

R&G FINANCIAL CORP
Form 10-K/A
November 02, 2007
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K/A

(Amendment No. 1)

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

For the fiscal year ended: December 31, 2004

OR

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

Commission File No.: 0-21137

R&G FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

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

290 Jesús T. Piñero Avenue

66-0532217
(I.R.S. Employer
Identification Number)

00918

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Hato Rey, San Juan, Puerto Rico
(Address of Principal Executive Offices)

(Zip Code)

Registrant's telephone number, including area code: (787) 758-2424

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
None	

Securities registered pursuant to Section 12(g) of the Act:

Class B Common Stock (par value \$.01 per share)*

Series A-D Noncumulative Perpetual Monthly Income Preferred Stock

(liquidation value \$25 per share and par value \$.01 per share)

(Title of Class)

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES NO

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES NO

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

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 Accelerated filer Non-accelerated filer

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

The aggregate value of the 27,780,426 shares of Class B Common Stock of the Registrant issued and outstanding on June 30, 2004, which excludes 1,762,410 shares held by all directors and officers of the Registrant as a group, was approximately \$918.4 million. This figure is based on the last known trading price of \$33.06 per share of the Registrant's Class B Common Stock on June 30, 2004. Number of shares of Class B Common Stock outstanding as of February 28, 2005: 29,572,120. (Does not include 21,559,584 shares of Class A Common Stock that are exchangeable into shares of Class B Common Stock at the option of the holder.)

* As of December 31, 2004, the Class B Common Stock was registered pursuant to Section 12(b) of the Securities Exchange Act of 1934 (the Exchange Act) and was listed on the New York Stock Exchange. The Class B Common Stock was subsequently delisted by the New York Stock Exchange in 2007, and the registration of the Class B Common Stock under Section 12(b) of the Exchange Act was terminated.

DOCUMENTS INCORPORATED BY REFERENCE**

** Part II 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.

Table of Contents

Explanatory Note

Background to Restatement

Overview. This amendment to the Annual Report on Form 10-K for the year ended December 31, 2004, or 2004 Annual Report on Form 10-K/A, is being filed by R&G Financial Corporation, or R&G, RGF, R&G Financial or the Company, to amend Items 1 and 3 of Part I, Items 6, 7, 7A, 8 and 9A of Part II and Item 15 of Part IV of its Annual Report on Form 10-K for the year ended December 31, 2004 which was originally filed on March 16, 2005. The amendment includes the restatement of R&G Financial's financial results described in this 2004 Annual Report on Form 10-K/A.

Information in this 2004 Annual Report on Form 10-K/A is generally stated as of December 31, 2004 and generally does not reflect any subsequent information or events other than the restatement described below, except as described under "Subsequent Events" below and in "Future Operations" under Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations" or where explicitly stated otherwise. Information regarding subsequent periods will be contained in the Annual Reports on Form 10-K for the years ended December 31, 2005 and 2006 and other filings with the Securities and Exchange Commission, or SEC. This filing should be read and considered in conjunction with such filings.

Background. In April 2005, the Company determined to reassess the independent market valuations it used to value the residual interests, or IO strips, retained in certain of the Company's mortgage loan transfers. The Company further determined that it was necessary to correct the methodology used in determining the fair value of these residual interests. The Company concluded that the previously filed interim and annual Consolidated Financial Statements for the periods from January 1, 2003 through December 31, 2004 would be materially affected as a result of this correction and should be restated. The Audit Committee of the Board of Directors, or the Audit Committee, determined that the interim and annual Consolidated Financial Statements for these periods should not be relied upon. In addition, the Company concluded that Management's Report on Internal Control Over Financial Reporting in the 2004 Annual Report on Form 10-K should also be restated and should no longer be relied upon. In July 2005, the Company further concluded that its interim and annual Consolidated Financial Statements for the year ended December 31, 2002 also needed to be restated, and the Audit Committee determined that such financial statements should not be relied upon. As the restatement progressed, the Company also concluded that selected financial data, as required by Item 301 of Regulation S-K and certain additional information required by Industry Guide 3 should also be restated for each of the five years in the period ended December 31, 2004.

As part of the restatement process, the Company decided to review other matters related to its previously issued annual Consolidated Financial Statements, including the sale accounting treatment of its mortgage loan transfers. Ultimately, the principal adjustments to the Company's previously issued annual Consolidated Financial Statements related to a correction in the accounting for certain mortgage loan transfers that had originally been recorded as sales to recharacterize those transfers as secured borrowings due to their failure to meet certain of the sale accounting criteria set forth in Statement of Financial Accounting Standards, or SFAS, No. 140 "Accounting for Transfer and Servicing of Financial Assets, or SFAS No. 140. As a result, the Company's restated audited Consolidated Financial Statements no longer reflect any residual interests such as mortgage servicing rights or IO strips retained in connection with these mortgage loan transfers.

In addition to reflecting the recharacterizations described above in this 2004 Annual Report on Form 10-K/A, management has evaluated, and in some cases made accounting adjustments to, certain categories including:

The accounting for transfers of mortgage loans to and from other financial institutions and other private investors, including a transaction involving generally contemporaneous purchases and sales of mortgage loans from and to a local financial institution where the amounts purchased and sold, and other terms of the transactions, were nearly identical;

The accounting for transfers of commercial loan participations to and from other financial institutions;

The assumptions and processes used to calculate gains on sale of mortgage loans;

The accounting for securitizations of mortgage loans;

Table of Contents

The assumptions, models and data used in the valuation of mortgage servicing assets and the capitalization, impairment and amortization of such assets;

The accounting for the recognition and deferral of loan origination fees and costs and related amortization;

The accounting for derivative financial instruments;

The accounting for investment securities, including amortization of premiums and accretion of discounts;

The accounting for real estate held for sale;

The accounting for lease obligations, including lessee's involvement in asset construction and the recognition of rent expense under operating leases;

The accounting for the allowance for loan and lease losses;

The accounting for servicing-related advances and payments;

The accounting for mortgage loans held for sale, including classification and the lower of cost or market valuation allowance; and

The accounting for deferred taxes and the related provision for income taxes as a result of the effect of the restatement adjustments listed above.

Subsequent Events

Since the Company's restatement announcement in April 2005 and as a result of the restatement process, deteriorating macroeconomic conditions in Puerto Rico, the weakening of the real estate and housing market in Florida, the restructuring of mortgage loan transfers initially recorded as sales and subsequently recharacterized as secured borrowings and the disruption of the secondary mortgage market for the sale of mortgage loans, among other factors, the Company has faced a number of financial challenges that have had a material adverse effect on the Company's liquidity, financial condition and results of operations. As a result, the Company expects its results of operations for 2005, 2006 and 2007 to be significantly lower than those reported for 2004.

In addition, although the Company continues to have adequate capital and has been able to satisfy its contractual obligations, its access to capital resources has been adversely affected by a number of factors related to the restatement process. These factors include the Company's inability to timely file its annual and quarterly reports with the SEC, delisting of its common stock from the New York Stock Exchange, or NYSE, successive downgrades in the credit ratings of the Company and its securities and the termination of commitments to sell non-conforming mortgage loans in the local market. During the restatement process, the Company has relied on, as its principal sources of liquidity, brokered deposits, short-term borrowings under Federal Home Loan Bank, or FHLB, advances and repurchase agreements secured by pledges of its mortgage loans and mortgage-backed securities, warehousing lines of credit and sales of mortgage loans in the secondary market to agencies or U.S. financial institutions.

Upon the closing of the sale of R-G Crown Bank, the Company's wholly owned Florida thrift subsidiary, or Crown Bank, to Fifth Third Financial Corporation, the Company anticipates having sufficient funds available to meet its near-term liquidity and capital needs. The Company's liquidity, however, is subject to the unpredictability of the outcomes of the shareholder and other legal and regulatory proceedings described below. The Company is also a guarantor under R&G Mortgage's warehousing lines of credit which terminated on October 31, 2007. The Company is in the process of negotiating short-term extensions of these credit facilities but can give no assurance it will be able to obtain such

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extensions under either or both of its credit facilities, or to obtain certain waivers, further described below, that the Company would need if it is able to obtain such extensions. Additionally, the Company expects that until it has filed its Annual Reports on Form 10-K for the years ended December 31, 2005 and 2006 and resolved its ongoing legal and regulatory proceedings, it will have limited access to financing arrangements or other external sources of liquidity. The Company is evaluating various alternatives to provide additional liquidity and capital. Failure to consummate or any significant delay in the consummation of the sale of Crown Bank, acceleration or a demand for payment of any outstanding amounts by the lenders under either of the credit facilities or a failure to obtain extensions of the credit facilities would have a material adverse effect on the Company's liquidity and financial condition and could result in banking regulators placing further restrictions on the Company's operations and its banking subsidiaries or taking actions that could have a material adverse effect on the value of the Company's preferred and common stock.

