensive regulation and examination by the Commissioner and the FDIC, and is subject to certain requirements established by the Federal Reserve Board. The federal and state laws and regulations which are applicable to banks regulate, among other things, the scope of their business, their investments, their reserves against deposits, the timing and availability of deposited funds, and the nature and amount of and collateral for certain loans. In addition to the impact of regulations, commercial banks are affected significantly by the actions of the Federal Reserve Board as it attempts to control the money supply and credit availability in order to influence the economy. References herein to applicable statutes or regulations are brief summaries of portions thereof which do not purport to be complete and which are qualified in their entirety by reference to those statutes and regulations. Any change in applicable laws or regulations may have a material adverse effect on the business of commercial banks and bank holding companies, including FirstBank and the Corporation. However, management is not aware of any current proposals by any federal or state regulatory authority that, if implemented, would have or would be reasonably likely to have a material effect on the liquidity, capital resources or operations of FirstBank or the Corporation.

As a creditor and financial institution, FirstBank is subject to certain regulations promulgated by the Federal Reserve Board, including, without limitation, Regulation B (Equal Credit Opportunity Act), Regulation DD (Truth in Savings Act), Regulation E (Electronic Funds Transfer Act), Regulation F (Limits on Exposure to Other Banks), Regulation Z (Truth in Lending Act), Regulation CC (Expedited Funds Availability Act), Regulation X (Real Estate Settlement Procedures Act), Regulation BB (Community Reinvestment Act) and Regulation C (Home Mortgage Disclosure Act).

There are periodic examinations by the Commissioner and the FDIC to test FirstBank s compliance with various statutory and regulatory requirements. This regulation and supervision establishes a comprehensive framework of activities in which an institution can engage and is intended primarily for the protection of the FDIC s insurance fund and depositors. The regulatory structure also gives the regulatory authorities extensive discretion in connection with their supervisory and enforcement activities and examination policies, including policies with respect to the classification of assets and the establishment of adequate loan loss reserves for regulatory purposes. This enforcement authority includes, among other things, the ability to assess civil money penalties, to issue cease-and-desist or removal orders and to initiate injunctive actions against banking organizations and institution-affiliated parties, as defined. In general, these enforcement actions may be initiated for violations of laws and regulations and unsafe or unsound practices. In addition, certain actions are required by statute and implementing regulations. Other actions or inaction may provide the basis for enforcement action, including the filing of misleading or untimely reports with regulatory authorities.

For a discussion of bank regulatory action relating to FirstBank Florida, see the discussion under Subsequent Events Governmental Action, Banking Regulators.

Dividend Restrictions

The Corporation is subject to certain restrictions generally imposed on Puerto Rico corporations with respect to its declaration and payment of dividends (i.e., that dividends may be paid out only from the Corporation s net assets in excess of capital or in the absence of such excess, from the Corporation s net earnings for such fiscal year and/or the preceding fiscal year). The Federal Reserve Board has also

issued a policy statement that provides that bank holding companies should generally pay dividends only out of current operating earnings.

At December 31, 2004, the principal source of funds for the Corporation is dividends declared and paid by its subsidiary, FirstBank. The ability of FirstBank to declare and pay dividends on its capital stock is restricted by the Puerto Rico Banking Law, the Federal Deposit Insurance Act (the FDIA), and FDIC regulations. In general terms, the Puerto Rico Banking Law provides that when the expenditures of a bank are greater than receipts, the excess of expenditures over receipts shall be charged against undistributed profits of the bank and the balance, if any, shall be charged against the required reserve fund of the bank. If the reserve fund is not sufficient to cover such balance in whole or in part, the outstanding amount must be charged against the bank s capital account. The Puerto Rico Banking Law provides that, until said capital has been restored to its original amount and the reserve fund to 20% of the original capital, the bank may not declare any dividends.

In general terms, the FDIA and the FDIC regulations restrict the payment of dividends when a bank is undercapitalized, when a bank has failed to pay insurance assessments, or when there are safety and soundness concerns regarding such bank.

The Consent Orders impose certain restrictions on dividend payments. FirstBank, the insured institution, may not declare or pay dividends or any other form of payment representing a reduction in capital without the prior written approval of the FDIC. All requests for prior approval must comply with specific deadlines for approval request and must contain, but not be limited to, an analysis of the impact such dividend or other payment would have on FirstBank s capital position, cash flow, concentrations of credit, asset quality, and allowance for loan and lease loss needs. The FDIC will approve a dividend or any other form of payment representing a reduction in capital provided that the FDIC determines that such dividend or payment will not have an unacceptable impact on FirstBank s capital position, cash flow, concentrations of credit, asset quality and allowance for loan and lease loss needs. In addition, the Corporation may not pay dividends or other payments without the permission of the Federal Reserve Bank.

Limitations on Transactions with Affiliates

Transactions between financial institutions such as FirstBank and any affiliate are governed by Sections 23A and 23B of the Federal Reserve Act and by Regulation W. An affiliate of a financial institution is any corporation or entity, which controls, is controlled by, or is under common control with the financial institution. In a holding company context, the parent bank holding company and any companies which are controlled by such parent bank holding company are affiliates of the financial institution. Generally, Sections 23A and 23B of the Federal Reserve Act (i) limit the extent to which the financial institution or its subsidiaries may engage in covered transactions (defined below) with any one affiliate to an amount equal to 10% of such financial institution s capital stock and surplus, and contain an aggregate limit on all such transactions with all affiliates to an amount equal to 20% of such financial institution s capital stock and surplus and (ii) require that all covered transactions be on terms substantially the same, or at least as favorable, to the financial institution or affiliate, as those provided to a non-affiliate. The term covered transaction includes the making of loans, purchase of assets, issuance of a guarantee and other similar transactions. In addition, loans or other extensions of credit by the financial institution to the affiliate are required to be collateralized in accordance with the requirements set forth in Section 23A of the Federal Reserve Act.

The Gramm-Leach-Bliley Act provides that financial subsidiaries of banks be treated as affiliates for purposes of Sections 23A and 23B of the Federal Reserve Act, but provides that (i) the 10% capital

limit on transactions between the bank and such financial subsidiary as an affiliate is not applicable, and (ii) the investment by the bank in the financial subsidiary does not include retained earnings of the financial subsidiary. The Gramm-Leach-Bliley Act provides that: (1) any purchase of, or investment in, the securities of a financial subsidiary by any affiliate of the parent bank is considered a purchase or investment by the bank; and (2) if the Federal Reserve Board determines that such treatment is necessary, any loan made by an affiliate of the parent bank to the financial subsidiary is to be considered a loan made by the parent bank.

The Federal Reserve Board adopted a new regulation, Regulation W, effective April 1, 2003, that interprets the provisions of Sections 23A and 23B. The regulation unifies and updates staff interpretations issued over the years, incorporates several new interpretations and provisions (such as to clarify when transactions with an unrelated third party will be attributed to an affiliate), and addresses new issues arising as a result of the expanded scope of nonbanking activities engaged in by banks and bank holding companies in recent years and authorized for financial holding companies under the Gramm-Leach-Bliley Act.

In addition, Sections 22(h) and (g) of the Federal Reserve Act, implemented through Regulation O , place restrictions on loans to executive officers, directors, and principal stockholders. Under Section 22(h) of the Federal Reserve Act, loans to a director, an executive officer, a greater than 10% stockholder of a financial institution, and certain related interests of these, may not exceed, together with all other outstanding loans to such person and affiliated interests, the financial institution s loans to one borrower limit, generally equal to 15% of the institution s unimpaired capital and surplus. Section 22(h) of the Federal Reserve Act also requires that loans to directors, executive officers, and principal stockholders be made on terms substantially the same as offered in comparable transactions to other persons and also requires prior board approval for certain loans. In addition, the aggregate amount of extensions of credit by a financial institution to insiders cannot exceed the institution s unimpaired capital and surplus. Furthermore, Section 22(g) of the Federal Reserve Act places additional restrictions on loans to executive officers.

The Consent Orders with banking regulators imposed some additional restrictions and reporting requirements on the Corporation and FirstBank. Under its Consent Order with the FDIC**,** FirstBank must not, directly or indirectly, enter into, participate, or in any other manner engage in any of the following transactions with any affiliate without the prior written approval of the FDIC: (i) a loan or extension of credit to the affiliate; (ii) a purchase of or an investment in securities issued by the affiliate; (iii) a purchase of assets, including assets subject to an agreement to repurchase, from the affiliate; (iv) the acceptance of securities issued by the affiliate as collateral security for a loan or extension of credit to any person or company; (v) the issuance of a guarantee, acceptance, or letter of credit, including an endorsement or standby letter of credit, on behalf of an affiliate; (vi) the sale of securities or other assets to an affiliate, including assets subject to an agreement to repurchase; (vii) the payment of money or furnishing of services to an affiliate under contract, lease or otherwise; (viii) any transaction in which an affiliate acts as agent or broker or receives a fee for its services to FirstBank; and (ix) any transaction or series of transactions with a third party if an affiliate has a financial interest in the third party, or an affiliate is a participant in such transaction or series of transactions. Under its Consent Order with the Federal Reserve Bank, the Corporation must report all covered transactions and not engage in insider transactions.

In February 2006, the Office of Thrift Supervision (OTS) imposed restrictions on FirstBank Florida, formerly Unibank, a subsidiary acquired by First BanCorp in March 2005. Under these restrictions, FirstBank Florida cannot make any payments to the Corporation or its affiliates pursuant to a tax-sharing agreement nor can the bank employ or receive consultative services from an executive officer of the Corporation or its affiliates without the prior written approval of the OTS Regional Director.

Additionally, FirstBank Florida cannot enter into any agreement to sell loans or any portions of any loans to the Corporation or its affiliates nor can the bank make any payment to the Corporation or its affiliates via an intercompany account or arrangement unless pursuant to a pre-existing contractual agreement for services rendered in the normal course of business.

Federal Reserve Board Capital Requirements

The Federal Reserve Board has adopted capital adequacy guidelines pursuant to which it assesses the adequacy of capital in examining and supervising a bank holding company and in analyzing applications to it under the Bank Holding Company Act. The Federal Reserve Board capital adequacy guidelines generally require bank holding companies to maintain total capital equal to 8% of total risk-adjusted assets, with at least one-half of that amount consisting of Tier I or core capital and up to one-half of that amount consisting of Tier II or supplementary capital. Tier I capital for bank holding companies generally consists of the sum of common stockholders equity and perpetual preferred stock, subject in the case of the latter to limitations on the kind and amount of such perpetual preferred stock that may be included as Tier I capital, less goodwill and, with certain exceptions, other intangibles. Tier II capital generally consists of hybrid capital instruments, perpetual preferred stock that is not eligible to be included as Tier I capital; term subordinated debt and intermediate-term preferred stock; and, subject to limitations, allowances for loan losses. Assets are adjusted under the risk-based guidelines to take into account different risk characteristics, with the categories ranging from 0% (requiring no additional capital) for assets such as cash to 100% for the bulk of assets**,** which are typically held by a bank holding company, including multi-family residential and commercial real estate loans, commercial business loans and commercial loans. Off-balance sheet items also are adjusted to take into account certain risk characteristics.

In addition to the risk-based capital requirements, the Federal Reserve Board requires bank holding companies to maintain a minimum leverage capital ratio of Tier I capital to total assets of 3.0%. Total assets for purposes of this calculation do not include goodwill and any other intangible assets and investments that the Federal Reserve Board determines should be deducted. The Federal Reserve Board has announced that the 3.0% Tier I leverage capital ratio requirement is the minimum for the top-rated bank holding companies without supervisory, financial or operational weaknesses or deficiencies or those which are not experiencing or anticipating significant growth. Other bank holding companies will be expected to maintain Tier I leverage capital ratios of at least 4.0% or more, depending on their overall condition. As of December 31, 2004, after giving effect to the restatement, the Corporation exceeded each of its capital requirements and was a well-capitalized institution as defined in the Federal Reserve Board regulations.

The federal banking agencies are currently analyzing regulatory capital requirements as part of an effort to implement the Basel Committee on Banking Supervision new capital adequacy framework for large, internationally active banking organizations (Basel II), as well as to update their risk-based capital standards to enhance the risk-sensitivity of the capital charges, to reflect changes in accounting standards and financial markets, and to address competitive equity questions that may be raised by U.S. implementation of the Basel II framework. Accordingly, the federal agencies, including the Federal Reserve and the FDIC are considering several revisions to regulations issued in response to an earlier set of standards published by the Basel Committee in 1988 (Basel I). The agencies are expected to publish a notice of proposed rulemaking, which implements Basel II, as well as, a notice addressing the Basel I-based rules this year. In the meantime, the agencies published an advance notice of proposed rulemaking as to the Basel I-based rules on October 20, 2005 (the ANPR). In the ANPR the agencies propose:

Increasing the number of risk-weight categories to which credit exposures may be assigned;

Expanding the use of external credit ratings as an indicator of credit risk for externally-rated exposures;

Expanding the range of collateral and guarantors that may qualify an exposure for a lower risk weight;

Using loan-to-value ratios, credit assessments, and other broad measures of credit risk for assigning risk weights to residential mortgages;

Modifying the credit conversion factor for various commitments, including those with an original maturity of under one year;

Requiring that certain loans 90 days or more past due or in a non-accrual status be assigned to a higher risk-weight category;

Modifying the risk-based capital requirements for certain commercial real estate exposures;

Increasing the risk sensitivity of capital requirements for other types of retail, multifamily, small business, and commercial exposures; and

Assessing a risk-based capital charge to reflect the risks in securitizations backed by revolving retail exposures with early amortization provisions.

FDIC Capital Requirements

The FDIC has promulgated regulations and adopted a statement of policy regarding the capital adequacy of state-chartered non-member banks like FirstBank. These requirements are substantially similar to those adopted by the Federal Reserve Board regarding bank holding companies, as described above.