Under the applicable Federal Reserve Board capitalization guidelines, a bank holding company should avoid over-reliance on preferred stock and other forms of non-voting equity within its Tier 1 capital. As a result of the restatement adjustments, approximately 46.9% of R&G Financial Corporation's Tier 1 capital as of December 31, 2004 consisted of elements other than voting common equity. However, as a result of further reductions in stockholders' equity since December 31, 2004, approximately 65.6% of R&G Financial Corporation's Tier 1 capital as of August 31, 2007 consisted of elements other than voting common equity. R&G Financial Corporation's ability to raise capital through means other than the issuance of voting common stock may be limited. It is unclear what actions, if any, the Federal Reserve could take as a result of the reduction in voting common stock as the principal form of Tier 1 capital.

Table of Contents

General

Following the announcement of the restatement, a number of significant events occurred, including:

The conclusion by R&G Financial's management, under the oversight of the Audit Committee, of an internal review of the Company's books, records and accounting practices;

The retention of Fried, Frank, Harris, Jacobson & Shriver LLP, or Fried Frank, as independent outside counsel to the Audit Committee, and the conclusion of an investigation by the Audit Committee, assisted by Fried Frank and Promontory Financial Group, LLC, a financial services consulting firm, described below under Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations Background to Restatement ;

The initiation of numerous private lawsuits, including purported class action lawsuits alleging violations of federal securities laws, and shareholder derivative actions alleging breach of fiduciary duties owed to R&G Financial, described below under Item 3 Legal Proceedings ;

The delisting of the Company's Class B common stock (par value \$.01 per share), or the Class B Common Stock, from the NYSE and the delisting of the Company's four outstanding classes of preferred securities from The Nasdaq Stock Market because of the Company's failure to comply with the reporting requirements for continued listing on each of those exchanges;

The commencement of a formal investigation by the SEC into the matters surrounding the restatement;

Changes in the Company's management, described below under Corporate Governance Changes in Senior Management ;

The receipt of inquiries from federal and Puerto Rican bank regulatory agencies regarding the status and impact of the restatement, including the receipt in February 2006 of a notification from the Office of Thrift Supervision, or OTS, informing Crown Bank that it was imposing certain restrictions and requirements on Crown Bank, relating primarily to payment of dividends and related party transactions, or the Crown Notification;

The issuance of consent orders by the Board of Governors of the Federal Reserve System, or FRB, the Federal Deposit Insurance Corporation, or FDIC, and the Office of Commissioner of Financial Institutions of Puerto Rico, or OCFI, against R&G Financial and R-G Premier Bank of Puerto Rico, the Company's wholly owned Puerto Rico commercial bank subsidiary, or Premier Bank, imposing several operational and reporting obligations and restrictions on dividend payments, among other things, described below under Other Subsequent Events Regulatory Orders ;

The August 28, 2006 termination, based upon improved controls and procedures implemented by Premier Bank, of a previously disclosed Memorandum of Understanding, dated December 16, 2004, entered into between Premier Bank and the FDIC with respect to the correction and strengthening of deficiencies in Premier Bank's Bank Secrecy Act and anti-money-laundering programs;

The issuance of a consent order by the OTS against Crown Bank that, among other things, imposes certain operational and reporting obligations and incorporates certain restrictions on capital distributions by Crown Bank and transactions with affiliates previously set forth in the Crown Notification, described below under Other Subsequent Events Regulatory Orders ;

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The agreement to sell Crown Bank, the Company's Florida- and Georgia-based banking operations, described below under Other Subsequent Events - Restructuring and Divestitures ;

The issuance and sale by R&G Financial's wholly owned Florida subsidiary, R&G Acquisition Holdings Corporation, or RAC, of 150,000 shares of noncumulative perpetual Series A preferred stock, or the Series A Preferred Stock, which has been structured to fully count as Tier I capital, for a purchase price of \$150 million, and the simultaneous grant of immediately exercisable warrants to purchase shares of R&G Financial's common stock and certain Additional Purchase Rights Investments, and subsequent developments related to these instruments in conjunction with the sale of Crown Bank, all as described below under Other Subsequent Events - March 2006 Private Placement ;

Page 4

Table of Contents

The sale by the Company of the retail brokerage business of R-G Investments Corporation, or R-G Investments, its wholly owned securities broker-dealer subsidiary in Puerto Rico, described below under Other Subsequent Events Restructuring and Divestitures ;

The restructuring of some of the Company's previous mortgage loan sale transactions, described below under Other Subsequent Events Restructuring of Certain Prior Mortgage Loan Transfers ;

The disruption of the secondary mortgage market, which has affected the ability of the Company to access liquidity through sales of mortgage loans, many of which were brought back onto its balance sheet as part of the restatement, as further described below in Risk Factors ;

The determination by the Company to record a valuation allowance related to its mortgage loans held for sale, resulting in a provision for losses of \$39.9 million for the quarter ending September 30, 2007 as a result of the aforementioned reduced liquidity in the secondary mortgage market;

The determination by the Company to record a provision for loan and lease losses of \$15.3 million for the quarter ending September 30, 2007 as a result of the Company's reassessment of a number of its lending relationships with developers and homebuilders in the Central/North Florida area, as further described below in Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations Future Operations ;

The September 28, 2007 sale by R&G Mortgage of a residential mortgage loan portfolio, as further described below under Other Subsequent Events Sale of Mortgage Loan Portfolio ;

The sale by Crown Bank of the portion of its servicing portfolio related to loans serviced by Crown for others, described below under Other Subsequent Events Sale of Portion of Crown Servicing Portfolio ;

The downgrading by Fitch Ratings of the Company's long-term issuer default rating to CCC, with a negative outlook, in a series of downgrades;

The commencement by the Company of a profit improvement program designed to reduce operating expenses, increase productivity and enhance income, described below under Other Subsequent Events Profit Improvement Programs for R&G Mortgage and Premier Bank ;

The receipt of a number of notices regarding the status of R&G Mortgage's mortgage banking authorizations from certain of the government agencies and government-sponsored entities, or GSEs, with whom it has mortgage banking relationships, as further described below under Other Subsequent Events Status of Mortgage Banking Licenses ;

The entry into agreements with the Puerto Rico Department of Treasury regarding tax treatment related to prior intra-company transfers of IO strips;

The identification, as a result of the investigation by the Audit Committee mentioned above, of certain actions taken by the former chief financial officer and the former controller of Crown Bank, as described below under Other Subsequent Events Deferral of Acquisition-Related Expenses ; and

The identification of various material weaknesses in the Company's internal control over financial reporting, described below under Item 9A Controls and Procedures. For further information regarding the Company's remediation efforts in connection with the material weaknesses in its internal control over financial reporting, refer to Item 9A Controls and Procedures Remediation of Material Weaknesses.

Table of Contents

Corporate Governance

Changes in Senior Management. Since the announcement of the restatement, the following changes have been made in the senior management of the Company:

Effective August 24, 2005, Mr. Joseph R. Sandoval, the Executive Vice President and Chief Financial Officer of R&G Financial, was placed on an indefinite leave of absence and was removed from his positions as Executive Vice President and Chief Financial Officer of the Company. Mr. Sandoval also served as a director and officer of various Company subsidiaries. Effective the same day, the Board of Directors of the Company appointed Mr. Vicente Gregorio as Senior Vice President and Chief Financial Officer of the Company.

On January 5, 2006, the Board of Directors of the Company took the following actions, among others, based on the results to that point of the investigation conducted by the Audit Committee into the circumstances surrounding the restatement:

The Board of Directors accepted the resignation of Mr. Ramón Prats from his positions as an officer and a director of the Company and of its subsidiaries. Prior to his resignation, Mr. Prats was a director, Vice Chairman of the Board of Directors, President of the Company, President of R&G Mortgage Corp., the Company's wholly owned mortgage banking subsidiary, or R&G Mortgage, President of Premier Bank, and also served as a director and officer of various other Company subsidiaries.

The Board of Directors accepted the resignation of Mr. Mario Ruiz, who was formerly Executive Vice President of Premier Bank, from all of his positions with the Company and its subsidiaries. Mr. Ruiz also served as director and officer of various Company subsidiaries.

The Board of Directors terminated the employment of Mr. Sandoval with the Company and its subsidiaries, following Mr. Sandoval's tendering of his resignation on terms other than those requested by the Board.

Mr. Víctor Irrizarry was promoted to Executive Vice President and Chief Lending Officer. Mr. Carlos Mantaras was promoted to Executive Vice President in Charge of Retail Banking and Consumer Lending, and Ms. Melba Acosta was promoted to Executive Vice President and Chief Administration Officer of Premier Bank.

To fill the vacancies created at R&G Mortgage, Mr. Steven Vélez was promoted to President of R&G Mortgage. Mr. Víctor L. Galán, Jr. was promoted to Executive Vice President in Charge of Production and Retail Mortgage Banking. Mr. Héctor Sécola was appointed Executive Vice President of Human Resources of the Company and Mr. Gregorio was promoted to Executive Vice President of the Company.

Subsequently, Mr. José Díaz joined Premier Bank as its President, Mr. Rolando Rodríguez was named the President and Chief Executive Officer of Crown Bank and Mr. Norberto Medina was appointed General Counsel for the Company. Mr. Andrés I. Pérez was appointed as an Executive Vice President of the Company on October 1, 2006, and replaced Mr. Gregorio as Chief Financial Officer of the Company on November 1, 2006.

Effective January 1, 2007, Mr. Víctor J. Galán resigned from his positions as President and Chief Executive Officer of the Company and as an officer of its subsidiaries. Mr. Galán continued as Chairman of the Board until June 30, 2007 and remains a member of the Board of Directors. Effective January 1, 2007, Mr. Rolando Rodríguez, the President and Chief Executive Officer of Crown Bank, assumed the positions of President and Chief Executive Officer of R&G Financial. Effective January 19, 2007, Mr. Rafael Saldaña

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was appointed as the President of Crown Bank.

Effective March 15, 2007, Jorge Sanchez was removed as Crown Bank's chief financial officer and is now Crown Bank's chief investment officer, with no responsibility for the preparation or oversight of Crown Bank's financial statements. As of the same date, Roberto Romanelli was removed as Crown Bank's controller and was named a project manager under the supervision of Crown Bank's new chief accounting officer. By letter dated April 17, 2007, Mr. Romanelli submitted his resignation, effective May 1, 2007. Mr. Romanelli has served as a consultant for Crown Bank during the process of its sale, described below; in this capacity, he has provided historical information about the period during which he was employed by Crown Bank, but has had no responsibility for the preparation or oversight of Crown Bank's financial statements.

Page 6

Table of Contents

Changes in Board of Directors. Since the announcement of the restatement, the composition of the Company's Board of Directors has changed as follows:

Effective May 31, 2006, Mr. Ivan Méndez resigned from his positions as a director of the Company and certain of its subsidiaries in connection with his acceptance of an executive position at another financial institution;

Effective January 1, 2007, Mr. Rolando Rodríguez was appointed to the Board of Directors and was named to the Strategic Capital Committee of the Board of Directors;

Effective February 15, 2007, Mr. Juan Agosto Alicea was appointed to the Board of Directors as its Vice-Chairman, and succeeded Mr. Galán as Chairman of the Board of Directors on July 1, 2007. Mr. Agosto Alicea is also a member of the Company's Audit Committee; and

Effective March 27, 2007, Mr. Laureano Carus Abarca resigned from his position as a director of the Company and certain of its subsidiaries in connection with his retirement.

Other Subsequent Events

Regulatory Orders. On March 14, 2006, the Board of Directors of the Company consented to the issuance of a Cease and Desist Order, or the FRB Order, by the FRB. The FRB Order became effective on March 16, 2006. On the same date, the Board of Directors of Premier Bank entered into a Stipulation and Consent to the Issuance of an Order to Cease and Desist with the FDIC. The FDIC Order to Cease and Desist, or the FDIC Order, was issued and became effective on March 16, 2006. The OCFI and Premier Bank also agreed that the issuance of the FDIC Order would be binding upon the OCFI and Premier Bank with the same legal effect as if the OCFI had issued a separate order, or the OCFI Order. The OCFI Order, FRB Order and the FDIC Order are herein collectively referred to as the Orders.

The Orders require the Company and Premier Bank to, among other things, file with the FRB and the FDIC within prescribed time periods updated plans with respect to capital and liquidity and to engage an independent consultant to report to it on specified matters related to mortgage loans in its loan portfolio, including those loans sold with recourse, and to act on recommendations resulting therefrom.

The Orders also require that the Company and its banking subsidiaries receive the prior permission of its applicable regulator prior to making or declaring any dividends or payments on their outstanding securities. In requesting approval for such payments, the Company must provide current and projected information on consolidated earnings, cash flow, capital, asset quality and allowance for loan and lease loss needs of Premier Bank and Crown Bank as well as information regarding the sources of funds for such payments. The FRB then determines whether to approve the payment pursuant to FRB policy, including but not limited to the proposed payment's impact on the Company's continued ability to serve as a source of financial strength to Premier Bank and Crown Bank. Requests by the Company and Premier Bank for permission from the FDIC to make such payments must demonstrate that the proposed payment will not have an unacceptable impact on Premier Bank's capital position, cash flow, concentrations of credit, asset quality and allowances for loan and lease losses.

While the Company cannot give assurances that it will continue to receive the required regulatory permissions to make dividend payments, the Company has requested and received permission to make all monthly dividend payments on its outstanding series of preferred stock and interest payments on four of its trust preferred securities issues when due since the issuance of the Orders. The Company believes that its subsidiary banks were well capitalized at August 31, 2007, after taking adjustments related to the restatement into consideration.

Table of Contents

The Company indicated on March 31, 2006 that its common stock dividend, paid on March 23, 2006 to the holders of its Class B Common Stock, would be the last dividend paid on the common stock until the Company completes the restatement of its audited financial statements and becomes current on its public reporting obligations for 2005 and 2006.

Finally, the Orders require the Company and its affiliates to only engage in transactions with each other which comply with applicable federal affiliate transaction regulations, to report certain transactions on a monthly basis to the applicable regulator and to obtain the prior approval of the applicable federal regulator for certain transactions. Under the Orders, the Company and its affiliates are permitted to continue to conduct business with each other as they have done in the past. Under the terms of the Orders, the Company, Premier Bank and the respective regulatory agencies recognize that the Company and Premier Bank neither admit nor deny any unsafe and unsound banking practices. No fines or monetary penalties were assessed against the Company or Premier Bank under the Orders.

On October 3, 2006, the Board of Directors of Crown Bank consented to the issuance of a Cease and Desist Order, or the Crown Order, by the OTS. Under the terms of the Crown Order, Crown Bank and the OTS recognized that Crown Bank neither admitted nor denied that grounds existed to initiate such a proceeding or as to the findings in the Crown Order. No fines or monetary penalties have been assessed against Crown Bank under the Crown Order. The Crown Order became effective on October 3, 2006.

The Crown Order was issued based on OTS findings resulting from an examination of Crown Bank that was conducted during the first half of 2006. The OTS determined that Crown Bank in the conduct of its business had violated various laws and regulations, including the Currency and Foreign Transactions Reporting Act, as amended by the USA Patriot Act and other laws, or the Bank Secrecy Act or BSA, the National Flood Insurance Act and the Flood Disaster Protection Act, which are herein collectively referred to as the FDPA, and OTS regulations governing the filing of suspicious activity reports, or SARs. The OTS determined that Crown Bank was engaged in unsafe and unsound banking practices, including (i) failing to maintain an effective consumer compliance strategy and program that provides for adequate and appropriate resources, system controls, real-time monitoring, periodic self-assessment, organizational accountability, responsiveness to needed improvements and effective training, (ii) failing to conduct appropriate customer reviews and account oversight to monitor accounts and transactions for potentially unlawful activity, (iii) failing to fully address prior examination criticisms and implement effective and appropriate corrective actions, (iv) failing to maintain adequate and appropriate loan diversification policies, procedures and guidelines for residential acquisition, development and/or construction loans to avoid undue concentration of credit risk and (v) failing to maintain adequate and effective policies, procedures, systems and controls to ensure accurate and timely financial recordkeeping and reporting and appropriate and effective oversight by Crown Bank's Board of Directors.

The Crown Order required Crown Bank to file with the OTS within prescribed time periods updated plans and reports as specified in the Crown Order. Among other things, Crown Bank was required to comprehensively review its program for compliance with the BSA and related regulations and SAR regulations and take any required corrective actions resulting from such review as well as certain actions specified in the Crown Order.

Crown Bank's management was apprised of the OTS regulatory criticisms of its BSA compliance program at the time of the on-site regulatory examination earlier in 2006 and immediately implemented corrective actions. Crown Bank's management believes that it has substantially addressed all of the criticisms set forth in the regulatory examination of its BSA compliance program.

The Crown Order also requires Crown Bank to review and amend its FDPA policies and procedures to comply with the Crown Order, law and regulations and to address the specific weaknesses identified in the OTS on-site regulatory examination. Crown Bank was also required under the Crown Order to review its lines of business and operations and long term operating strategy and develop a comprehensive three year business plan for the years 2007-2009.

In October 2007, Crown Bank consented to the assessment of a civil money penalty of approximately \$20 thousand under the National Flood Insurance Act. While Crown Bank has not at this time been notified of the assessment of a civil money penalty under the BSA, a civil money penalty may be assessed in certain circumstances.