The FDIC requires that banks meet a risk-based capital standard. The risk-based capital standard for banks requires the maintenance of total capital (which is defined as Tier I capital and supplementary (Tier 2) capital) to risk weighted assets of 8%. In determining the amount of risk-weighted assets, weights used (range from 0% to 100%) are based on the risks the FDIC believes are inherent in the type of asset or item. The components of Tier I capital are equivalent to those discussed below under the 3.0% leverage capital standard. The components of supplementary capital include certain perpetual preferred stock, certain mandatory convertible securities, certain subordinated debt and intermediate preferred stock and generally allowances for loan and lease losses. Allowance for loan and lease losses includable in supplementary capital is limited to a maximum of 1.25% of risk-weighted assets. Overall, the amount of capital counted toward supplementary capital cannot exceed 100% of core capital.

The FDIC s capital regulations establish a minimum 3.0% Tier I capital to total assets requirement for the most highly-rated state-chartered, non-member banks, with an additional cushion of at least 100 to 200 basis points for all other state-chartered, non-member banks, which effectively will increase the minimum Tier I leverage ratio for such other banks to 4.0% to 5.0% or more. Under the FDIC s regulations, the highest-rated banks are those that the FDIC determines are not anticipating or experiencing significant growth and have well diversified risk, including no undue interest rate risk exposure, excellent asset quality, high liquidity, good earnings and, in general, are considered a strong banking organization and are rated composite I under the Uniform Financial Institutions Rating System. Leverage or core capital is defined as the sum of common stockholders equity including retained earnings, noncumulative perpetual preferred stock and related surplus, and minority interests in consolidated subsidiaries, minus all intangible assets other than certain qualifying supervisory goodwill and certain purchased mortgage servicing rights.

In August 1995, the FDIC and other federal banking agencies published a final rule modifying their existing risk-based capital standards to provide for consideration of interest rate risk when assessing

the capital adequacy of a bank. Under the final rule, the FDIC must explicitly include a bank s exposure to declines in the economic value of its capital due to changes in interest rates as a factor in evaluating a bank s capital adequacy. In June 1996, the FDIC and other federal banking agencies adopted a joint policy statement on interest rate risk policy. Because market conditions, bank structure, and bank activities vary, the agencies concluded that each bank needs to develop its own interest rate risk management program tailored to its needs and circumstances. The policy statement describes prudent principles and practices that are fundamental to sound interest rate risk management, including appropriate board and senior management oversight and a comprehensive risk management process that effectively identifies, measures, monitors and controls such interest rate risk.

Failure to meet capital guidelines could subject an insured bank like FirstBank to a variety of prompt corrective actions and enforcement remedies under the FDIA (as amended by FDICIA), including, with respect to an insured bank, the termination of deposit insurance by the FDIC, and certain restrictions on its business. In general terms, undercapitalized depository institutions are prohibited from making any capital distributions (including dividends), are subject to restrictions on borrowing from the Federal Reserve System, are subject to growth limitations and are required to submit capital restoration plans.

At December 31, 2004, and after giving effect to the restatement, FirstBank was well capitalized. Like any other institution, FirstBank s capital category, as determined by applying the prompt corrective action provisions of law, may not constitute an accurate representation of the overall financial condition or prospects of FirstBank, and should be considered in conjunction with other available information regarding FirstBank s financial condition and results of operations.

Set forth below are the Corporation s and FirstBank s capital ratios at December 31, 2004, after giving effect to the restatement, based on existing Federal Reserve and FDIC guidelines.

		First BanCorp Banking Subsidiary	
	First BanCorp (As Restated)	FirstBank (As Restated)	Well-Capitalized Minimum
Total capital (Total capital to risk-weighted assets)	12.83%	10.60%	10.00%
Tier 1 capital ratio (Tier 1 capital to risk-weighted assets)	11.62%	9.44%	6.00%
Leverage ratio	9.26%	7.51%	5.00%

The Consent Orders entered into with banking regulators required the Corporation and FirstBank Puerto Rico to submit a capital plan to ensure that an adequate capital position is maintained by both FirstBank and the Corporation in light of the reclassification of the mortgage-related transactions as secured loans. The capital plan was submitted to regulators and is being periodically reviewed against actual results.

Activities and Investments

The activities as principal and equity investments of FDIC-insured, state-chartered banks such as FirstBank are generally limited to those that are permissible for national banks. Under regulations dealing with equity investments, an insured state-chartered bank generally may not directly or indirectly acquire or retain any equity investments of a type, or in an amount, that is not permissible for a national bank. An insured state bank is not prohibited from, among other things, (i) acquiring or retaining a majority interest in a subsidiary, (ii) investing as a limited partner in a partnership the sole purpose of

which is direct or indirect investment in the acquisition, rehabilitation or new construction of a qualified housing project, provided that such limited partnership investments may not exceed 2% of the bank s total assets, (iii) acquiring up to 10% of the voting stock of a corporation that solely provides or reinsures directors , trustees and officers liability insurance coverage or bankers blanket bond group insurance coverage for insured depository institutions, and (iv) acquiring or retaining the voting shares of a depository institution if certain requirements are met. In addition, an insured state-chartered bank may not, directly, or indirectly through a subsidiary, engage as a principal in any activity that is not permissible for a national bank unless the FDIC has determined that such activity would pose no risk to the insurance fund of which it is a member and the bank is in compliance with applicable regulatory capital requirements. Any insured state-chartered bank directly or indirectly engaged as a principal in any activity that is not permitted for a national bank must cease the impermissible activity.

Federal Home Loan Bank System

FirstBank is a member of the Federal Home Loan Bank (FHLB) system. The FHLB system consists of twelve regional Federal Home Loan Banks governed and regulated by the Federal Housing Finance Board (FHFB). The Federal Home Loan Banks serve as reserve or credit facilities for member institutions within their assigned regions. They are funded primarily from proceeds derived from the sale of consolidated obligations of the FHLB system, and they make loans (advances) to members in accordance with policies and procedures established by the FHLB system and the Board of directors of each regional FHLB.

FirstBank is a member of the FHLB of New York (FHLB-NY) and as such is required to acquire and hold shares of capital stock in that FHLB in a certain amount, which is calculated in accordance with the requirements set forth in applicable laws and regulations. FirstBank is in compliance with the stock ownership requirements of the FHLB-NY. All loans, advances and other extensions of credit made by the FHLB-NY to FirstBank are secured by a portion of FirstBank s mortgage loan portfolio, certain other investments and the capital stock of the FHLB-NY held by FirstBank.

Ownership and Control

Because of FirstBank s status as an FDIC-insured bank, as defined in the Bank Holding Company Act, owners of the common stock are subject to certain restrictions and disclosure obligations under various federal laws, including the Bank Holding Company Act and the Change in Bank Control Act (the CBCA). Regulations pursuant to the Bank Holding Company Act generally require prior Federal Reserve Board approval for an acquisition of control of an insured institution (as defined) or holding company thereof by any person (or persons acting in concert). Control is deemed to exist if, among other things, a person (or persons acting in concert) acquires more than 25% of any class of voting stock of an insured institution or holding company thereof. Under the CBCA, control is presumed to exist subject to rebuttal, if a person (or persons acting in concert) acquires more than 10% of any class of voting stock and either (i) the corporation has registered securities under Section 12 of the Securities Exchange Act of 1934, or (ii) no person will own, control or hold the power to vote a greater percentage of that class of voting securities immediately after the transaction. The concept of acting in concert is very broad and also is subject to certain rebuttable presumptions, including among others, that relatives, business partners, management officials, affiliates and others are presumed to be acting in concert with each other and their businesses. The FDIC s regulations implementing the CBCA are generally similar to those described above.

The Puerto Rico Banking Law requires the approval of the Commissioner for changes in control of a Puerto Rico bank. See Puerto Rico Banking Law.

Cross-Guarantees

Under the FDIA, a depository institution (which term includes both banks and savings associations), the deposits of which are insured by the FDIC, can be held liable for any loss incurred by, or reasonably expected to be incurred by, the FDIC in connection with (i) the default of a commonly controlled FDIC-insured depository institution or (ii) any assistance provided by the FDIC to any commonly controlled FDIC-insured depository institution in danger of default. Default is defined generally as the appointment of a conservator or a receiver and in danger of default is defined generally as the existence of certain conditions indicating that a default is likely to occur in the absence of regulatory assistance. In some circumstances (depending upon the amount of the loss or anticipated loss suffered by the FDIC), cross-guarantee liability may result in the ultimate failure or insolvency of one or more insured depository institutions liable to the FDIC, and any obligations of that bank to its parent corporation is subordinated to the subsidiary bank s cross-guarantee liability with respect to commonly controlled insured depository institutions. FirstBank and FirstBank Florida are currently the only FDIC insured depository institutions controlled by the Corporation.

Standards for Safety and Soundness

The FDIA, as amended by FDICIA and the Riegle Community Development and Regulatory Improvement Act of 1994, requires the FDIC and the other federal bank regulatory agencies to prescribe standards of safety and soundness, by regulations or guidelines, relating generally to operations and management, asset growth, asset quality, earnings, stock valuation, and compensation. The FDIC and the other federal bank regulatory agencies adopted, effective August 9, 1995, a set of guidelines prescribing safety and soundness standards pursuant to FDIA**,** as amended. The guidelines establish general standards relating to internal controls and information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth and compensation, fees and benefits. In general, the guidelines require, among other things, appropriate systems and practices to identify and manage the risks and exposures specified in the guidelines. The guidelines prohibit excessive compensation as an unsafe and unsound practice and describe compensation as excessive when the amounts paid are unreasonable or disproportionate to the services performed by an executive officer, employee, director or principal shareholder. For additional information, see the discussion under Subsequent Events Governmental Action, Banking Regulators.

Brokered Deposits

FDIC regulations adopted under the FDIA govern the receipt of brokered deposits by banks. Well capitalized institutions are not subject to limitations on brokered deposits, while adequately capitalized institutions are able to accept, renew or rollover brokered deposits only with a waiver from the FDIC and subject to certain restrictions on the yield paid on such deposits. Undercapitalized institutions are not permitted to accept brokered deposits. As of December 31, 2004, FirstBank was a well-capitalized institution and was therefore nor subject to any limitations on brokered deposits.

Puerto Rico Banking Law

As a commercial bank organized under the laws of the Commonwealth, FirstBank is subject to supervision, examination and regulation by the Commissioner pursuant to the Puerto Rico Banking Law of 1933, as amended (the Banking Law). The Banking Law contains provisions governing the incorporation and organization, rights and responsibilities of directors, officers and stockholders as well as the corporate powers, lending limitations, capital requirements, investment requirements and other aspects of FirstBank and its affairs. In addition, the Commissioner is given extensive rule making power and administrative discretion under the Banking Law.

The Banking Law authorizes Puerto Rico commercial banks to conduct certain financial and related activities directly or through subsidiaries, including finance leasing of personal property and operating a small loan corporation.

The Banking Law requires every bank to maintain a legal reserve which shall not be less than twenty percent (20%) of its demand liabilities, except government deposits (federal, state and municipal), which are secured by actual collateral. The reserve is required to be composed of any of the following securities or combination thereof: (1) legal tender of the United States; (2) checks on banks or trust companies located in any part of Puerto Rico, to be presented for collection during the day following that on which they are received, (3) money deposited in other banks provided said deposits are authorized by the Commissioner, subject to immediate collection; (4) federal funds sold to any Federal Reserve Bank and securities purchased under agreement to resell executed by the bank with such funds that are subject to be repaid to the bank on or before the close of the next business day; and (5) any other asset that the Commissioner determines from time to time.

The Banking Law permits Puerto Rico commercial banks to make loans to any one person, firm, partnership or corporation, up to an aggregate amount of fifteen percent (15%) of the sum of: (i) the bank s paid-in capital; (ii) the bank s reserve fund; (iii) 50% of the bank s retained earnings; and (iv) any other components that the Commissioner may determine from time to time. If such loans are secured by collateral worth at least twenty five percent (25%) more than the amount of the loan, the aggregate maximum amount may reach one third of the sum of the bank s paid-in capital, reserve fund, 50% of retained earnings and such other components that the Commissioner may determine from time to time. There are no restrictions under the Banking Law on the amount of loans which are wholly secured by bonds, securities and other evidences of indebtedness of the Government of the United States, of the Commonwealth of Puerto Rico, or by bonds, not in default, of municipalities or instrumentalities of the Commonwealth of Puerto Rico.

As previously discussed, the Corporation is restating previously issued financial statements because of the revised classification of mortgage-related transactions as secured commercial loans, among other corrections. Such revised classification caused the transactions to be treated as two secured commercial loans, which were in excess of lending limits imposed by the Banking Law. FirstBank received a ruling from the Commissioner that results in FirstBank being considered in continued compliance with the loan to one borrower limitation.

The Banking Law prohibits Puerto Rico commercial banks from making loans secured by their own stock, and from purchasing their own stock, unless such purchase is made pursuant to a stock repurchase program approved by the Commissioner or is necessary to prevent losses because of a debt previously contracted in good faith. The stock purchased by the Puerto Rico commercial bank must be sold by the bank in a public or private sale within one year from the date of purchase.

The Banking Law provides that no officers, directors, agents or employees of a Puerto Rico commercial bank may serve or discharge a position of officer, director, agent or employee of another Puerto Rico commercial bank, financial corporation, savings and loan association, trust corporation, corporation engaged in granting mortgage loans or any other institution engaged in the money lending business in Puerto Rico. This prohibition is not applicable to the affiliates of a Puerto Rico commercial bank.

The Banking Law requires that Puerto Rico commercial banks strike each year a general balance of their operations, and submit such balance for approval to a regular general meeting of stockholders, together with an explanatory report thereon. The Banking Law also requires that at least ten percent

(10%) of the yearly net income of a Puerto Rico commercial bank be credited annually to a reserve fund. This apportionment is required to be done every year until such reserve fund shall be equal to the total paid in capital of the bank.

The Banking Law also provides that when the expenditures of a Puerto Rico commercial bank are greater than receipts, the excess of the expenditures over receipts shall be charged against the undistributed profits of the bank, and the balance, if any, shall be charged against the reserve fund, as a reduction thereof. If there is no reserve fund sufficient to cover such balance in whole or in part, the outstanding amount shall be charged against the capital account and no dividend shall be declared until said capital has been restored to its original amount and the reserve fund to twenty percent (20%) of the original capital.

The Banking Law requires the prior approval of the Commissioner with respect to a transfer of capital stock of a bank that results in a change of control of the bank. Under the Banking Law, a change of control is presumed to occur if a person or a group of persons acting in concert, directly or indirectly, acquire more than 5% of the outstanding voting capital stock of the bank. The Commissioner has interpreted the restrictions of the Banking Law as applying to acquisitions of voting securities of entities controlling a bank, such as a bank holding company. Under the Banking Law, the determination of the Commissioner whether to approve a change of control filing is final and non-appealable.

The Finance Board, which is composed of the Commissioner, the Secretary of the Treasury, the Secretary of Commerce, the Secretary of Consumer Affairs, the President of the Economic Development Bank, the President of the Government Development Bank, and the President of the Planning Board, has the authority to regulate the maximum interest rates and finance charges that may be charged on loans to individuals and unincorporated businesses in Puerto Rico. The current regulations of the Finance Board provide that the applicable interest rate on loans to individuals and unincorporated businesses, including real estate development loans but excluding certain other personal and commercial loans secured by mortgages on real estate properties, is to be determined by free competition. Regulations adopted by the Finance Board deregulated the maximum finance charges on retail installment sales contracts, and for credit card purchases. These regulations do not set a maximum rate for charges on retail installment sales contracts and for credit card purchases and set aside previous regulations which regulated these maximum finance charges. Furthermore, there is no maximum rate set for installment sales contracts involving motor vehicles, commercial, agricultural and industrial equipment, commercial electric appliances and insurance premiums.

International Banking Act of Puerto Rico (IBE Act)

The business and operations of the First BanCorp IBE, FirstBank IBE and FirstBank Overseas Corporation are subject to supervision and regulation by the Commissioner. Under the IBE Act, certain sales, encumbrances, assignments, mergers, or exchanges or transfers of shares, interests or participation(s) in the capital of an international banking entity (an IBE) may not be initiated without the prior approval of the Commissioner. The IBE Act and the regulations issued thereunder by the Commissioner (the IBE Regulations) limit the business activities that may be carried out by an IBE. Such activities are limited in part to persons and assets located outside of Puerto Rico.

Pursuant to the IBE Act and the IBE Regulations, each of First BanCorp and FirstBank IBEs and FirstBank Overseas Corporation must maintain books and records of all its transactions in the ordinary course of business. The First BanCorp and FirstBank IBEs and FirstBank Overseas Corporation are also required thereunder to submit to the Commissioner quarterly and annual reports of their financial condition and results of operations, including annual audited financial statements.

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The IBE Act empowers the Commissioner to revoke or suspend, after notice and hearing, a license issued thereunder if, among other things, the IBE fails to comply with the IBE Act, the IBE Regulations or the terms of its license, or if the Commissioner finds that the business or affairs of the IBE are conducted in a manner that is not consistent with the public interest.

Puerto Rico Income Taxes

Under the Puerto Rico Internal Revenue Code of 1994 (the Code), all companies are treated as separate taxable entities and are not entitled to file consolidated tax returns. The Company, and each of its subsidiaries are subject to a maximum statutory corporate income tax rate of 39% or an alternative minimum tax (AMT) on income earned from all sources, whichever is higher. The excess of AMT over regular income tax paid in any one year may be used to offset regular income tax in future years, subject to certain limitations. The Code provides for a dividend received deduction of 100% on dividends received from wholly owned subsidiaries subject to income taxation in Puerto Rico and 85% on dividends received from other taxable domestic corporations.

The Corporation has maintained an effective tax rate lower than the maximum statutory tax rate of 39% as of December 31, 2004, mainly by investing in government obligations and mortgage-backed securities exempt from U.S. and Puerto Rico income tax combined with income from the international banking divisions (IBE s) of the Corporation and the Bank and by the Bank s subsidiary FirstBank Overseas Corporation. The IBE divisions and FirstBank Overseas Corporation were created under the IBE Act, which provides for Puerto Rico tax exemption on net income derived by the IBE s operating in Puerto Rico. Pursuant to the provisions of Act No. 13 of January 8, 2004, the IBE Act was amended to impose income tax at normal rates on IBE s that operate as units of a bank, to the extent that the IBE s net income exceeds 40% of the bank s total net taxable income (including net income generated by the IBE unit) for taxable year commenced on July 1, 2003, 30% for a taxable year commenced on July 1, 2004 and 20% for taxable years commencing July 1, 2005, and thereafter. These amendments apply only to IBE s that operate as units of a bank; it does not impose income tax on an IBE that operates as a subsidiary of a bank.

In computing its interest expense deduction, the Company s interest deduction will be reduced in the same proportion that its average exempt assets bear to its average total assets. Therefore, to the extent that the Company holds certain investments and loans which are exempt from Puerto Rico income taxation, part of its interest expense will be disallowed for tax purposes.

United States Income Taxes

The Corporation is also subject to federal income tax on its income from sources within the United States and on any item of income that is, or is considered to be, effectively connected with the active conduct of a trade or business within the United States. The U.S. Tax code provides for tax exemption on portfolio interest received by a foreign corporation from sources within the United States, therefore, the Corporation is not subject to federal income tax on certain U.S. investments which qualify under the term portfolio interest .

Insurance Operations Regulation

FirstBank Insurance Agency, Inc. is registered as an insurance agency with the Insurance Commissioner of Puerto Rico and is subject to regulations issued by the Insurance Commissioner relating to, among other things, licensing of employees, sales, solicitation and advertising practices, and to the FDIC as to certain consumer protection regulations mandated by the Gramm-Leach-Bliley Act and implementing regulations**.**

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Community Reinvestment

Under the Community Reinvestment Act (CRA), federally insured banks have a continuing and affirmative obligation to meet the credit needs of their entire community, including low and moderate-income residents, consistent with their safe and sound operation. The CRA does not establish specific lending requirements or programs for financial institutions nor does it limit an institution s discretion to develop the type of products and services that it believes are best suited to its particular community, consistent with the CRA. The CRA requires the federal supervisory agencies, as part of the general examination of supervised banks, to assess the bank s record of meeting the credit needs of its community, assign a performance rating, and to take such record and rating into account in its evaluation of certain applications by such bank. The CRA also requires all institutions to make public disclosure of their CRA ratings. FirstBank received a satisfactory CRA rating in its most recent examination by the FDIC.

Mortgage Banking Operations

FirstBank is subject to the rules and regulations of Federal Housing Administration (FHA), U.S. Department of Veteran Affairs (VA), Federal National Mortgage Association (FNMA), Federal Home Loan Mortgage Corporation (FHLMC), Housing and Urban Development (HUD) and Government National Mortgage Association (GNMA) with respect to originating, processing, selling and servicing mortgage loans and the issuance and sale of mortgage-backed securities. Those rules and regulations, among other things, prohibit discrimination and establish underwriting guidelines which include provisions for inspections and appraisals, require credit reports on prospective borrowers and fix maximum loan amounts, and with respect to VA loans, fix maximum interest rates. Moreover, lenders such as FirstBank are required annually to submit to FHA, VA, FNMA, FHLMC, GNMA and HUD, audited financial statements, and each regulatory entity has its own financial requirements. FirstBank s affairs are also subject to supervision and examination by FHA, VA, FNMA, FHLMC, GNMA and HUD at all times to assure compliance with the applicable regulations, policies and procedures. Mortgage origination activities are subject to, among others, the Equal Credit Opportunity Act, Federal Truth-in-Lending Act, and the Real Estate Settlement Procedures Act and the regulations promulgated thereunder which, among other things, prohibit discrimination and require the disclosure of certain basic information to mortgagors concerning credit terms and settlement costs. FirstBank is licensed by the Commissioner under the Puerto Rico Mortgage Banking Law, and as such is subject to regulation by the Commissioner, with respect to, among other things, licensing requirements and establishment of maximum origination fees on certain types of mortgage loans products.

Section 5 of the Puerto Rico Mortgage Banking Law requires the prior approval of the Commissioner for the acquisition of control of any mortgage banking institution licensed under such law. For purposes of the Puerto Rico Mortgage Banking Law, the term control means the power to direct or influence decisively, directly or indirectly, the management or policies of a mortgage banking institution. The Puerto Rico Mortgage Banking Law provides that a transaction that results in the holding of less than 10% of the outstanding voting securities of a mortgage banking institution shall not be considered a change in control.

Recent Legislation

Act 41 of August 1, 2005 amended the Puerto Rico Internal Revenue Code by imposing a transitory additional tax of 2.5% on net taxable income for all corporations. This transitory tax effectively increased the statutory tax rate from 39% to 41.5%. The Act is effective for taxable years commencing after December 31, 2004 and ending on or before December 31, 2006, therefore, effective for the 2005 and 2006 taxable years with a retroactive effect to January 1, 2005.

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Puerto Rico Internal Revenue Code Act 89 of May 13, 2006 imposes a 2% additional income tax on the net income subject to regular taxes of all corporations operating pursuant to Act 55 of 1933 (The Puerto Rico Banking Act). The Act will be effective for the taxable year commencing after December 31, 2005 and on or before December 31, 2006. Therefore, increasing the statutory tax for the 2006 taxable year to 43.5%.

Act 98 of May 16, 2006 imposed an extraordinary 5% tax on the net taxable income reported in the corporate tax return of corporations whose gross income exceeded $10 million for the taxable year ended on or before December 31, 2005. Covered taxpayers are required to file a special return and pay the tax no later than July 31, 2006. The extraordinary tax paid will be taken as a credit against the income tax of the entity determined for taxable years commencing after July 31, 2006, subject to certain limitations. Any unused credit may be carried forward to subsequent taxable years.

CERTAIN FACTORS THAT MAY AFFECT FUTURE RESULTS

Certain factors that may affect the Corporation s future results of operations are discussed below.

Risks Relating to the Restatement Process

First BanCorp is subject to the ongoing regulatory investigation by the SEC.

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. The Company believes that the inquiry relates to, among other things, the accounting for mortgage loans purchased by the Corporation from two other financial institutions during the calendar years 2000 through 2004. 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 is fully cooperating with the SEC s investigation.

The Corporation cannot predict when this investigation will be completed or what the results of this investigation will be. The effects and results of this may have a material adverse effect on the Corporation s business, results of operations, financial condition, and liquidity. In addition, the findings of the investigation may affect the course of the civil litigation pending against the Corporation, which is further described below.

Pending litigation could adversely affect First BanCorp s results of operations.

As a consequence of the accounting review and restatement, the Corporation is subject to pending shareholder class-action litigation beyond those in the ordinary course of business (refer to Subsequent Events above). The Corporation cannot determine whether these actions, suits, claims and proceedings will, individually or collectively, have a material adverse effect on the business, results of operations, financial condition and liquidity of the Corporation.

Banking regulators could take adverse action against the Corporation or its banking subsidiaries as a result of the restatement.

The Corporation is subject to supervision and regulation by the Board of Governors of the Federal Reserve System. The Corporation is a bank holding company that qualifies as a financial holding corporation. As such, the Corporation is permitted to engage in a broader spectrum of activities than those

permitted to bank holding companies that are not financial holding companies. To continue to qualify as a financial holding corporation, each of the Corporation s banking subsidiaries must continue to qualify as well capitalized and well managed. As of December 31, 2004, after giving effect to the restatement, the Corporation and its banking subsidiary continue to satisfy all applicable capital guidelines. This, however, does not prevent banking regulators from taking adverse actions against the Corporation or its banking subsidiaries as a result of the restatement or related internal control matters. If the Corporation were not to continue to qualify as a financial holding corporation, it might be required to discontinue certain activities and may be prohibited from engaging in new activities without prior regulatory approval.

Federal banking regulators, in the performance of their supervisory and enforcement duties, have significant discretion and power to initiate enforcement actions for violations of laws and regulations and unsafe or unsound practices. Failure of the Corporation or FirstBank to remain in compliance with the terms of the Consent Orders could result in the imposition of cease and desist orders and/or in money penalties.

Downgrades in the Corporation s credit ratings could potentially increase the cost of borrowing funds.

Following the Corporation s announcement on October 21, 2005 that the SEC issued a formal order of investigation, the major rating agencies downgraded the Corporation s and FirstBank s ratings in a series of actions. Fitch lowered the Corporation s long-term senior debt rating from BBB- to BB and placed the rating on Rating Watch Negative. S&P lowered the long-term senior debt and counterparty rating of FirstBank, from BBB- to BB+ and placed the rating on Credit Watch Negative. Moody s lowered FirstBank s long term senior debt rating from Baa3 to Ba1 and placed the rating on negative outlook. These or further downgrades may adversely affect the Corporation s and FirstBank s ability to access capital and will likely result in more stringent covenants and higher interest rates under the terms of any future indebtedness.

The Corporation s liquidity is contingent upon its ability to obtain external sources of funding to finance its operations. Downgrades in credit ratings can hinder the Corporation s access to external funding and/or cause external funding to be more expensive, which could in turn adversely affect the results of operations.

These debt and financial strength ratings are current opinions of the rating agencies. As such, they may be changed, suspended or withdrawn at any time by the rating agencies as a result of changes in, or unavailability of, information or based on other circumstances.

Management has identified several material weaknesses in the Corporation s internal control over financial reporting.