Table of Contents

Until Crown Bank demonstrates to the satisfaction of the OTS that it has addressed the asset quality deficiencies set forth in its examination report and the corrective actions set forth in the Crown Order, Crown Bank may not originate or commit to originate any new construction, acquisition and development or land loans, or ADCL Loans. ADCL Loans do not include non-speculative residential lot loans made by Crown Bank to individual customers for the construction of a residence thereon. Crown Bank may: (i) continue to fund legally binding ADCL loan commitments entered into prior to August 31, 2006, (ii) make residential construction/permanent loans where the completed residence will be used by the buyer as either a primary residence or a secondary residence where repayment of or qualification for the loan is not dependent upon rental or lease income from the secondary residence, and (iii) renew or rollover existing ADCL Loans as well as builder lines of credit that are documented to be performing in compliance with the terms and conditions of the original loan. Crown Bank may fund additional credit to existing ADCL Loan borrowers, in an aggregate amount not to exceed \$15 million without prior regulatory approval, as necessary to protect Crown Bank's creditor position and/or to preserve its collateral. Crown Bank is required to adopt a loan concentration and diversification policy in accordance with applicable regulations and to undertake a review of Crown Bank's loan review function and to ensure that it is adequately staffed by experienced personnel.

Finally, the Crown Order specifically incorporated restrictions on capital distributions by Crown Bank as well as restrictions on transactions with affiliates and insiders that were set forth in the February 2006 Crown Notification, except that the limitation on Crown Bank's ability to pay dividends to RAC to fund RAC's trust preferred obligations was increased from \$4.0 million to \$5.0 million in any calendar year without the need for prior regulatory approval so long as Crown Bank remains well capitalized following such payment.

Profit Improvement Programs for R&G Mortgage and Premier Bank. During 2006, profit improvement programs for R&G Mortgage and Premier Bank were launched to provide focus, depth and visibility to ongoing profit improvement initiatives.

R&G Mortgage

A profit improvement program was launched at R&G Mortgage in May 2006, designed to improve profitability while maintaining market leadership. Areas of opportunity were identified and initiatives were launched, including rationalizing production staffing, consolidating the existing branch network (including the elimination of The Mortgage Store brand), optimizing marketing investments and enhancing R&G Mortgage's pricing strategy.

Significant results have been achieved to date, including the reduction of approximately 23% of total headcount at R&G Mortgage since December 31, 2005, the closing of 17 branches, an approximately 49% reduction in advertising expense and the increase of average origination fees per loan by approximately 61%, each as of June 30, 2007.

Other strategic initiatives currently underway include the implementation of a mortgage loan tracking and automated workflow system, the expansion of secondary market options for the Company's non-conforming loans and the implementation of a full reengineering agenda for its mortgage servicing department.

Premier Bank

A profit improvement program was launched at Premier Bank in September 2006, designed to improve the competitiveness of each of the business lending units. Areas of opportunity were identified and initiatives were launched, including rationalizing branch personnel while improving customer service, capitalizing on the economies of scale of the Company's consumer lending business to allow for profitable growth and strengthening its corporate and commercial organization through organization changes and deeper market focus. Other initiatives underway include the ongoing review of non-core businesses for potential divestitures.

March 2006 Private Placement and Subsequent Amendment. On March 31, 2006, the Company announced that it was selling, through RAC, \$150 million of noncumulative perpetual Series A preferred stock. The Series A Preferred Stock was sold to a small group of investors, or the Investors, in a private placement which closed on March 31, 2006, bears a 9.5% annual dividend rate which is payable in quarterly installments, and is non-callable for seven years, except in certain circumstances including a change of control of the Company, RAC or Crown Bank, subject to regulatory approval. RAC's Series A Preferred Stock has the same priority with respect to dividends and rights upon liquidation as the Company's other outstanding series of preferred stock with respect to R&G Financial. The Series A Preferred Stock has been structured to fully count as Tier I regulatory capital on consolidation.

Table of Contents

Consistent with the terms of a securities purchase agreement, or the Securities Purchase Agreement, entered into with the Investors on March 27, 2006, RAC contributed \$15 million to Crown Bank and retained \$15 million, which is \$750,000 more than the dividend payments due on the Series A Preferred Stock for one year. RAC transferred to RGF approximately \$110 million of the net remaining proceeds, which the Company used to make capital contributions to Premier Bank and R&G Mortgage, as needed, and for general corporate purposes.

In connection with the transaction, the Company granted the Investors immediately exercisable warrants to purchase between 8 and 10 million shares of the Company's common stock at an exercise price ranging from \$12 to \$14 per share. Initially, warrants for 10 million shares were issued at a \$12.00 per share exercise price. For every quarter that RAC pays a dividend on the Series A Preferred Stock, the number of warrants decreases by 250,000 (down to a minimum of 8 million shares) and the per share exercise price increases by \$0.25 (up to a maximum of \$14.00 per share). Conversely, if RAC fails to pay a quarterly dividend, the number of the Company's warrants correspondingly increases and the exercise price correspondingly decreases, but never to more than 10 million shares or less than a \$12.00 per share exercise price. The ability of the Company and its subsidiaries to pay dividends is subject to the prior approval of its regulators.

The Company, through RAC, granted the Investors Additional Purchase Rights Investments, or APRI, that provide the Investors with the right to monetize a 20% interest in the value of RAC and Crown Bank. Pursuant to an APRI Agreement, the APRI had an initial aggregate value of \$80 million. Beginning five years from the date of closing of the private placement (or earlier in the event of a change of control) and not later than ten years from the closing of the private placement, the Investors can require an appraisal of RAC or Crown Bank, which would be based on the average of the public market value and the control sale value of the entity. Upon exercise of the APRI, at the Company's election, it may issue shares of the Company's common stock or cash to the investors equal to the greater of (i) 20% of the appraised value so determined or (ii) \$80 million, in each case minus the strike price. An aggregate of 8 million APRI were issued to the investors at an exercise price of \$10.00 per APRI. For every quarter that RAC fails to pay a dividend on the Series A Preferred Stock, the exercise price of the APRI will decline by \$0.4894375.

Under the various agreements, the Investors must pay for the exercise of the warrants for the Company's common stock or the APRI through a corresponding reduction in the number of outstanding Series A Preferred Stock, subject to regulatory approval, thereby minimizing the dilutive impact of the exercise.

The Company and RAC have agreed not to take certain actions that would impair or jeopardize the investment made by the Investors. Thus, for so long as the Series A Preferred Stock is outstanding, RAC will not (i) pledge the common stock of Crown Bank or (ii) issue debt or equity senior to the Series A Preferred Stock, without the permission of the holders of a majority in interest of the Series A Preferred Stock, except that outstanding indebtedness such as RAC's trust preferred securities may be refinanced on more favorable terms. Further, the Company and RAC will not (A) permit Premier Bank or Crown Bank to make distributions of dividends when the effect would cause them to not be well capitalized or at any time when the bank is not well capitalized under applicable regulations or (B) permit Crown Bank to engage in transactions with affiliates that would violate applicable regulations. If the Company or RAC violates either of the first two covenants, or if RAC incurs a loss of \$100 million or more (or the Investors incur a loss in value of RAC of \$20 million or more) as the result of violations of the last two covenants (except, that with respect to the covenant on transactions with affiliates, the monetary penalty only applies to transactions where RAC or its subsidiary improperly purchases assets from an affiliate), the exercise price of the warrants for the Company's common stock declines to \$1.00 per warrant, the exercise price of each APRI declines from \$10.00 to \$0.01, and the Company and RAC are required to use commercially reasonable best efforts to sell Crown Bank.

In connection with this transaction, the Company and the Investors entered into a Registration Agreement pursuant to which the Investors were granted certain registration rights with respect to the warrants and the APRI and which provides for the registration of the Series A Preferred Stock under certain circumstances if the Company is not able to file a registration statement. Simultaneously with the above-described transactions, the Company sold to RAC 4.8 million shares of the Company's noncumulative perpetual Series E preferred stock, par value \$0.01 per share, with an aggregate liquidation preference of \$120 million, or the Series E Preferred Stock, which has terms identical in all material respects to the Series A Preferred Stock and which has the same priority and preference as to dividends and to distributions in liquidation as the other outstanding series of the Company's preferred stock. The Series E Preferred Stock, which is eliminated upon consolidation in the Company's audited Consolidated Financial Statements, is the instrument which the Company uses to pay to RAC its proportionate share on the interest to be paid by RAC on the Series A Preferred Stock, and is based on the proceeds it is receiving.

Table of Contents

Financial Stocks, Inc., or FSI, which manages over \$3 billion in assets and specializes in, among other things, investing in banks, thrifts, insurance companies, REITs, real estate operating companies and specialty finance companies, was the lead investor in the private placement. Steve Stein, FSI's co-founder and its Chairman and Chief Executive Officer, was elected as a member of the Board of Directors of RAC and Crown Bank. There was no relationship between the Investors and the Company or RAC prior to this private placement transaction.