The Corporation s management has concluded that the Corporation s internal control over financial reporting was not effective at December 31, 2004 as a result of several material weaknesses described in this Amended Form 10-K. In addition, this report includes an adverse opinion from PricewaterhouseCoopers LLP, the Corporation s independent registered public accounting firm, on management s assessment of the Corporation s internal controls over financial reporting.

A discussion of the material weaknesses that have been identified by management can be found in Item 9A of Part II of this Amended Form 10-K. The Corporation is in the process of remediating the material weakness identified. Management believes that the material weaknesses relating to Accounting for Purchases of Mortgage-Related Transactions and Accounting for Derivatives have been fully remediated.

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There is a lack of public disclosure concerning the Corporation.

The Corporation has not yet filed with the SEC its quarterly reports on Form 10-Q for the fiscal quarters ended June 30, 2005, September 30, 2005, March 31, 2006, and June 30, 2006 and annual report on Form 10-K for the year ended December 31, 2005. The Corporation expects to file these reports as soon as practicable after the filing of this Amended Form 10-K and Amended Form 10-Q for the quarter ended March 31, 2005. Until the Corporation files these quarterly and annual reports, there will be limited public information available concerning the Corporation s more recent results of operations and financial condition. Lack of public disclosure may have an adverse impact on First BanCorp s results of operations as a consequence of a decrease in confidence in First BanCorp s ability to implement its business plan.

Failure to comply with reporting covenants under debt arrangements may result in the acceleration of payment obligations.

Under certain debt instruments and notes, the Corporation is required to timely file its periodic reports with the appropriate counterparty holders. As a result of the restatement, the Corporation has not yet filed its quarterly reports on Form 10-Q for the fiscal quarters ended June 30, 2005, September 30, 2005, March 31, 2006 and June 30, 2006 (the Delayed Reports).

The Corporation is not currently in default as the counterparty holders either have extended or are expected to extend the timing required for the filing of the Delayed Reports. However, if the Corporation were to default on the filing of the delayed reports, the counterparty holders will have the right to accelerate the maturity of the debt arrangements and the Corporation may not be able to meet payment of the obligations nor refinance the debt.

The Corporation s reputation may be affected by the restatement.

The Corporation s ability to attract customers and investors may be adversely affected by the restatement and the risks and uncertainties it suggests, and may have an adverse effect on the Corporation s ability to attract and retain key employees and management personnel.

Risks Relating to the Corporation s Business

Fluctuations in interest rates may impact the Corporation s results of operations.

Increases in interest rates are the primary market risk affecting the Corporation. Interest rates are highly sensitive to many factors, such as governmental monetary policies and domestic and international economic and political conditions that are beyond the control of the Corporation.

Since the year 2004, interest rates have been increasing and this may negatively affect the following areas of the Corporation s business:

- The net interest income;
- The value of holdings of securities, including interest rate swaps; and
- the number of loans originated, particularly mortgage loans.

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Increases in Interest Rates May Reduce Net Interest Income.

Increases in short-term interest rates may reduce net interest income, which is the principal component of the Corporation s earnings. Net interest income is the difference between the amount received by the Corporation on its interest-earning assets and the interest paid by the Corporation on its interest-bearing liabilities. When interest rates rise, the Corporation must pay more in interest on its liabilities while the interest earned on its assets does not rise as quickly. This may cause the Corporation s profits to decrease.

Increases in Interest Rates May Reduce the Value of Holdings of Securities, including Interest Rate Swaps.

Fixed-rate securities and the undesignated interest rate swaps entered by the Corporation are generally subject to decreases in market value when interest rates rise, which would require recognition of a loss, thereby potentially affecting results of operations adversely.

Increases in Interest Rates May Reduce Demand for Mortgage and Other Loans.

Higher interest rates increase the cost of mortgage and other loans to consumers and businesses and may reduce demand for such loans, which may negatively impact the Corporation s profits by reducing the amount of loan origination income.

In addition, the Corporation s net interest margin may be negatively impacted by the excess liquidity from cash receipts from Doral and R&G for the repayment of secured loans to these institutions. The negative impact could be the result of reinvestment of proceeds in lower yielding assets and the timing of payment of brokered certificates of deposit as they mature.

The Corporation is subject to default risk on loans, which may adversely affect its results.

The Corporation is subject to the risk of loss from loan defaults and foreclosures with respect to the loans it originates. The Corporation establishes provisions for loan losses, which lead to reductions in its income from operations, in order to maintain its allowance for inherent loan losses at a level which is deemed appropriate by its management based upon an assessment of the quality of its loan portfolio. Although the Corporation s management utilizes its best judgment in providing for loan losses, there can be no assurance that management has accurately estimated the level of inherent loan losses or that the Corporation will not have to increase its provisions for loan losses in the future as a result of future increases in non-performing loans or for other reasons beyond its control. Any such increases in the Corporation s provisions for loan losses or any loan losses in excess of its provisions for loan losses would have an adverse effect on the Corporation s future financial condition and results of operations.

The Corporation s business concentration in Puerto Rico imposes higher risks.

The Corporation conducts its operations in a geographically concentrated area, as its main market is Puerto Rico. This imposes risks from lack of diversification in the geographical portfolio. The Corporation s financial condition and results of operations are highly dependent on the economic conditions in Puerto Rico, where adverse political or economic developments, natural disasters, etc. could affect the volume of loan originations, increase the level of nonperforming assets, increase the rate of foreclosure losses on loans, and reduce the value of the Corporation s loans and loan servicing portfolio. These factors could materially and adversely affect the Corporation s condition and results of operations. As a result of the reclassification of purchases of mortgage loans, the Corporation had substantial secured

loans to local financial institutions in the amount of $3.8 billion and $2.1 billion in 2004 and 2003, respectively.

First BanCorp is subject to risks associated with the Commonwealth of Puerto Rico s temporary budget crisis.

At December 31, 2004, the Corporation had investment securities amounting to $13.6 million in Puerto Rico Government and agencies held-to-maturity with aggregate unrealized gross gains of $886 thousand that are one notch below investment grade. Due to a budget impasse, the Commonwealth of Puerto Rico (the Commonwealth) closed all public agencies on May 1, 2006, except those related to safety, health and other essential services. All agencies were subsequently opened two weeks later and a budget approval by the Legislature and signed into law by the Governor, Aníbal Acevedo Vilá. Subsequently, Moody s Investors Service downgraded the Commonwealth s general obligation bond rating to Baa3 from Baa2, and kept the rating on Watchlist for possible further downgrade.

According to Moody s, this action reflects the Commonwealth s strained financial condition, and ongoing political conflict and lack of agreement regarding the measures necessary to end the government s multi-year trend of financial deterioration. A fiscal reform has been recently approved, however, significant budget deficits and fiscal imbalance could continue in the coming years.

The Corporation s business activities and credit exposure have historically been concentrated in Puerto Rico. Accordingly, the Corporation s financial condition and results of operations are dependent to a significant extent upon the economic conditions prevailing in Puerto Rico. Any significant adverse political or economic developments in Puerto Rico resulting from the budget impasse, or otherwise, could have a negative impact on the Corporation s future financial condition and results of operations.

Changes in regulations and legislation could have a financial impact on First BanCorp

As a financial institution, the Corporation is subject to the scrutiny of various regulatory and legislative bodies. Any change in regulations and/or legislation, whether in the United States or Puerto Rico, could have a financial impact on the results of operations of the Corporation.

Item 3. Legal Proceedings

During 2005, the Corporation became subject to various legal proceedings, including regulatory investigations and civil litigation, as a result of the restatement. For information on these proceedings, see Subsequent Events Governmental Action and Subsequent Events Private Litigation , above.

Additionally, the Corporation and its subsidiaries are defendants in various lawsuits arising in the ordinary course of business. In the opinion of the Corporation s management, except as described above, the pending and threatened legal proceedings of which management is aware will not have a material adverse effect on the financial condition or results of operations of the Corporation.

PART II

Item 5. Market for Registrant s Common Equity and Related Stockholder Matters and Issuer Purchases of Equity Securities

Market and Holders Information

The Corporation s common stock is traded on the New York Stock Exchange (the NYSE) under the symbol FBP. On December 31, 2004, there were 630 holders of record of the Corporation s common stock.

The following table sets forth the high and low prices of the Corporation s common stock for the periods indicated as reported by the NYSE. This table does not reflect the effect of the June 2005 stock split.

Quarter ended	High	Low	Last
2004:			
December	$64.85	$47.30	$63.51
September	49.85	39.62	48.30
June	42.67	35.14	40.75
March	43.32	39.00	41.60
2003:			
December	$40.32	$31.24	$39.55
September	31.98	28.35	30.75
June	31.68	27.45	27.45
March	28.00	22.71	26.98
2002:			
December	$26.38	$22.08	$22.60
September	27.61	22.82	25.41
June	25.13	19.13	25.13
March	19.80	18.43	19.27

First BanCorp has five outstanding series of non convertible preferred stock: 7.125% noncumulative perpetual monthly income preferred stock, Series A (liquidation preference $25 per share), 8.35% noncumulative perpetual monthly income preferred stock, Series B (liquidation preference $25 per share), 7.40% noncumulative perpetual monthly income preferred stock, Series C (liquidation preference $25 per share), 7.25 % noncumulative perpetual monthly income preferred stock, Series D (liquidation preference $25 per share), 7.00% noncumulative perpetual monthly income preferred stock, Series E (liquidation preference $25 per share) (collectively Preferred Stock), which trade on the NYSE.

On April 13, 2006, the Corporation notified the NYSE that, given the delay in the filing of the Corporation s 2005 Form 10-K, which required the postponement of the 2006 Annual Meeting of Stockholders, the Corporation was not going to distribute its annual report to shareholders by April 30, 2006. As a result, the Corporation is not in compliance with Section Rule 203.01, *Annual Report Requirement*, of the NYSE Listed Company Manual, which requires a listed company to distribute its annual report within 120 days after its fiscal year end.

The NYSE s Section 802.01E procedures apply to the Corporation given its failure to file the Form 10-K for the fiscal year ended December 31, 2005, which the NYSE explained in a letter dated April 3, 2006. These procedures contemplate that the NYSE will monitor a company that has not timely

filed a Form 10-K. If the company does not file its annual report within six months of the filing due date, the NYSE may, in its sole discretion, allow the company s securities to be traded for up to an additional six months depending on the company s specific circumstances. If the NYSE determines that an additional trading period of up to six months is not appropriate, suspension and delisting procedures will be commenced. If the NYSE determines that an additional trading period of up to six months is appropriate and the company fails to file its annual report by the end of that additional period, suspension and delisting procedures will generally commence. The procedures provide that the NYSE may commence delisting proceedings at any time. The Corporation expects to file its 2005 Form 10-K within the six months after its filing due date.

Dividends

The Corporation has a policy providing for the payment of quarterly cash dividends on its outstanding shares of common stock. Accordingly, the Corporation declared a cash dividend of $0.12 per share for each quarter of 2004, $0.11 per share for each quarter of 2003 and $0.10 per share for each quarter of 2002. See the discussion under Dividend Restrictions under Item 1 for additional information concerning restrictions on the payment of dividends that apply to the Corporation and FirstBank.

The Puerto Rico Internal Revenue Code requires the withholding of income tax from dividend income derived by resident U.S. citizens, special partnerships, trusts and estates and by non-resident U.S. citizens, custodians, partnerships, and corporations from sources within Puerto Rico.

Resident U.S. Citizens

A special tax of 10% is imposed on eligible dividends paid to individuals, special partnerships, trusts, and estates to be applied to all distributions unless the taxpayer specifically elects otherwise. Once this election is made it is irrevocable. However, the taxpayer can elect to include in gross income the eligible distributions received and take a credit for the amount of tax withheld. If he does not make this election in his tax return, then he can exclude from his gross income the distributions received and reported without claiming the credit for the tax withheld.

Nonresident U.S. Citizens

Nonresident U.S. citizens have the right to certain exemptions when a Withholding Tax Exemption Certificate (Form 2732) is properly completed and filed with the Corporation. The Corporation as withholding agent is authorized to withhold a tax of 10% only from the excess of the income paid over the applicable tax-exempt amount.

U.S. Corporations and Partnerships

Corporations and partnerships not organized under Puerto Rico laws that have not engaged in trade or business in Puerto Rico during the taxable year in which the dividend is paid are subject to the 10% dividend tax withholding. Corporations or partnerships not organized under the laws of Puerto Rico that have engaged in trade or business in Puerto Rico are not subject to the 10% withholding, but they must declare the dividend as gross income on their Puerto Rico income tax return.

Equity Compensation Plan Disclosure

The following summarizes equity compensation plans approved by security holders and equity compensation plans that were not approved by security holders as of December 31, 2004:

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Plan category	(A) Number of Securities to be Issued Upon Exercise of Outstanding Options	(B) Weighted-Average Exercise Price of Outstanding Options		(C) Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (A))
Equity compensation plans approved by stockholders:				
Stock Option Plans	2,394,030	$	22.60	1,401,374
Sub-total	2,394,030	$	22.60	1,401,374
Equity compensation plans not approved by stockholders	N/A		N/A	N/A
Total	2,394,030	$	22.60	1,401,374

Sales of Unregistered Securities

Prior to its filing on September 8, 2004 of a Registration Statement on Form S-8 (SEC File 333-118853) (the Registration Statement) registering under the Securities Act of 1933 (the 1933 Act), the shares of the Corporation acquired through the exercise of stock options under the Corporation s Stock Option Plan, which covers certain employees of the Corporation and its subsidiaries, the shares previously acquired by such employees had not been registered with the Securities and Exchange Commission under the 1933 Act on the basis of the exemption provided in section 3(a)(11) thereof. The Corporation understands that this exemption was applicable for the period prior to the filing of the Registration Statement because: (i) it is a corporation organized under the laws of the Commonwealth of Puerto Rico whose principal office and place of business are located in the Commonwealth of Puerto Rico; and (ii) all employees that had exercised options to acquire shares were residents of the Commonwealth of Puerto Rico. The number of shares of common stock acquired under the Corporation s Stock Option Plan for the period from January 1, 2004 to September 7, 2004 was 225,370 (72,750 for the year ended December 31, 2003) at a weighted average exercise price per option of $12.05 ($15.43 for the year ended December 31, 2003). In accordance with applicable rules of the SEC, the Registration Statement became effective upon its filing on September 8, 2004, and therefore all shares acquired pursuant to the Corporation s Stock Option Plan after such date are registered shares under the 1933 Act.

During the quarter and year ended December 31, 2004 the Corporation did not repurchase any of its securities.

Item 6. Selected Financial Data

The following table presents consolidated financial and operating information for the Corporation as of the dates indicated. This information should be read in conjunction with the financial statements and the notes thereto. As described in Note 1 to the audited consolidated financial statements and in Item 7 of this Amended Form 10-K, the financial data for 2000 to 2004 has been restated.

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SELECTED FINANCIAL DATA (3)
(In thousands except for per share and financial ratios results)

	2004 (As Restated)	2003 (As Restated)	2002 (As Restated)	2001 (As Restated)	2000 (As Restated)
Condensed Income Statements: Year ended					
Total interest income	$ 690,334	$ 549,466	$ 550,107	$ 526,841	$ 474,411
Total interest expense	292,853	297,528	235,575	292,067	272,615
Net interest income	397,481	251,938	314,532	234,774	201,796
Provision for loan losses	52,800	55,915	62,302	61,030	45,719
Other income	59,624	106,798	48,785	40,773	37,725
Other operating expenses	180,480	164,630	132,811	120,522	112,395
Income before income tax provision, and cumulative effect of accounting change	223,825	138,191	168,204	93,995	81,407
Provision for income tax	46,500	18,297	35,342	15,002	14,726
Income before cumulative effect of accounting change	177,325	119,894	132,862	78,993	66,681
Cumulative effect of accounting change				(1,015)	
Net income	177,325	119,894	132,862	77,978	66,681
Per Common Share Results (1): Year ended					
Income before cumulative effect of accounting change diluted	$ 3.30	$ 2.18	$ 2.63	$ 1.56	$ 1.46
Cumulative effect of accounting change				(0.03)	
Net income per common share diluted	$ 3.30	$ 2.18	$ 2.63	$ 1.53	$ 1.46
Net income per common share basic	$ 3.41	$ 2.24	$ 2.67	$ 1.54	$ 1.47
Cash dividends declared	$ 0.48	$ 0.44	$ 0.40	$ 0.35	$ 0.29
Average shares outstanding	40,209	39,994	39,901	39,851	40,415
Average shares outstanding diluted	41,505	40,983	40,553	40,144	40,718
Balance Sheet Data: End of year					
Loans and loans held for sale	$ 9,697,994	$ 7,041,056	$ 5,635,023	$ 4,306,963	$ 3,496,439
Allowance for possible loan losses	141,036	126,378	111,911	91,060	76,919
Investments	5,598,601	5,367,823	3,728,669	3,827,481	2,233,216
Total assets	15,637,045	12,679,042	9,625,110	8,331,382	5,919,587
Deposits	7,912,322	6,771,869	5,445,714	4,100,233	3,345,984
Borrowings	6,300,573	4,634,237	3,238,369	3,414,236	2,064,334
Total common equity	654,233	523,722	455,522	326,379	268,184
Total equity	1,204,333	1,073,822	816,022	594,879	433,184
Book value per common share	16.20	13.08	11.40	12.28	10.15
Selected Financial Ratios (In Percent): Year ended					
Net income to average total assets	1.30	1.15	1.51	1.16	1.27

Net income to average total equity	15.73	13.31	18.63	14.80	21.07
Net income to average common equity	23.75	18.21	29.49	19.83	27.62
Average total equity to average total assets	8.28	8.64	8.11	7.84	6.05
Dividend payout ratio	14.10	19.66	15.00	22.51	19.92
Efficiency ratio (2)	39.48	45.89	36.56	43.74	46.93
Common Stock Price: End of year	$ 63.51	$ 39.55	$ 22.60	$ 19.00	$ 15.75
Offices:					
Number of full service branches	57	54	54	48	48

1- Amounts presented were recalculated, when applicable, to retroactively consider the effect of the September 30, 2002 common stock split.

2- Other operating expenses to the sum of net interest income and other income.

3- Periods from 2000 to 2004 were restated from previously reported amounts.

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Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations

MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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

Restatement of Previously Issued Financial Statements

The net cumulative effect of the restatement through December 31, 2004 was a decrease in the Corporation s retained earnings and legal surplus of $17.1 million, which includes a cumulative decrease of $9.1 million for the 2004, 2003 and 2002 periods and $8.0 million related to periods prior to 2002. Of the $17.1 million cumulative decrease in retained earnings and legal surplus through December 31, 2004, approximately $15.1 million, represents non-cash adjustments to correct the accounting for interest rate swaps and for the placement fees paid upon issuance to brokers selling the related hedged financial instruments (broker placement fees), as a result of the misapplication of the short-cut method of hedge accounting under SFAS 133 (the short-cut method).

The cumulative decrease in income tax expense resulting from the restatement amounted to $8.4 million through December 31, 2004, which includes a cumulative decrease in the Corporation s income tax expense of $2.8 million for the 2004, 2003 and 2002 periods, and a cumulative decrease of $5.6 million for periods prior to 2002. The decrease results mainly from deferred tax benefits arising from non-cash valuation adjustments relating to the interest rate swaps now reflected in the restated net income.

The restatement also resulted in a decrease in the Corporation s stockholders equity of $18.6 million and an increase in Tier 1 capital of $4.1 million or -1.52% and 0.31%, respectively, as of December 31, 2004, compared to previously reported results.

Background to Restatement

The financial statements included in this Amended Annual Report on Form 10-K/A for the fiscal year ended December 31, 2004 have been restated primarily as a result of the Audit Committee s review of the accounting treatment of certain mortgage-related transactions that the Corporation entered into with two financial institutions between 1999 and 2005 and of interest rate swaps that economically hedge the interest rate risk related to the fixed interest rate on the Corporation s outstanding brokered certificates of deposit (brokered CDs) and certain medium term notes (medium-term notes). The Corporation had previously reflected mortgage-related transactions with Doral Financial Corp. (Doral) and subsidiaries of R&G Financial Corp. (referred to collectively as R&G) as purchases in bulk of mortgage loans and pass-through trust certificates (the mortgage-related transactions) by the Corporation s subsidiary, FirstBank Puerto Rico (FirstBank or the Bank), and had used the short-cut method of accounting to account for the interest rate swaps. The restated financial statements reflect the mortgage-related transactions as commercial loans secured by mortgage loans and pass-through trust certificates and recognize the impact of changes in the market value of the interest rate swaps without offsetting adjustments to the related hedged items. The other matters that are reflected in the restatement were identified by the Corporation s management, which began an internal review of the Corporation s books, records, and accounting practices under the oversight of the Audit Committee and with the assistance of outside consultants following the commencement of the Audit Committee s review of the mortgage-related transactions.

The Corporation first announced the Audit Committee s review in a Form 12b-25 filed with the Securities and Exchange Commission (SEC) on August 10, 2005 reporting that the Corporation was unable to file its Form 10-Q for the quarter ended June 30, 2005. The Audit Committee decided to undertake this review after discussions with the Corporation s

independent registered public accounting firm. To assist it in the review of the mortgage-related transactions, the Audit Committee engaged as independent counsel the law firms of Martínez Odell & Calabria and Clifford Chance U.S. LLP, which retained forensic accountants FTI Consulting Inc.

The Audit Committee s principal areas of review relevant to the restatement of the Corporation s restated financial statements reflected in this Amended Annual Report on Form 10-K/A were (1) whether the Corporation should have recognized any of the mortgage-related transactions as commercial loans made by FirstBank to the sellers of the mortgage loans and pass-through trust certificates, which were secured by mortgages, rather than as purchases of mortgage loans and pass-through trust certificates under Statement of Financial Accounting Standards (SFAS) No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities a replacement of FASB Statement No. 125 (SFAS 140); and (2) whether the Corporation properly applied SFAS No. 133, as amended, Accounting for Derivative Instruments and Hedging Activities (SFAS 133), in accounting for the interest rate swaps that hedge its interest rate risk related mainly to the fixed interest rate on the Corporation s outstanding brokered CDs and certain medium-term notes.

FirstBank began to enter into the mortgage-related transactions in November 1999. Between November 1999 and March 2005, FirstBank recognized approximately $4.5 billion of purchases of mortgage loans from Doral and approximately $1.0 billion of purchases of mortgage loans and pass-through trust certificates, which represented interests in grantors trusts that owned mortgages, from R&G. Most of the mortgage loans were residential mortgages. The balance of the mortgage loans were commercial mortgages.

The purchase prices for most of the mortgage loans and pass-through trust certificates were the principal amounts of the mortgage loans and the pass-through trust certificates. The written agreements for the mortgage-related transactions with Doral and R&G included recourse provisions. The agreements with Doral provided that Doral would either repurchase or substitute mortgages that became 120 days or more delinquent within the first 24-month period after the purchase, with a limit on the repurchase obligation related to commercial mortgage loans of no more than 10% of the principal amount of such commercial mortgage loans. The first few agreements executed with R&G stated that R&G would repurchase all delinquent mortgage loans, for an unspecified period of time. Thereafter, all of the R&G agreements provided that R&G guaranteed timely payment of principal and interest. Under some of the later agreements, R&G had the right to substitute mortgage loans and agreed to cover any losses in the event of foreclosures. In connection with the mortgage-related transactions, Doral and R&G retained the servicing on all of the mortgage loans at issue and agreed to remit to FirstBank scheduled principal payments and, with respect to most of the transactions, interest calculated at a variable rate, between 120 and 150 basis points over three-month LIBOR. Finally, with respect to each agreement with Doral and certain agreements with R&G, Doral and R&G had written options to repurchase the mortgage loans if the variable interest rate that they were required to pay FirstBank reached or exceeded an agreed upon interest rate relating to the underlying mortgage loans.

The Audit Committee s review identified evidence that Doral had agreed orally and in emails to extend the recourse provision beyond the 24-month period included in the written agreements to recourse for the duration of the mortgage loans involved in the mortgage-related transactions with FirstBank. The Audit Committee found that neither the existence nor the terms

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of the oral agreements and emails were documented in the Corporation s accounting records or communicated to the Corporation s independent registered public accounting firm by neither the former CEO, former CFO, former executive vice-president responsible for the retail and mortgage banking business, or the former Treasurer. In contrast to the oral agreements and emails with Doral to extend the recourse period, the written agreements with R&G included express recourse provisions for the lives of the underlying mortgage loans and pass-through trust certificates. In December 2004 with respect to a transaction with R&G, the Corporation requested and obtained an opinion of its outside counsel who opined that the particular transaction with R&G constituted a true sale.

In October 2005, Martínez Odell & Calabria, upon its review of the matter, issued an opinion stating that the purchase of mortgage loans from R&G were not true sales principally because of the applicable recourse provisions. Thereafter, after considering the impact of the agreements that Doral made orally and in emails to extend recourse beyond the 24-month period included in the written agreements, Martínez Odell & Calabria rendered an opinion in December 2005 that the mortgage-related transactions with Doral were not true sales principally in light of the full recourse nature of the mortgage-related transactions. Based upon these opinions, the Audit Committee and the Board concluded that the mortgage-related transactions with Doral and R&G were not true sales but, rather, commercial loans secured by mortgages and pass-through certificates.

Management and the Audit Committee also reviewed the accounting for the Corporation s interest rate swaps. The review of the accounting for the interest rate swaps was prompted by the receipt of an SEC comment letter dated August 11, 2005 relating to the 2004 Form 10-K and the March 31, 2005 Form 10-Q of the Corporation. SFAS 133 permits the use

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of the short-cut method of accounting for certain hedging relationships when the strict technical requirements for the use of the method are met, including the necessary documentation of the hedge positions. When those strict requirements are not met, a company is not entitled to assume that the changes in the fair value of a hedged item exactly offset the changes in the value of the related derivative but can instead implement the long-haul method under SFAS 133, under which the effectiveness of the hedging relationship is evaluated on an ongoing basis and the changes in the fair value of the derivative and related hedged item are calculated independently.

Since it first implemented SFAS 133 on January 1, 2001, the Corporation had used the short-cut method to account for interest rate swaps that hedged its interest rate risk related mainly to the fixed interest rate on the Corporation s outstanding brokered CDs and certain medium-term notes. Although the Corporation had received upfront payments from the interest rate swap counterparties, management had believed that the existence of terms in the interest rate swaps that mirrored the terms of the respective hedged instruments, together with substantially complete short-cut method hedge documentation prepared at the time of issuing the interest rate swaps, entitled it to use the short-cut method.

Management, the Audit Committee and the Board concluded that the Corporation had misapplied the short-cut method of accounting under SFAS 133. They reached this conclusion after a discussion of the issue with the Corporation s independent registered public accounting firm. In this regard, the Corporation has determined that the particular interest rate swaps did not qualify for the short-cut method in prior periods because the related upfront payments caused the swap not to have a fair value of zero at inception, which is required by SFAS 133 to qualify for the short-cut method.

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On December 13, 2005, the Corporation issued a press release announcing its conclusions relating to the mortgage-related transactions with Doral and its determination to restate its financial statements to correct the accounting for the mortgage-related transactions as well as the interest rate swaps accounted for under the short-cut method. The Corporation explained that the restatement would require it to classify the mortgage-related transactions as secured commercial loans and to reflect the changes in the fair value of the interest rate swaps as gains or losses in the income statement with no offsetting adjustments to the hedged items.