On October 1, 2007, the Company, RAC, FSI and Elliott Associates, L.P., who, together with FSI, we refer to as the Majority Holders, entered into Amendment No. 1, or the SPA Amendment, to the Securities Purchase Agreement. Pursuant to the terms of the Securities Purchase Agreement, the actions by the Majority Holders in entering into the SPA Amendment constitute action on behalf of all of the Investors. As further described below under Restructuring and Divestitures, the Company has entered into a stock purchase agreement, or the Crown Agreement, for the sale of Crown Bank to Fifth Third Financial Corporation. The transactions contemplated by the Crown Agreement constitute a change of control of Crown Bank within the meaning of the Series A Preferred Stock certificate of designation and allows for an automatic redemption of the Series A Preferred Stock at 110% of stated value, subject to receipt of applicable regulatory approval. In addition, the redemption of the Series A Preferred Stock is a condition to closing the sale of Crown Bank. The Company has sought and received permission from the FRB to redeem the Series A Preferred Stock in connection with the closing of the transactions contemplated by the Crown Agreement and it is the Company's and RAC's intention to redeem such instrument at the time of closing of such transaction.

While RAC has timely made all required quarterly dividend payments on the Series A Preferred Stock since the closing of the transaction in March 2006 and while the Company and RAC had obtained regulatory permission to make the dividend payment required on the Series A Preferred Stock for the dividend period ending September 30, 2007, the Board of Directors of RAC nonetheless advised the Majority Holders that they were considering not paying the dividend due to be paid on the Series A Preferred Stock for the dividend period ending September 30, 2007, as is RAC's right under such instrument. In order to induce RAC to make such dividend payment, the Majority Holders agreed to enter into the SPA Amendment, which amends the Securities Purchase Agreement and the warrants, and which binds all of the Investors by such actions.

Pursuant to the SPA Amendment, RAC authorized and paid in full the dividend due to be paid on the Series A Preferred Stock for the dividend period ended September 30, 2007. The Companies further agreed to file for regulatory permission to pay dividends on the Series A Preferred Stock for the period from October 1, 2007 through the date of the closing of the transactions contemplated by the Crown Agreement. While the Company and RAC have agreed to use their best efforts to obtain such regulatory permission, the SPA Amendment makes clear that the failure to obtain such approval is not a condition to consummation of the transactions contemplated by the SPA Amendment. In consideration for such actions, the Majority Holders have agreed, on behalf of themselves and all Investors, to sell all of their warrants back to the Company upon closing of the transactions contemplated by the Crown Agreement for a cash payment of \$0.001 for each share of the Company's Class B Common Stock subject to such warrants. The Majority Holders further agreed to notify all Investors of the signing of the SPA Amendment and to provide each Investor with a copy of the SPA Amendment, and that following the closing of the transactions contemplated by the Crown Agreement, to so notify each Investor and advise them of their rights under their warrants as modified and amended by the SPA Amendment. Finally, the parties agreed in the SPA Amendment that upon the closing of the transactions contemplated by the Crown Agreement and the payment of the amounts referenced in the SPA Amendment which were permitted by regulators to be made, all obligations of the Company and RAC to the Investors under the various transactions contemplated by the Securities Purchase Agreement shall, in all respects and for all purposes, be deemed terminated and of no further force or legal effect.

Restructuring of Certain Prior Mortgage Loan Transfers. The Company and its subsidiaries have restructured the terms of certain prior mortgage loan transfers which had been originally recorded as sales or purchases but were subsequently recharacterized as secured borrowings or lendings, respectively. Certain of these restructurings are described below:

On October 5, 2005, Banco Popular de Puerto Rico and R&G Mortgage restructured various agreements involving approximately \$136.0 million of mortgage loans previously transferred. The modifications to the original agreements deleted or modified any previous conditions that had precluded accounting for the transactions as sales. These modifications included a limited recourse of up to 10% of the unpaid principal balance of the mortgage loans.

Table of Contents

On November 23, 2005, Premier Bank repaid the secured borrowing with Banco Santander Puerto Rico resulting from the recharacterization of the mortgage loan transfers and assumed control of the mortgage loans collateralizing the borrowing amounting to \$301.3 million. In addition, the Company paid a premium of \$6 million which will be recognized as a loss on extinguishment of debt in 2005.

On December 22, 2005, Premier Bank repaid the secured borrowing with Banco Bilbao Vizcaya Argentaria Puerto Rico resulting from the recharacterization of the mortgage loan transfers and assumed control of the mortgage loans collateralizing the borrowing amounting to \$70.2 million.

On December 30, 2005, Premier Bank repaid a portion of the secured borrowings with FirstBank Puerto Rico, the Puerto Rico commercial bank subsidiary of First BanCorp, or FirstBank, resulting from the recharacterization of the mortgage loan transfers and assumed control of the mortgage loans collateralizing the borrowing amounting to \$137.3 million.

On December 10, 2004, Premier Bank and Doral entered into certain master mortgage loan purchase and servicing agreements whereby the parties agreed to purchase up to \$1 billion in mortgage loans from each other. Of this amount, \$200.1 million was transferred by Premier Bank to Doral during the fourth quarter of 2004. These agreements were terminated on May 11, 2005. The investigation, described in Note 1 to the consolidated financial statements, determined that there was insufficient contemporaneous documentation to substantiate the Company's business purpose for these transactions in light of the timing, certain terms of the transactions, and the similarity of the purchase and sale amounts. Accordingly, these mortgage loan transactions have been deemed to be, for accounting purposes, secured borrowings from Doral. On October 2, 2006, Premier Bank, R&G Mortgage and Doral Bank entered into an agreement whereby Doral Bank accepted mortgage loans with an unpaid principal balance of \$398.7 million collateralizing the secured borrowing resulting from the recharacterization of the mortgage loan transfers, including \$239.4 million transferred during 2005, as repayment in full of the secured borrowing. Following this payment in kind, Doral Bank has legal title to the mortgage loans acquired from Premier Bank (and which Doral Bank held as collateral under the secured borrowing). The servicing rights for all of the underlying mortgage loans were retained by R&G Mortgage, the entity that had previously serviced the loans.

On October 2, 2006, Premier Bank and Doral Financial Corporation entered into an agreement whereby the Company accepted mortgage loans with an unpaid principal balance of \$411.2 million collateralizing the Company's secured loan to Doral resulting from the recharacterization of the mortgage loan transfers, including additional loan transfers occurring in the first quarter of 2005, as repayment in full of the Company's secured loan to Doral. Following this payment in kind, the Company has legal title to the mortgage loans acquired from Doral (and which the Company held as collateral under the secured lending). The servicing rights for all of the underlying mortgage loans were retained by Doral, the entity that had previously serviced the loans.

On October 18, 2006, the Company completed restructuring transactions with Westernbank Puerto Rico, or Westernbank, the Puerto Rico commercial bank subsidiary of W Holding Company, Inc. R&G Mortgage and Westernbank entered into two credit agreements totaling \$46.5 million to document the mortgage loan transfers between the parties, which had previously been accounted for as sales to Westernbank, as secured borrowings of R&G Mortgage. The credit agreements are secured by a pledge of the mortgage loans pursuant to a pledge and security agreement entered into between R&G Mortgage and Westernbank. With respect to Premier Bank's portion of the secured borrowing, which amounted to \$24.8 million, Premier Bank repaid its secured borrowing resulting from the recharacterization of the mortgage loan transfers and assumed control of the mortgages which collateralized such borrowings.

Table of Contents

During February 2007, the Company completed two restructuring transactions with FirstBank. First, R&G Mortgage and FirstBank entered into a credit agreement totaling \$267.2 million to document the mortgage loan transfers between the parties that had previously been accounted for as sales to FirstBank as secured borrowings of R&G Mortgage. The credit agreements are secured by a pledge of the mortgage loans pursuant to a pledge and security agreement entered into between R&G Mortgage and FirstBank. With respect to Premier Bank's share of the remainder of the secured borrowing, which amounted to \$50.1 million, Premier Bank repaid its secured borrowing and assumed control of the mortgages which collateralized such borrowings. Second, FirstBank and R&G Financial agreed to restructure various agreements involving approximately \$189.0 million of securities collateralized by loans that were originally sold through five grantor trusts. The modifications to the original agreements deleted or modified any previous conditions that precluded accounting for the transactions as sales. These modifications included a limited recourse of up to 10% of the unpaid principal balance of the mortgage loans.

On June 29, 2007, the Company and the Puerto Rico Mortgage Backed & U.S. Government Securities Fund restructured various agreements, deleting or modifying any previous conditions that precluded accounting for the transactions as sales.

On July 10, 2007, the Company completed restructuring transactions with Oriental Bank and Trust, a Puerto Rico chartered commercial bank, or Oriental. The restructuring involved certain mortgage loan transfers from Premier Bank to Oriental that were originally accounted for as sales but which were recharacterized as secured borrowings. As part of the restructuring, Oriental agreed to retain mortgage loans with an unpaid principal balance of \$26.6 million as of July 1, 2007. In addition, Premier Bank substituted certain mortgage loans with an unpaid principal balance of \$25.9 million as of July 1, 2007 with mortgage loans selected by Oriental that comply with its policies. Premier Bank also agreed to pay \$19.8 million to extinguish its secured borrowings from Oriental and assumed control of the mortgages which collateralized such borrowings. The substitution of mortgage loans carried a discount of \$900,000 which Premier Bank will recognize as a loss on the sale in 2007. In connection with this restructuring, Oriental and Premier Bank agreed to settle all pending litigation claims relating to the payment of certain prepayment penalties associated with the mortgage loans.

Status of Mortgage Banking Licenses. As previously disclosed, due to its lack of audited financial statements, R&G Mortgage has received a number of notices regarding the status of its mortgage banking authorizations from certain of the government agencies and GSEs with whom it has mortgage business relationships. As previously disclosed, R&G Mortgage has received notice from the United States Department of Housing and Urban Development, or HUD, of the immediate withdrawal of its status as a HUD-FHA Title II approved lender. R&G Mortgage has appealed this withdrawal to HUD. On September 28, 2007, as a result of the failure of HUD to properly follow its regulations in withdrawing R&G Mortgage as a HUD-FHA Title II approved lender, the chief administrative law judge of the HUD Office of Administrative Law Judges ordered HUD to reinstate R&G Mortgage's lender status pending the outcome of R&G Mortgage's appeal of the withdrawal of such status. This status was reinstated as of October 3, 2007.

As also previously disclosed, the Government National Mortgage Association, or GNMA, notified R&G Mortgage that it was withdrawing R&G Mortgage's authority to act as a GNMA issuer and as a servicer of GNMA mortgage pools. R&G Mortgage had received notice from GNMA extending until October 9, 2007 its authority to act as a servicer of GNMA mortgage pools. GNMA has since granted a further extension to R&G Mortgage until it completes its appeal with HUD. However, the Company cannot issue GNMA guaranteed mortgage-backed securities.

R&G Mortgage has also received notices from the Federal National Mortgage Association, or FNMA, placing certain conditions and limitations on R&G Mortgage's selling and servicing relationship with FNMA. On October 5, 2007, the Company announced that FNMA had not approved the application made by Premier Bank to become a FNMA Seller/Servicer. As a consequence, R&G Mortgage has to sell its FNMA servicing portfolio to a FNMA-approved mortgage servicer by a deadline which has now been extended to November 30, 2007. R&G Mortgage is working to effect the sale of this servicing portfolio as soon as possible. The FNMA servicing constituted approximately 2% of R&G Mortgage's total servicing portfolio as of June 30, 2007. FNMA has indicated that it determined to take these actions with respect to R&G Mortgage's servicing portfolio because of, among other reasons, recent ratings downgrades and the failure of R&G Mortgage to provide current audited financial statements. To date, R&G Mortgage remains a Seller/Servicer with the Federal Home Loan Mortgage Corporation, or FHLMC, and Premier Bank has also received approval to act as a FHLMC Seller/Servicer. FHLMC servicing amounted to approximately 40% of R&G Mortgage's servicing portfolio as of June 30, 2007.

Table of Contents

As previously disclosed, the Company is taking steps to address the issues posed by the foregoing actions of government agencies and GSEs. Premier Bank will seek to obtain authorization from GNMA to act as a GNMA Issuer/Servicer. Premier Bank has received approval from HUD to act as a HUD-FHA approved Title II lender. As a HUD-FHA approved lender, Premier Bank will be able to offer FHA-insured loans previously offered by R&G Mortgage. In addition, Premier Bank has received approval from FHLMC to act as a FHLMC Seller/Servicer.

If Premier Bank obtains approval from GNMA, it is the Company's intent to have R&G Mortgage transfer its GNMA servicing operations, including its servicing contracts and rights, to Premier Bank. This transfer will require regulatory approval from the FRB and the FDIC and other approvals from GNMA and third parties. While Premier Bank believes that it should be able to obtain all necessary approvals, no assurances can be given that Premier Bank will be successful in obtaining GNMA authorization or the required approvals for the transfer of the servicing rights or the mortgage banking business. If the Company is not successful in these efforts, such failure would have a material adverse effect on the Company.

Restructuring and Divestitures. On May 20, 2007, R&G Financial Corporation and its direct and indirect wholly owned subsidiaries, RAC and Crown Bank, entered into the Crown Agreement with Fifth Third Financial Corporation, or Fifth Third, pursuant to which Fifth Third would acquire all of the outstanding shares of common stock of Crown Bank for \$288 million, and assume the approximately \$50 million of outstanding trust preferred obligations of RAC. As previously disclosed, this transaction resulted in a goodwill impairment of approximately \$50 million. The Company now anticipates that upon closing the purchase price will be reduced to approximately \$259 million. Concurrent with the execution of the Crown Agreement, affiliates of Fifth Third entered into real estate purchase agreements, or the Crown Real Estate Agreements, with R-G Crown Real Estate, LLC, a Delaware limited liability company, or Crown LLC, which is wholly owned by Víctor J. Galán, the controlling shareholder and a director of the Company, with respect to the purchase by Fifth Third affiliates in connection with, and subject to, the transactions contemplated by the Crown Agreement, of certain real property owned by Crown LLC, which presently leases branch offices located on such properties in Florida and Georgia to Crown Bank.

The transaction is expected to close in the fourth quarter of 2007, pending receipt of all requisite regulatory approvals by Fifth Third and the satisfaction of various closing conditions, including the concurrent closings of the transactions contemplated by the Crown Agreement and the Crown Real Estate Agreements.

Effective October 10, 2006, the Company sold certain assets of the retail brokerage business of R-G Investments to UBS Financial Services Incorporated of Puerto Rico, or UBS PR, a subsidiary of UBS AG. The sale was approved by the National Association of Securities Dealers, or NASD.

The related purchase and sale agreement provided for cash consideration based upon the value of the assets in the customer accounts being transferred, with a portion paid at closing and additional cash consideration to be paid over a four-year period after the closing, based upon the value of the customer assets in the transferred accounts during such four-year period. Subsequent to the consummation of the transaction, R-G Investments continued to operate as a broker-dealer for the purpose of transferring accounts and winding up its operations until its broker-dealer registration with the NASD and the SEC was withdrawn, effective June 26, 2007. Upon completion of the transaction, the consideration received from the sale, plus existing capital of approximately \$10.9 million after payment of expenses associated with winding up R-G Investments operations, a process which the Company completed on June 29, 2007, was transferred to the Company to further support the Company's core banking business.

In order to continue offering a full range of brokerage services to its customers and in connection with the sale of certain assets described above, the Company also entered into a lease and customer access agreement, dated November 21, 2006, whereby Premier Bank can refer customers to UBS PR to service their investment needs. UBS PR financial advisors are available at designated Premier Bank branch locations.

Table of Contents

On June 30, 2005, Continental Capital Corporation, or Continental, a mortgage banking subsidiary of Crown Bank, sold its loan origination business, including certain assets, and assigned certain liabilities to Nation's Standard Mortgage Corp., an entity organized by Continental's senior management, for \$80,000. Subsequently, Continental's remaining net assets, consisting primarily of mortgage loans, were contributed to Crown Bank and the Company dissolved the corporate entity in 2007.

Sale of Mortgage Loan Portfolio. On September 28, 2007, R&G Mortgage completed the sale of a residential mortgage loan portfolio, primarily sub-performing and non-performing mortgage loans, for approximately \$64 million to a private investor and used the proceeds of the sale to repay approximately \$55.9 million of outstanding borrowings under its mortgage loan warehousing and working capital credit facilities (including \$4.5 million to repay outstanding borrowings to Premier Bank under a warehousing credit facility that is eliminated in consolidation) and to meet certain other operational commitments. This transaction resulted in a realized loss on the sale of approximately \$31 million.

Sale of Portion of Crown Servicing Portfolio. On December 29, 2006, Crown Bank sold to EverBank, a federal savings association based in Jacksonville, Florida, the portion of its mortgage servicing rights portfolio which was serviced for others with an unpaid principal balance of approximately \$1.5 billion.

Tax Agreements Related to Inter-Subsidiary IO Strip Transfers. During 2007, as a result of the correction in the accounting for certain mortgage loan transfers being recharacterized as secured borrowings, the Company entered into a new agreement with the Puerto Rico Treasury Department, or PRTD. The new agreement clarified that notwithstanding the aforementioned recharacterization, the 2005 intercompany IO strip transaction permitted the Company to acquire separate and identifiable assets with a tax basis of \$123.9 million related to the IO strips subject to the payment of the capital gains tax. The agreement further clarified that the IO tax asset is a stand-alone intangible asset subject to a straight-line amortization based on a useful life of 15 years.