On March 17, 2006, the Corporation announced that Martínez Odell & Calabria had concluded that the pass-through trust certificates acquired from R&G were not true sales.

The restatement included in this Amended Annual Report on Form 10-K/A for the fiscal year ended December 31, 2004 also reflects various other less significant adjustments. A description of all of the matters reflected in the restatement is set forth in Note 1 to the Consolidated Financial Statements in this Amended Annual Report on Form 10-K/A.

Certain Additional Matters Reviewed by the Audit Committee

During its review of the mortgage-related transactions, the Audit Committee also considered whether the uncapped variable interest rate feature that enables FirstBank to receive interest from Doral and R&G under the terms of some of the mortgage-related transactions created a derivative under SFAS 133. The Corporation s written agreements entered into with Doral beginning in October 2003 and R&G beginning in December 2004 provided that the variable interest rate would not exceed the weighted average coupon (WAC) on the related mortgage loans. None of the prior written agreements with Doral and none of the prior written agreements with R&G that provided for variable interest rates contained a written cap on the variable interest rate to be paid to FirstBank.

The issue whether the variable interest rate feature created a derivative was not relevant to the ultimate accounting treatment of the mortgage-related transactions in this restatement because SFAS 133 would have applied to the variable interest rate feature only if the mortgage loans and pass-through trust certificates had been purchased, and the Audit Committee concluded that the mortgage-related transactions were not purchases. Therefore, the restatement does not include any adjustment relating to the variable interest rate feature associated with the mortgage-related transactions. However, in the course of its review of this issue the Audit Committee discovered certain inappropriate conduct by certain former members of senior management, as described below.

In or about November of 2004, in an effort to avoid accounting for a derivative created by the uncapped variable interest rate feature associated with the mortgage-related transactions with Doral and R&G , the former CEO, former CFO, and an executive vice-president who was responsible for the retail and mortgage banking business who resigned from the Corporation in the Spring of 2005, inappropriately created documents intended to make it appear to the Corporation s independent registered public accounting firm that such documents were created at the inception of the mortgage-related transactions that involved the variable interest rate feature (the hedge documentation) in order to comply with the requirement in SFAS 133. The Corporation s independent registered public accounting firm did not agree that hedge accounting could be used to account for the uncapped variable interest rate feature.

In a further effort to avoid accounting for a derivative, the former CEO and former CFO asserted to the Corporation s independent registered public accounting firm that the parties to the mortgage-related transactions had agreed orally at the time of the original negotiation of the mortgage-related transactions that the variable interest rates provided for in the agreements were

in fact capped at the WAC of the related mortgage loans. At the request of the independent registered public accounting firm this assertion was confirmed in writing with the counterparties. The written confirmations were executed by the former CEO, the former CFO, and the former executive vice-president responsible for the retail and mortgage business and by executives of R&G and Doral. Based on the foregoing and the receipt by the Corporation of a legal opinion issued by its outside counsel that oral agreements were enforceable under Puerto Rico law, management took the position that the variable interest rate feature did not create a derivative. The Corporation s independent registered public accounting firm concurred with management s position based upon its audit work, certain oral representations which were incorporated in the written confirmations (which were subsequently determined to have been inaccurate and false), the legal opinion and a certification from the former CEO and former CFO to the Corporation s independent registered public accounting firm, which also contained inaccurate statements.

In or about March 2005, the Corporation s prior outside counsel learned about the creation of the hedge documentation and prompted the former General Counsel to look into the matter. In response, the former General Counsel conducted an internal review of the propriety of the creation of the hedge documentation. The former General Counsel failed to advise the Audit Committee or the Board about the concerns regarding the creation of the hedge documentation or about the results of her review, notwithstanding the provisions of the Audit Committee s whistleblower procedures. These procedures, which implement the requirement in Rule 10A-3(b)(3) under the Securities Exchange Act of 1934, as amended, that the Audit Committee establish procedures for the receipt, retention, and treatment of complaints regarding accounting, internal accounting controls, or auditing matters and the confidential, anonymous submission by employees of concerns regarding questionable accounting or auditing matters and are set forth in

a document entitled Employee Complaint Procedures for Accounting and Auditing Matters, and require that any complaints or concerns regarding accounting, internal accounting controls, or auditing matters be reviewed under the Audit Committee s direction.

As a result of these findings, the Audit Committee recommended that the Board seek the resignations of the former CEO and former CFO. The Audit Committee made this recommendation because of the Audit Committee s conclusion that the former CEO, former CFO and former executive vice-president had acted improperly with respect to the mortgage-related transactions, as described above. In addition, the Audit Committee concluded that the former CEO may have falsely reported to the Board that the Corporation s outside derivatives consultant had told the former CEO and former CFO to prepare the hedge documentation.

By press release dated September 30, 2005, the Corporation announced that the former CEO had stepped down from his management positions on that same date and was retiring as Chairman of the Board as of December 31, 2005, and that the former CFO had resigned from her positions as CFO and director also as of September 30, 2005 and was retiring as of October 31, 2005. In addition, the Corporation announced the election of the present CEO and chief operating officer (COO), who also became directors, and the appointment of an interim CFO.

Subsequently, the Corporation terminated the former General Counsel on October 25, 2005 based on her conduct in connection with her internal review and for subsequent related conduct. Also, the former Treasurer of the Corporation, who was involved in the negotiations with respect to some of the mortgage-related transactions, resigned from the Corporation on August 11, 2006 upon recommendation of the Board of Directors.

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The internal review conducted by the Corporation also included evaluations of, among other matters:

- the accounting for loan sales and purchases;
- the accounting for derivative instruments and investment securities;
- the accounting for and the recognition and deferral of loan origination fees and costs;
- the accounting for placement fees on brokered certificates of deposit;
- the accounting for rent expense under operating leases;
- the accounting for finance leases;
- the assumptions and methodology followed for core deposit intangibles;
- the accounting for premiums and discounts on investments;
- the methodology for determining the provision for loan and lease losses;
- the evaluation of other-than-temporary impairments on the Corporation s investment portfolio;
- the appropriate identification of and financial statement disclosures about industry segments;
- the evaluation of certain accounting estimates;
- the accounting for contingencies; and
- the materiality of previously identified immaterial unrecorded accounting adjustments.

The Corporation s management understands that the scope of the Audit Committee s and management s internal review procedures was sufficient to identify the issues of material nature that could affect the Corporation s consolidated financial statements. The ongoing SEC investigation, however, could result in the Corporation having to amend its public disclosures further.

Internal Control over Financial Reporting

As part of the internal review, the Corporation s management, including the current CEO and the CFO, evaluated the effectiveness of the Corporation s internal control over financial reporting as of December 31, 2004 and concluded that the Corporation s internal control over financial reporting was not effective as of December 31, 2004.

During the reassessment process, the Corporation also initiated an analysis of the key factors that contributed to the need for restatement of the Corporation s financial statements. The review was conducted under the supervision of the Audit Committee and management to improve the internal control environment surrounding the financial reporting process. For additional information regarding the review of internal control over financial reporting and management s conclusion that there are material weaknesses in internal controls, along with the remediation plan to address each weakness in the internal controls over financial reporting, see Item 9A Controls and Procedures in this Amended Form 10-K.

Summary of Restatement Results

The following table summarizes the key results of the restatement for each of the five years ending December 31, 2004.

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Restated Net Income for the Five Years Ended December 31, 2004:

	Net Income (in thousands)			Diluted Earnings Per Common Share (in dollars)			Stockholders Equity (in thousands)		
Year Ended December 31,	As Previously Reported	As Restated	Change (%)	As Previously Reported	As Restated	Change (%)	As Previously Reported	As Restated	Change (%)
2004	$178,878	$177,325	-1%	$3.34	$3.30	-1%	$1,222,911	$1,204,333	-2%
2003	$152,338	$119,894	-21%	$2.98	$2.18	-27%	$1,089,569	$1,073,822	-1%
2002	$107,956	$132,862	23%	$2.01	$2.63	31%	$ 798,424	$ 816,022	-2%
2001	$ 86,001	$ 77,978	-9%	$1.73	$1.53	-12%	$ 602,919	$ 594,879	-1%
2000	$ 67,276	$ 66,681	-1%	$1.47	$1.46	-1%	$ 434,461	$ 433,184	0

The Corporation s restated net income reflects a decrease or increase from previously reported earnings for certain periods, as well as an increased volatility from quarter to quarter when compared to previously reported earnings. The changes in restated net income from 2000 through 2004 reflect primarily the correction to the accounting for the interest rate swaps that hedge brokered CDs and the amortization of broker placement fees, which mirrored the up-front fees received from swap counterparties. The need for these adjustments resulted from the conclusion that hedge accounting under the short-cut method of SFAS 133 was not appropriate. There was no adjustment to net income related to the mortgage-related transactions.

Effects of Restatement on Balance Sheet and Regulatory Capital

The Corporation s restated balance sheet primarily reflects a revised classification of mortgage loans and investment securities and a decrease in retained earnings. The Corporation s total loans as restated, mainly reflect a significant increase in commercial loans secured by real estate mortgages and a corresponding decrease in residential real estate loans and investment securities. These changes resulted from the revised classification of the mortgage-related transactions as secured commercial loans to Doral and R&G, rather than as residential, commercial mortgages and pass-through trust certificates, because the mortgage-related transactions with Doral and R&G did not meet the provisions of SFAS 140 for sale accounting.

The net cumulative effect of the restatement through December 31, 2004 was a decrease to the Corporation s retained earnings and legal surplus of $17.1 million, which includes a cumulative decrease of $9.1 million for the 2004, 2003 and 2002 periods and $8.0 million related to periods prior to 2002. The cumulative decrease in retained earnings is mainly attributable to the amortization of broker placement fees partially offset by changes in the fair value of interest rate swaps now reflected in the restated net income. Since hedges of brokered CDs did not qualify for hedge accounting under the short-cut method of SFAS 133, the previously recorded fair value adjustments to brokered CDs were eliminated and broker placement fees, which mirrored the up-front fees received from swap counterparties, are now separately recorded as a deferred cost on the brokered CDs and amortized over their expected maturities as a yield adjustment. For additional information regarding the interest rate swaps and other items adjusted in this restatement, please refer to Note 1 Restatement of Previously Issued Financial Statements to the audited consolidated financial statements.

As of December 31, 2004, 2003 and 2002 and after giving effect to the restatement, the Corporation and FirstBank were in compliance with all the regulatory capital requirements that were applicable to them as a financial holding corporation and state non-member bank, respectively (i.e., total capital and Tier 1 capital to risk-weighted assets of at least 8% and 4%, respectively, and Tier 1 capital to

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average assets of at least 4%). The Corporation s banking subsidiary, FirstBank, is considered to be well-capitalized, within the meaning established by the FDIC. Set forth in the tables below are the Corporation s and FirstBank s regulatory capital ratios (as previously reported and restated) as of the end of 2004, 2003 and 2002, based on existing Federal Reserve and FDIC guidelines and the cumulative decrease of retained earnings through December 31, 2004 for the Corporation.

	As of December 31,		
	2004	**2003**	**2002**
Regulatory capital ratios (as previously reported)			
Total Capital:			
First BanCorp	14.89%	15.22%	13.75%
FirstBank	12.28%	13.49%	12.50%
Tier 1 Capital:			
First BanCorp	13.57%	13.65%	11.90%
FirstBank	11.03%	12.00%	10.68%
Leverage Ratio:			
First BanCorp	9.25%	8.35%	7.35%
FirstBank	7.50%	7.38%	6.62%
Regulatory capital ratios (as restated)			
Total Capital:			
First BanCorp	12.83%	13.78%	13.55%
FirstBank	10.60%	12.23%	12.39%
Tier 1 Capital:			
First BanCorp	11.62%	12.24%	11.76%
FirstBank	9.44%	10.78%	10.63%
Leverage Ratio:			
First BanCorp	9.26%	8.41%	7.85%
FirstBank	7.51%	7.44%	7.12%

Summary of Accounting Adjustments by Category

The Corporation has classified the accounting practices and related adjustments that were affected by the restatement into the categories described below. For a more detailed description of the accounting adjustments by category, see Note 1 Restatement of Previously Issued Financial Statements to the Corporation s accompanying audited consolidated financial statements.

(In thousands)	Cumulative (Decrease) Increase of Retained Earnings and Legal Surplus through December 31, 2004	
Pre-tax restatement adjustments:		
Accounting for derivative instruments and broker placement fees	$	(26,333)
Accounting for investment securities		3,483
Accounting for fees, costs, premiums and discounts on loans		(2,430)
Other adjustments		(191)
Total pre-tax restatement adjustments		(25,471)
Income tax impact of restatement adjustments and re-evaluation of income taxes on previously reported amounts		8,387
Total retained earnings and legal surplus impact	$	(17,084)

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

Accounting for Derivative Instruments and Broker Placement Fees

The Corporation uses derivative instruments in the normal course of business, primarily to reduce its exposure to market risk (principally interest rate risk) stemming from various assets and liabilities. As part of the restatement process, the Corporation reviewed its accounting for derivative instruments and concluded that its use of the short-cut method of hedge accounting under SFAS 133 for interest rate swaps that economically hedge mainly brokered CDs was not consistent with generally accepted accounting principles in the United States.

Since the 1990 s, the Corporation has entered into interest rate swaps to hedge the interest rate risk inherent mainly in certain of its brokered CDs. The Corporation believes that using interest rate swaps to convert the interest expense on brokered CDs from fixed to variable is prudent from an asset liability management standpoint. The brokered CDs are typically structured with terms of more than one year depending on the interest rate scenario and with a call option on the Corporation s part, but no surrender option for the CD holder, other than upon the death of the holder. The extended term of the brokered CDs minimizes liquidity risk while the Corporation s option to call the CDs provides funding flexibility. 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 to variable rates, therefore, reducing the Corporation s sensitivity to interest rate changes. The Corporation considers that economically these hedges have fulfilled and continue to fulfill their intended results.