Deferral of Acquisition-Related Expenses. As part of the Audit Committee's investigation mentioned above, the Company learned that, in the spring of 2005, the former chief financial officer of Crown Bank and the former controller of Crown Bank became aware, as a result of the former controller's discussion with a representative of Crown Bank's independent registered public accountants, that GAAP required that certain acquisition-related expenses be expensed as incurred rather than deferred and amortized. Crown Bank's former chief financial officer and former controller nonetheless deferred and amortized these costs.

Remediation of Material Weaknesses in Internal Control Over Financial Reporting. During the restatement process, the Company initiated a remediation program, under the oversight of the Audit Committee and management, to address the principal factors that contributed to the need for the restatement and to enhance the Company's overall corporate governance. For additional information regarding this program, refer to Remediation of Material Weaknesses under Item 9A, Controls and Procedures in this 2004 Annual Report on Form 10-K/A.

Certain of these and other subsequent events are addressed in the Company's Current Reports on Form 8-K filed with the SEC on April 26, 2005, April 29, 2005, May 20, 2005, July 27, 2005, August 24, 2005, August 26, 2005, October 5, 2005, October 25, 2005, November 4, 2005, January 5, 2006, January 13, 2006, February 14, 2006, March 13, 2006, March 17, 2006, March 31, 2006, May 2, 2006, June 2, 2006, July 3, 2006, July 28, 2006, August 29, 2006, August 31, 2006, October 4, 2006, October 12, 2006, October 27, 2006, October 30, 2006, November 17, 2006, December 18, 2006, December 27, 2006, January 19, 2007, February 5, 2007, February 12, 2007, February 23, 2007, February 28, 2007, March 15, 2007, March 29, 2007, April 30, 2007, May 21, 2007, June 21, 2007, June 28, 2007, June 29, 2007, July 11, 2007, July 16, 2007, July 18, 2007, August 31, 2007, September 18, 2007 and October 5, 2007 and on Form 8-K/A filed with the SEC on July 25, 2005 and on June 4, 2007.

Table of Contents

Cautionary Statement Regarding Forward-Looking Statements

A number of the presentations and disclosures in this Form 10-K/A, including any statements preceded by, followed by or which include the words may, could, should, will, would, hope, might, believe, expect, anticipate, estimate, intend, plan, assume or forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995.

These forward-looking statements implicitly and explicitly include the assumptions underlying the statements and other information with respect to the Company's beliefs, plans, objectives, goals, expectations, anticipations, estimates, intentions, financial condition, results of operations, future performance and business, including its expectations and estimates with respect to its revenues, expenses, earnings, return on equity, return on assets, efficiency ratio, asset quality and other financial data and capital and performance ratios.

Although the Company believes that the expectations reflected in its forward-looking statements are reasonable, these statements involve risks and uncertainties that are subject to change based on various important factors (some of which are beyond the Company's control). The following factors, among others, could cause the Company's financial performance to differ materially from its goals, plans, objectives, intentions, expectations and other forward-looking statements:

Regulatory and judicial proceedings, including risks associated with the ongoing SEC investigation and potential adverse developments in connection with ongoing shareholder litigation against the Company;

Risks associated with being subject to cease and desist orders from federal and state regulators;

Risks associated with the Company's inability to prepare and timely submit regulatory filings;

Risks arising from material weaknesses in the Company's internal control over financial reporting;

Increased expenses associated with the restatement process and investigation;

The strength of the United States economy in general and the strength of the regional and local economies within Puerto Rico and Florida;

Risks arising from worsening economic conditions in Puerto Rico;

Potential further downgrades in the credit ratings of the Company and its securities;

The Company's ability to attract and retain key employees;

The Company's ability to successfully implement new business strategies;

The effects of, and changes in, trade, monetary and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System;

Inflation, interest rate, market and monetary fluctuations;

The Company's timely development of new products and services in a changing environment, including the features, pricing and quality of its products and services compared to the products and services of its competitors;

The willingness of users to substitute competitors' products and services for the Company's products and services;

The impact of changes in financial services policies, laws and regulations, including laws, regulations and policies concerning taxes, banking, securities and insurance, and the application thereof by regulatory bodies;

Table of Contents

Technological changes;

National disasters, including hurricanes;

Terrorist attacks;

Changes in consumer spending and savings habits; and

Regulatory or judicial proceedings.

If one or more of the factors affecting its forward-looking information and statements proves incorrect, then the Company's actual results, performance or achievements could differ materially from those expressed in, or implied by, forward-looking information and statements contained in this Form 10-K/A.

Therefore, the Company cautions readers not to place undue reliance on its forward-looking information and statements.

The Company does not intend to update its forward-looking information and statements, whether written or oral, to reflect changes. All forward-looking statements attributable to the Company are expressly qualified by these cautionary statements.

Table of Contents**TABLE OF CONTENTS**

<u>PART I</u>		
ITEM 1:	<u>BUSINESS</u>	19
ITEM 2:	PROPERTIES*	19
ITEM 3:	<u>LEGAL PROCEEDINGS</u>	80
ITEM 4:	SUBMISSIONS OF MATTERS TO A VOTE OF SECURITY HOLDERS*	
<u>PART II</u>		81
ITEM 5:	MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES*	
ITEM 6:	<u>SELECTED FINANCIAL DATA</u>	81
ITEM 7:	<u>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	85
ITEM 7A:	<u>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	159
ITEM 8:	<u>FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA</u>	159
ITEM 9:	CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE*	
ITEM 9A:	<u>CONTROLS AND PROCEDURES</u>	159
ITEM 9B:	OTHER INFORMATION*	
<u>PART III</u>		
ITEM 10:	DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT*	
ITEM 11:	EXECUTIVE COMPENSATION*	
ITEM 12:	SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS*	
ITEM 13:	CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS*	
ITEM 14:	PRINCIPAL ACCOUNTANT FEES AND SERVICES*	
<u>PART IV</u>		180
ITEM 15:	<u>EXHIBITS AND FINANCIAL STATEMENT SCHEDULES*</u>	180
<u>SIGNATURES</u>		
EX-12.1	COMPUTATION OF RATIO OF EARNINGS TO FIXED CHARGES	
EX-12.2	COMPUTATION OF RATIO OF EARNINGS TO FIXED CHARGES AND PREFERRED STOCK DIVIDENDS	
EX-21.1	LIST OF SUBSIDIARIES	
EX-31.1	SECTION 302 CERTIFICATION OF THE CEO	
EX-31.2	SECTION 302 CERTIFICATION OF THE CFO	
EX-32.1	SECTION 906 CERTIFICATION OF THE CEO	
EX-32.2	SECTION 906 CERTIFICATION OF THE CFO	

* Part I, Items 2 and 4, Part II, Items 5, 9 and 9B, Part III, Items 10, 11, 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. Copies may be obtained electronically through R&G Financial's website at www.rgonline.com in the Investor Relations section or from Andrés I. Pérez, R&G Financial Corporation, 290 Jesús T. Piñero Avenue, Hato Rey, San Juan, Puerto Rico 00918. Part III, Items 11, 13 and 14 and portions of Part III, Items 10 and 12 were included in R&G Financial's Definitive Proxy Statement used in connection with R&G Financial's 2005 Annual Meeting of Stockholders.

Table of Contents

PART I

ITEM 1: BUSINESS.

General

The Company

As of December 31, 2004, R&G Financial Corporation was a financial holding company organized as a Puerto Rico corporation that operates Premier Bank, a Puerto Rico commercial bank, and Crown Bank, a Florida domiciled federal savings bank. The Company also operates R&G Mortgage, which was the second largest mortgage company in Puerto Rico as of December 31, 2004. The Company conducts an insurance agency business in Puerto Rico through R-G Insurance Corporation (formerly Home & Property Insurance Corp.). As of December 31, 2004, the Company also operated The Mortgage Store of Puerto Rico, Inc., or The Mortgage Store, a subsidiary of R&G Mortgage, and Continental, which conducted business in the continental United States. As of December 31, 2004, the Company offered broker-dealer services in Puerto Rico through R-G Investments. The Company, in separate subsequent actions, sold Continental's loan origination business in June 2005 and subsequently contributed its remaining net assets to Crown Bank, which we refer to as the 2005 Continental disposition, merged The Mortgage Store into R&G Mortgage during 2006 and on June 29, 2007 liquidated R-G Investments following the sale of certain assets of its retail brokerage business to UBS Financial Services Incorporated of Puerto Rico in late 2006. On May 20, 2007, the Company entered into a stock purchase agreement with Fifth Third pursuant to which the Company agreed to sell Crown Bank, as described above under Explanatory Note Other Subsequent Events Restructuring and Divestitures .