Since the Corporation first implemented SFAS 133 on January 1, 2001, it applied a method of fair value hedge accounting to account for the brokered CD swaps that resulted in the Corporation assuming no ineffectiveness in these transactions (i.e., the short-cut method). The Corporation has now concluded that the interest rate swaps hedging the brokered CDs did not qualify for the short-cut method because the fee received from the swap counterparty at inception of the relationship caused 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). Furthermore, although historical effectiveness testing performed in December 2005 demonstrated that the brokered CD swaps would have qualified for hedge accounting under the long-haul method, hedge accounting under SFAS 133 is not allowed retrospectively because the hedge documentation required for the long-haul method was not in place at the inception of the hedge. The documentation at the inception of the hedges was intended to support the use of the short-cut method.

The short-cut method allows a company to record the effective portion of the change in fair value of the hedged item (in this case, the brokered CDs) as an adjustment to income that offsets the fair value

adjustment on the related interest rate swaps. Eliminating the application of fair value hedge accounting reverses the fair value adjustments that were made to the brokered CDs. Therefore, while the interest rate swap is recorded on the consolidated balance sheet at its fair value, the related hedged item, the brokered CD, is required to be carried at cost. In addition, the broker placement fees, which mirrored the up-front fees received from swaps counterparties, are now separately recorded as a deferred cost within the brokered CDs and amortized through the expected maturities of the related brokered CDs as a yield adjustment using the effective interest method. Previously, the placement fees were offset with the upfront fees received from the swap counterparties at inception with no separate accounting recognition.

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. The accounting consequences of that conclusion are similar to the accounting consequences discussed above relating to the accounting for brokered CD swaps. In this case, eliminating the application of fair value hedge accounting reverses the fair value adjustments that were made to the medium-term notes, corporate bonds and to the loans receivable.

The net cumulative pre-tax effect related to the correction of the accounting for interest rate swaps and the amortization of broker placement fees, as a result of the misapplication of the short-cut method of accounting under SFAS 133 is $26.3 million as of December 31, 2004. In summary, the cumulative adjustments mainly represent the effect 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 the interest rate swaps as of the end of each reporting period.

The following table details the components of the pre-tax cumulative effect from the correction in the accounting for interest rate swaps and broker placement fees:

(In thousands)		**Cumulative (Decrease) Increase of Retained Earnings Through December 31, 2004**
Elimination of fair value adjustments previously made to hedged items	$	(42,403)
Recognition of interest rate swap up-front fees		78,030
Broker placement fees amortization		(38,570)
Corrections to interest rate swap valuations		(23,390)
Total pre-tax retained earnings impact	$	(26,333)

At December 31, 2004, the cumulative broker placement fees mainly paid to brokered CDs and medium-term notes counterparties, which mirrored the up-front fees received from swap counterparties, approximates $78.0 million of which approximately $39.5 million remain unamortized.

Changes in the fair value of interest rate swaps and the interest payments exchanged are recognized in earnings as interest income or interest expense depending upon whether it is an asset or liability that is being economically hedged.

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

On December 13, 2005, the Corporation announced that it had concluded that a substantial portion of mortgage-related transactions that FirstBank entered into with Doral and R&G since 1999 did not qualify as sales for accounting purposes. In addition, on March 17, 2006, the Corporation announced that all of the transactions related to pass-through trust certificates from R&G were not sales for accounting purposes and are now classified as secured commercial loans.

The incorrect accounting, in the case of transactions with R&G resulted from the fact written contracts included unlimited recourse that tainted the true sale characterization. Notwithstanding the clauses in the R&G contracts, the Corporation previously accounted for the transactions with R&G as purchases. In the case of Doral transactions, the revised classification resulted from the existence of oral and email agreements that extended the 24-month recourse period included in the associated written transaction agreements to recourse for the duration of the respective underlying mortgage loans. Neither the existence nor the terms of these oral agreements and emails were documented in the Corporation s accounting records or communicated to the Corporation s independent registered public accounting firm. Based on the above, these purchases did not satisfy the standard of SFAS 140 regarding the isolation of assets (true sale).

During the review of the mortgage-related transactions, management and the Audit Committee also considered whether the uncapped variable interest rate that the Corporation was entitled to receive from Doral and R&G under the terms of some of the mortgage-related transactions created a derivative under SFAS 133. This issue became not relevant to the ultimate accounting treatment of the mortgage-related transactions in the restatement because SFAS 133 would have applied to the variable interest rate feature only if the mortgage loans and pass-through trust certificates had been purchased, and management and the Audit Committee concluded that the mortgage related transactions were not purchases. As previously discussed however, the Audit Committee s review determined that there was improper conduct by certain former members of management in an effort to avoid treating the uncapped variable interest rate feature associated with the mortgage-related transactions with Doral and R&G as a derivative. See Background to the Restatement, above.

The mortgage-related transactions with Doral and R&G were reflected in the Corporation s previously issued financial statements as purchases of residential mortgages, commercial mortgage loans and pass-through trust certificates. This 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 $3.6 billion and $2.1 billion in mortgage-related loans to secured loans to local financial institutions as of December 31, 2004 and 2003, respectively and $224.5 million in pass-through trust certificates to secured loans to local financial institutions as of December 31, 2004. The recharacterization of the mortgage-related transactions with Doral and R&G did not impact the Corporation s retained earnings as of December 31, 2004.

Accounting for investment securities

The Corporation evaluated the methodology used for the amortization of premiums and discounts on investment securities. The Corporation previously amortized the premiums and discounts under the straight line method adjusted for prepayments of securities. As part of the restatement, the Corporation concluded that it needed to correct its methodology. Accordingly, the historical financial statements were adjusted to reflect the amortization of premiums and discounts on investments securities under the interest method. The cumulative effect of this correction on the Corporation s pre-tax income through December 31, 2004 was an increase to interest income on investments of $3.5 million, all of which relate to the periods of 2002, 2003 and 2004.

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 . The adjustments are presented in the restated Consolidated Statements of Financial Condition.

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 the standard 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

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cumulative effect of this correction on the Corporation s pre-tax income through December 31, 2004 was a decrease to interest income on loans of $2.4 million. This includes cumulative charges of $2 million for 2002, 2003 and 2004 and $441,336 for periods prior to 2002.

Other Accounting Adjustments and Reclassifications

In addition, to the adjustments described above, the Corporation has identified other accounting errors that require additional corrections and reclassifications. The accounting corrections relate to various aspects of the Corporation s consolidated financial statements and are reflected in its restated results, including adjustments to the gain on sale of credit card portfolios, accrual for rental expense on lease contracts, valuation of financial instruments and adjustments to income from a loan origination subsidiary. The cumulative effect of all these other adjustments was a decrease in pre-tax income of $191,000 through December 31, 2004.

The reclassifications made to conform to generally accepted accounting principles in the United States included, among other matters, reclassifying late charges and prepayment fees on loans from other income to interest income on loans, and reclassifying dividends on equity securities 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 and reclassifying cash balances previously reported as non-interest bearing deposits.

Income Taxes

As a result of the corrections reflected in the restatement, the Corporation s cumulative income tax expense was reduced by approximately $2.8 million for the years ended December 31, 2004, 2003 and 2002, and $5.6 million for periods prior to 2002. This cumulative reduction resulted principally from changes in deferred taxes.

See Note 26 Income Taxes to the Corporation s audited consolidated financial statements, for additional details regarding the Corporation s income taxes.

Other Matters

Industry Segments

As part of the restatement, the Corporation evaluated its industry segment classification to reflect the method in which financial information was being evaluated by the Chief Operating Decision Maker as of December 31, 2004. Historically, the Corporation disclosed three reportable segments: Retail, which included consumer and mortgage operations; Commercial and Corporate Banking; and Treasury and Investments. Since both mortgage and consumer loans were originated through the same channels of distribution, the Corporation originally reported these activities within the same segment.

During the restatement process and after re-evaluation of the reportable segments, management concluded that mortgage banking should have been disclosed as a separate segment and that changes to the composition of reportable segments were necessary. Based upon the Corporation s organizational structure and the information provided to the Chief Operating Decision Maker and to a lesser extent the Board of Directors, the operating segments are driven primarily by the legal entities. The Corporation corrected the reportable segments to appropriately reflect the manner in which financial information was analyzed by and presented to the Chief Operating Decision Maker. The Corporation has four reportable segments: Commercial and Corporate Banking; Mortgage Banking; Consumer (Retail) Banking; and Treasury and Investments.

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 Banking segment also acquires and sells mortgages in the secondary markets. 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 sells funds to Commercial and Corporate Banking; Mortgage Banking; and Consumer segments to finance their lending activities and purchases funds gathered by those segments. The interest rates charged or credited by Treasury and Investments are based on market rates. The Other category is mainly composed of insurance, finance leases and other products. Refer to Note 31 Segment Information to the Corporation s audited consolidated financial statements, for additional details regarding the Corporation s reportable segments.

Overview

First BanCorp is the financial holding company of FirstBank, a commercial bank headquartered in San Juan, Puerto Rico. First BanCorp, the second largest financial holding company headquartered in San Juan, Puerto Rico based on assets as of December 31, 2004, had $15.6 billion in assets at December 31, 2004 and operated full-service banking branches in Puerto Rico and in the U.S. Virgin Islands (USVI) and British Virgin Islands (BVI). Since October 2004, the Bank also operates a loan agency in Coral Gables, Florida (USA). In addition, the holding company owns an insurance agency. Through its wholly- owned subsidiaries, the Bank, operates offices in Puerto Rico specializing in residential mortgage loans originations, small personal loans, finance leases and vehicle rental, and subsidiaries in the USVI and Barbados specializing in insurance agency services, small personal loans and foreign sales corporation management.

The Corporation s results of operations are sensitive to fluctuations in interest rates. Changes in interest rates can materially affect key earnings drivers such as the volume of loan originations, net interest income earned, and gains/losses on investment security holdings. Interest rate risk is constantly managed through asset/liability management strategies which include the use of various derivative instruments. Another important risk which the Corporation manages on a daily basis is credit risk in the loan portfolio. This risk is mainly managed through strong underwriting, loan review and collection functions. The Corporation s business activities and credit exposures are mainly concentrated in Puerto Rico. Consequently, its financial condition and results of operations are dependent on the economic conditions as well as changes in legislation on the Island.

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Financial Highlights

First BanCorp recorded earnings of $177.3 million or $3.41 per common share (basic) and $3.30 per common share (diluted) for 2004, compared to $119.9 million or $2.24 per common share (basic) and $2.18 per common share (diluted) for 2003, and $132.9 million or $2.67 per common share (basic) and $2.63 per common share (diluted) for 2002. For 2004 as compared to 2003, net income increased by $57.4 million or $1.12 per common share (diluted), and for 2003 as compared to 2002, net income decreased by $13.0 million or $0.45 per common share (diluted). During 2004, the Corporation obtained a return on average assets of 1.30% compared to 1.15% for 2003 and 1.51% for 2002 and a return on common equity of 23.75% for 2004 compared to 18.21% for 2003 and 29.49% for 2002.

Assets rose 23% from $12.7 billion at year-end 2003 to $15.6 billion at the end of 2004. Deposits increased 17% to $7.9 billion. Net loans increased 38% to $9.6 billion, due to an increase of $2.1 billion in commercial loans, $301 million in residential mortgage loans and $252 million in consumer loans and finance leases. The increase in commercial loans includes a $1.8 billion increase in the recharacterized secured loans to local financial institutions.

The Corporation s earnings increase is mainly the result of a significant growth of $3.2 billion in the average balance of earning assets and from increases in the average yield on investment securities, together with a lower cost of funding. The increase in interest income, when compared to 2003, is mainly attributable to the growth in the Corporation s loan and investment portfolios; the average balance of these portfolios increased by $1.7 billion and $1.4 billion, respectively. The increase in the loan portfolio was mainly driven by the origination of commercial loans, including secured loans to local financial institutions, while the increase in the investments portfolio is mainly attributable to substantial purchases of long-term agency securities.

While the yield on the investments portfolio increased as compared to 2003 due to the re-investment of proceeds from prepayments on mortgage-backed securities and to new investments in higher yielding long-term securities, the yields on loans decreased, given the re-pricing of variable rate loans and the purchase and origination of loans at lower rates. Total yield on earning assets on a taxable equivalent basis, excluding the impact changes in the fair value of interest rate swaps, was 5.68% for 2004 as compared to 5.73% for 2003. The decrease in interest expense as compared to 2003 is the result of decreases in rates, given the re-pricing of variable rate liabilities and the origination of new debt at lower rates partially offset by volume increases in interest-bearing liabilities to support the Corporation s investment and loan portfolio growth. The average cost of funds rate, excluding the impact of the change in the fair value of interest rate swaps, for 2004 was 2.62% compared to 2.86% for 2003.

The interest earned on earning assets is computed on a tax equivalent basis; both the yield on earning assets and cost of funds rate exclude the impact of the change in the fair value of interest rate swaps. When adjusted on a taxable equivalent basis and excluding valuation changes, yields on taxable and exempt assets are comparative. Also, the cost of funds rate, excludes non-cash adjustments from changes in the fair value of interest rate swaps changes that do not affect economically the Corporation s funding cost. Refer to the Net Interest Income section of this Management s Discussion and Analysis for further information.

Positive variances resulting from the increase in average earnings assets, higher yields on the investment s portfolio and lower cost of funds were partially offset by a decrease in the yields on the loan portfolio. The net impact on net interest income and earnings was positive, net interest income increased by $145.5 million as compared to the 2003 reported amount, or $123.3 million on a taxable equivalent basis, excluding the impact of the change in the fair value of interest rate swaps.

The provision for loan losses decreased by $3.1 million to $52.8 million in 2004, as a result of the Corporation s underwriting standards and stability in loan delinquencies during 2004, considering significant volume increases in the loan portfolios. The net charge offs as a percentage of average loans decreased to 0.48% from 0.66%.

Other income for 2004 decreased by $47.2 million as compared to 2003. The decrease is mainly attributable to gains realized in the year 2003 from the sale of investments and from the sale of a significant portion of the Corporation s credit card portfolio. These gains amounted $35.6 million and $32.4 million, respectively, for 2003 as compared to $9.5 million and $5.5 million, respectively, for 2004. Other income excluding net gains on sale of investments and gains on sale of credit card portfolios increased by $5.8 million as compared with the 2003 reported amount. The increase is in part attributable to increases in commission income from the Corporation s insurance businesses and increases in service charges on deposit accounts as a result of a larger volume of insurance transactions and deposit accounts during 2004, partially offset by decreases in other service charges on loans, due to the decrease in fees resulting from the sales of the credit card portfolios in 2003 and early in 2004.

Operating expenses increased by $15.9 million from $164.6 million in 2003 to $180.5 million in 2004. The increase as compared to 2003 is mainly attributable to increase personnel and occupancy costs to support the Corporation s growth, and to strong advertising and business promotion costs to support new products and services, especially those offered by FirstMortgage, the Corporation s mortgage loans origination subsidiary which started operations late in 2003.

Return on average assets was 1.30% for 2004, 1.15% for 2003 and 1.51% for 2002. Return on average equity was 15.73% for 2004, 13.31% for 2003 and 18.63% for 2002. Return on average common equity was 23.75% for 2004, 18.21% for 2003 and 29.49% for 2002.

During the first quarter of 2004, FirstBank Overseas Corporation, a wholly-owned subsidiary of FirstBank and an international banking entity under the International Banking Entity Act of Puerto Rico, commenced operations. Also in October 2004, the Corporation s subsidiary, FirstBank, started operations in Coral Gables, Florida, through the establishment of a loan agency.

In November 2004, the Corporation announced the signing of a definitive merger agreement for the acquisition of the parent company of Unibank, a federal savings and loan association with approximately $500 million in assets, which operates 9 full service branches in the southern region of the state of Florida. The acquisition was completed in the first quarter of 2005. The acquisition will allow the Corporation to build a platform in Florida from which to consider future expansion in the United States.

In 2003, FirstBank entered into a long-term strategic marketing alliance with MBNA Corporation. As part of the alliance, FirstBank became an MBNA Financial Institution Partner in Puerto Rico and is the only Puerto Rico-based financial institution whose credit cards are issued by MBNA. As mentioned earlier and in accordance with an agreement reached in 2003, FirstBank sold credit card loan portfolios to MBNA in late 2003 and in the first quarter of 2004; these sales generated before tax gains of $32.4 million and $5.5 million in 2003 and 2004, respectively, after considering certain restatement adjustments.

Critical Accounting Policies and Practices

The amounts reported in the Corporation s financial statements are based on 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 those estimates, if different assumptions or

conditions prevail. The Corporation believes that the following accounting policies involve a higher degree of judgment:

Investments Classification and Valuation

The Corporation classifies its investments in debt and equity securities as trading, held-to-maturity and available-for-sale securities at the time of purchase. The available-for-sale securities are carried at fair value, with unrealized gains and losses resulting from changes in the fair value, net of deferred tax effects, reported in other comprehensive income as a separate component of stockholders equity. The fair values of these securities were calculated based on quoted market prices and dealer quotes. To the extent that quarter market prices and dealer quotes are not available, however, the fair value is calculated based upon various assumptions. Changes in the assumptions used in calculating the fair values, such as interest rates, estimated prepayments rates for such securities subject to prepayment risk and discount rates, could affect the reported valuations. Held-to-maturity securities are accounted at amortized cost. Trading securities, if any, are reported at fair value with unrealized gains and losses included in earnings.

Evaluation for Other-Than-Temporary Impairment on Available-for-Sale and Held-to-Maturity Securities

The Corporation evaluates its investment securities for impairment. An impairment charge in the Consolidated Statements of Income is recognized when the decline in the fair value of investments below their cost basis is judged to be other-than-temporary. The Corporation considers various factors in determining whether it should recognize an impairment charge, including but not limited to, the length of time and extent to which the fair value has been less than its cost basis and the Corporation s intent and ability to hold the investment for a period of time sufficient to allow for any anticipated recovery in market value. For debt securities, the Corporation also considers, among other factors, the obligor s repayment ability on its bond obligations and its cash and capital generation ability. Any change in the factors evaluated to determine the need for an impairment charge could have an impact on that decision.

Allowance for Loan Losses

The Corporation maintains the allowance for loan losses at a level that management considers adequate to absorb losses inherent in the loan portfolio. The adequacy of the allowance for loan losses is reviewed on a quarterly basis as part of the continuing evaluation of the quality of the assets. Groups of small balance and homogeneous loans are collectively evaluated for impairment. The portfolios of residential mortgage loans, consumer loans, auto loans and finance leases are considered homogeneous and are evaluated collectively for impairment. In determining probable losses for each category of homogeneous pools of loans, management uses historical information about loan losses over several periods of time that reflect varying economic conditions and adjusts such historical data based on the current conditions, considering information and trends on charge-offs, non-accrual loans, changes in underwriting policies, risk characteristics relevant to the particular loan category and delinquencies. The Corporation measures impairment individually for those commercial and real estate loans with a principal balance exceeding $1 million. An allowance for impaired loans is established based on the present value of expected future cash flows or the fair value of the collateral, if the loan is collateral dependent. Accordingly, the measurement of impairment for loans evaluated individually involves assumptions by management as to the amount and timing of cash flows to be recovered and of appropriate discount rates. When the loans are collateral dependent, the fair value of the collateral is based on an independent appraisal that may also involve estimates of future cash flows and appropriate discount rates or adjustments to comparable properties.

Income Taxes

The Corporation is routinely subject to examinations from governmental taxing authorities. Such examinations may result in challenges to the tax return treatment applied by the Corporation to specific transactions. Management believes that the assumptions and judgments used to record tax-related assets or liabilities have been appropriate. Should tax laws change or the tax authorities assumptions differ from management s assumptions, the result and adjustments required could have a material effect on the Corporation s results of operations. In estimating taxes, management assesses the relative merits and risks of the appropriate tax treatment of transactions, taking into account statutory, judicial and regulatory guidance and recognizes tax benefits only when deemed probable. As of December 31, 2004, there were no open income tax investigations. Information regarding income taxes is included in Note 26 to the Corporation s financial statements.

Derivatives Financial Instruments

As part of the Corporation s overall interest rate risk management, the Corporation uses financial instruments (derivatives), including interest rate swaps, interest rate caps and options. In accordance with SFAS 133, all derivative instruments are measured and recognized on the Consolidated Statements of Financial Condition at their fair value. On the date the derivative instrument contract is entered into, the Corporation may designate the derivative as (1) a hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment (fair value hedge), (2) a hedge of a forecasted transaction or of the variability of cash flows to be received or paid related to a recognized asset or liability (cash flow hedge) or (3) as a standalone derivative instrument. Changes in the fair value of a derivative instrument that is highly effective and that is designated and qualifies as a fair-value hedge, along with the loss or gain on the hedged asset or liability that is attributable to the hedged risk (including losses or gains on firm commitments), are recorded in the then-current-period earnings. Changes in the fair value of a derivative instrument that is highly effective and that is designated and qualifies as a cash-flow hedge are recorded in other comprehensive income in the shareholders equity section of the Consolidated Statements of Financial Condition, until earnings are affected by the variability of cash flows (e.g., when periodic settlements on a variable-rate asset or liability are recorded in earnings). For all hedging relationships, derivative gains and losses that are not effective in hedging the changes in fair value or expected cash flows of the hedged item are recognized immediately in current earnings during the period of the change. Similarly, the changes in the fair value of standalone derivative instruments or derivatives not qualifying for hedge accounting under SFAS 133 are reported in the then-current-period earnings.

At the inception of the hedge and monthly thereafter, a formal assessment is performed to determine whether the changes in fair values of the derivatives have been highly effective in offsetting the changes in the fair values or cash flows of the hedged item and whether they are expected to be highly effective in the future. The Corporation discontinues hedge accounting prospectively when it is determined that the derivative is no longer effective in offsetting changes in the fair value or cash flows of the hedged item, the derivative expires, is sold, or terminated, or management determines that the designation of the derivative is no longer appropriate.

When hedge accounting is discontinued, the future gains and losses arising from any change in fair value are recorded as interest income or interest expense depending upon the asset or liability being economically hedged. When a fair value hedge is discontinued, the hedged asset or liability is no longer adjusted for changes in fair value and the existing basis adjustment is amortized or accreted over the remaining life of the asset or liability.

The Corporation uses interest rate swaps as economic hedges. These swaps either do not qualify for hedge accounting treatment or have not currently been qualified in 2004 by the Corporation for hedge accounting treatment. These economic hedge swaps mainly convert the fixed interest rate payments on certain of its deposits and debt obligations to a floating rate. Interest is exchanged periodically on the

notional value, with the Corporation receiving the fixed rate and paying various LIBOR-based floating rates. Changes in the fair value of these derivatives and the interest exchanged are recognized in earnings in the interest income or interest expense caption of the Consolidated Statements of Income depending upon whether it is an asset or liability being economically hedged. The fair values of these derivatives are included in either the Other Assets or Other Liabilities caption.

At December 31, 2004, 2003 and 2002, all interest rate swaps held by the Corporation are considered economic hedges as these did not qualify for hedge accounting under the short-cut method . Since at December 31, 2004, the Corporation s interest rate swaps did not qualify for hedge accounting, the impact from changes in the fair value of the hedged items can not be recognized in earnings, therefore, results of operations and reported earnings could be impacted significantly in the future. In April 2006, the Corporation implemented the long-haul method of hedge accounting for interest rate swaps hedging mainly brokered CDs and medium-term notes.

Accounting Pronouncements

During 2006, the Financial Accounting Standards Board (FASB), issued SFAS 156 *Accounting for Servicing of Financial Assets*, an amendment of SFAS 140; and SFAS 155 *Accounting for Certain Hybrid Financial Instruments*, an amendment of SFAS 133 and 140 and Financial Interpretation No. 48 *Accounting for Uncertainty in Income Taxes an interpretation of SFAS 109* (FIN 48).

During 2005, the FASB, issued SFAS No. 154 *Accounting Changes and Error Corrections a replacement of APB Opinion No. 20* and FASB Statement No. 3.

During 2004, the Financial Accounting Standards Board (FASB), its Emerging Issues Task Force (EITF) and the SEC issued several accounting pronouncements, namely FASB Statement No. 123R, *Share-Based Payment*, EITF Issue No. 04-10, *Determining Whether to Aggregate Operating Segments That Do Not Meet the Quantitative Thresholds*, EITF Issue No. 03-01, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments* and FASB Statement of Position (SOP) No. 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer*. Refer to Note 3 to Corporation s financial statements for a summary of the major provisions of these pronouncements. The Corporation s results of operations could be affected by the effect of new accounting pronouncements issued in the future.

Results of Operations

The Corporation s results of operations depend primarily on its net interest income, which is the difference between the interest income earned on interest earning assets, including investment securities and loans, and the interest expense on 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 is affected by the provision for loan losses, operating expenses (such as personnel, occupancy and other costs), other income (mainly service charges and fees on loans), the result of derivatives activities, gains on sale of investments and loans and income taxes.

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Net Interest Income

Net interest income increased to $397.5 million for 2004 from $251.9 million in 2003 and $314.5 million in 2002. The increase in net interest income for the year 2004 was mainly driven by the increase in the average volume of earnings assets by $3.2 billion attributable primarily to the growth in the Corporation s loan and investment portfolios, especially commercial loan portfolios and government agency securities.

The following table includes a detailed analysis of net interest income. Part I presents average volumes and rates on a tax equivalent basis, excluding the impact of changes in the fair value of derivatives, (please refer to explanation below regarding changes in the fair value of interest rate swaps). Part II presents the extent to which changes in interest rates and changes in volume of interest-related assets and liabilities have affected the Corporation s net interest income, the analysis is also on a tax equivalent basis and excluding changes in the fair value of derivatives. For each category of earning assets and interest bearing liabilities, information is provided on changes attributable to changes in volume (changes in volume multiplied by old rates), and changes in rate (changes in rate multiplied by old volumes). Rate-volume variances (changes in rate multiplied by changes in volume) have been allocated to the changes in volume and changes in rate based upon their respective percentage of the combined totals. Changes in the fair value of interest rate swaps recorded as part of interest income and interest expenses are excluded from the analysis (refer to explanation below regarding changes in the fair value of interest rate swaps).

Part I

Year ended December 31,	Average volume			Interest Income (1) / expense			Average rate (1)		
(As restated)	2004	2003	2002	2004	2003	2002	2004	2003	2002
				(Dollars in thousands)					
Earning assets:									
Money market investments	$ 308,962	$ 455,242	$ 60,522	$ 3,736	$ 4,707	$ 999	1.21%	1.03%	1.65%
Government obligations (2)	2,061,280	851,140	1,236,281	132,324	47,873	54,653	6.42%	5.62%	4.42%
Mortgage-backed securities	2,729,125	2,256,790	2,144,446	154,233	114,750	147,814	5.65%	5.08%	6.89%
Corporate bonds	57,462	181,063	259,840	(425)	6,795	15,094	-0.74%	3.75%	5.81%
FHLB stock	56,698	40,447	32,586	974	1,206	1,635	1.72%	2.98%	5.02%
Equity securities	43,876	34,158	52,703	511	703	705	1.16%	2.06%	1.34%
Total investments (3)	5,257,403	3,818,840	3,786,378	291,353	176,034	220,900	5.54%	4.61%	5.83%