As of December 31, 2004, the Company was in its 33rd year of operations and operates its business through its subsidiaries. The Company provides a full range of banking services through its banking subsidiaries, Premier Bank, with 33 branches in Puerto Rico, and Crown Bank, with 15 branches in Florida as of December 31, 2004. Banking services include commercial banking services, corporate real estate and business lending, residential construction lending, consumer lending and credit cards. Premier Bank and Crown Bank offer a diversified range of deposit products and, to a lesser extent, trust and investment services through Premier Bank's trust department and, prior to its disposition, the Company's broker-dealer, R-G Investments. The Company also provides a range of real estate secured lending activities, including the origination, servicing, purchase and sale of mortgages on single-family residences, the securitization and sale of various mortgage-backed and related securities, the holding and financing of mortgage loans and mortgage-backed and related securities for sale or investment and the purchase and sale of servicing rights associated with such mortgage loans.

In June 2002, the Company acquired Crown Bank, which operates in the Tampa St. Petersburg Clearwater, Lake Worth and Orlando metropolitan areas. According to the Metro Orlando Economic Development Commission, the Orlando market is one of the fastest growing markets in Florida, both generally and for Hispanics in particular (mainly Puerto Ricans). Management believed that owning and operating Crown Bank is a cost effective way to access the Hispanic markets in the United States, while providing a strong platform for further expansion in Florida. On October 11, 2004, the Company and Crown Bank entered into a purchase and assumption agreement with SouthTrust Bank to acquire 18 SouthTrust branches located in three banking markets in Florida and one banking market in Georgia. The acquisition was completed on February 18, 2005. The transaction permitted Crown Bank to expand its Central Florida footprint into nearby Lakeland and Deland, Florida and obtain a foothold in the Jacksonville, Florida and Augusta, Georgia markets. As described above, the Company has entered into an agreement to sell Crown Bank.

The Company has generally sought to achieve long-term financial strength and profitability by increasing the amount and stability of its net interest income and non-interest income. The Company has sought to implement this strategy by (i) expanding its retail banking franchise in order to achieve increased market presence and to increase core deposits, (ii) enhancing its net interest income by increasing its loans held for investment, particularly real estate secured loans, (iii) emphasizing the growth of its mortgage banking activities, including the origination and sale of mortgage loans, and growing its loan servicing operation, (iv) developing new business relationships through an increased emphasis on commercial real estate and commercial business lending, (v) diversifying its retail products and services, including an increase in consumer loan originations, (vi) meeting the financial needs of its customers through, among other things, the offering of trust and investment services and insurance products and (vii) emphasizing controlled growth, while pursuing a variety of acquisition opportunities when appropriate. Refer to Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations Future Operations for further information regarding the Company's initiatives and strategies since December 31, 2004.

Table of Contents

As of the date of this filing, the Company's principal executive offices are located at 290 Jesús T. Piñero Avenue, San Juan, Puerto Rico 00918 and its telephone number is (787) 758-2424.

Risk Factors

Some of the factors that could cause R&G Financial's actual results for future periods to differ materially from those anticipated are discussed below:

Risks Relating to the Restatement Process

R&G Financial is subject to ongoing regulatory investigations by the SEC, which could require it to pay substantial fines or penalties.

On April 26, 2005, R&G Financial announced that the SEC was conducting an informal investigation into the April 25, 2005 announcement that the Company would restate its financial statements and the underlying issues addressed in that announcement. On October 25, 2005, the Company filed a Form 8-K relating to the receipt of a notification from the SEC regarding the commencement of a formal investigation. A formal investigation enables the SEC to issue subpoenas for witnesses and documents, including third parties outside the Company. As part of a formal investigation, the Company received a subpoena from the SEC on October 21, 2005 seeking the production of documents principally regarding the restatement and related financial reporting matters and the terms of certain transactions with local financial institutions.

R&G Financial has also received an informal inquiry from the U.S. Attorney's Office for the Southern District of New York relating to these matters and the Company has provided information requested by the U.S. Attorney's Office. The Company is fully cooperating with all regulatory investigations.

R&G Financial cannot predict when these investigations will be completed or what the results of these investigations will be. The effects and results of these or other investigations may have a material adverse effect on R&G Financial's business, results of operations, financial condition and liquidity. Adverse developments related to such investigations, including any expansion of their scope, could negatively impact the Company and could divert efforts and attention of its management team from R&G Financial's ordinary business operations. R&G Financial may be required to pay material fines or suffer other penalties, each of which could have a material adverse effect on its business, results of operations, financial condition and liquidity. These investigations may adversely affect R&G Financial's ability to obtain, and increase the cost of obtaining, directors' and officers' liability insurance and other types of insurance, which could have a material adverse effect on R&G Financial's businesses, results of operations and financial condition. In addition, the findings of these investigations may affect the course of the civil litigation pending against R&G Financial, which is more fully described below.

Significant legal proceedings could adversely affect R&G Financial's results of operations.

In addition to being subject to litigation in the ordinary course of business, R&G Financial is a party to several legal and regulatory proceedings relating to the restatement. Refer to Explanatory Note Subsequent Events and Item 3 Legal Proceedings. R&G Financial cannot predict at this time the outcome of these proceedings or estimate the potential costs related to the proceedings. It is possible that the Company may be required to pay substantial fines, penalties, judgments or settlements that could have a material adverse effect on the Company's business, results of operations, financial condition or liquidity. In addition, the expenses incurred in connection with these proceedings (including substantial fees of lawyers and other professional advisors and potential obligations to indemnify officers and directors who may be parties to such actions) could have an adverse effect on the Company's cash position.

Table of Contents

R&G Financial and its banking subsidiaries are subject to the supervision and regulation of various banking regulators, and these regulators could take action against the Company or its banking subsidiaries.

As a regulated financial services firm, R&G Financial's good standing with its regulators is of fundamental importance to the continuation and growth of its businesses. R&G Financial is subject to supervision and regulation by the FRB. Premier Bank is subject to supervision and regulation by the FDIC and the OCFI. Crown Bank is subject to supervision and regulation by the OTS and the FDIC. R&G Financial is a bank holding company that, as of December 31, 2004, was registered as a financial holding company. The Company withdrew its election to be treated as a financial holding company, which became effective September 7, 2007. Banking regulators may take adverse actions against R&G Financial or its banking subsidiaries as a result of the restatement or related or other internal control matters.

As described above under Explanatory Note Subsequent Events Other Subsequent Events Regulatory Orders, the Board of Directors of R&G Financial consented to the issuance of the FRB Order, the Board of Directors of Premier Bank consented to the issuance of the FDIC Order and the Board of Directors of Crown Bank consented to the issuance of the Crown Order. R&G Financial and its subsidiaries continue to respond to inquiries and requests for documents from the FRB and the other banking regulators of the Company and its subsidiaries regarding the status and impact of the restatement and related or other safety and soundness concerns. The enforcement powers available to federal banking regulators include, among other things, the ability to assess civil monetary penalties, to issue cease-and-desist or removal orders, to require written agreements and to initiate injunctive actions. 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. It is possible that the banking regulators will take action beyond the Orders and the Crown Order, and that any such action may have a material adverse effect on R&G Financial.

At this time, R&G Financial cannot predict whether any actions taken by its banking regulators will have a material adverse effect on R&G Financial's business, financial condition or results of operations.

Downgrades in R&G Financial's credit ratings will increase the Company's borrowing costs and may lessen its ability to compete in certain businesses.

Prior to the Company's April 25, 2005 announcement that it would restate its financial statements, Fitch Ratings had given the Company a long-term issuer default rating of BBB with a credit negative outlook. Since that time, Fitch Ratings has maintained the credit negative outlook and lowered the long-term issuer default rating of the Company to CCC.

The long-term issuer default rating is assigned based on the rating agency's assessment of a company's ability to meet all of its most senior financial obligations on a timely basis over the term of the obligation and is, therefore, effectively a rating of the benchmark probability of default. These ratings or further downgrades may therefore adversely affect R&G Financial's ability to access capital, including preferred stock, and will likely result in more stringent covenants and higher interest rates under the terms of any future indebtedness incurred by the Company. These ratings could also increase the Company's borrowing costs and margin requirements and could therefore adversely affect the Company's liquidity and results of operations.

These ratings are the current opinions of a rating agency. 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. Ratings may also be withdrawn at the request of the Company's management. These ratings actions have affected and will continue to affect R&G Financial's business and results of operations in a number of ways.

Management has identified several material weaknesses in R&G Financial's internal control over financial reporting.

R&G Financial's management has concluded that the Company's internal control over financial reporting was not effective at December 31, 2004 as a result of several material weaknesses discussed in this report on Form 10-K/A. As a result, this report includes an adverse opinion from PricewaterhouseCoopers LLP, the Company's independent registered public accounting firm, on R&G Financial's internal control over financial reporting. Each material weakness results in more than a remote likelihood that a material misstatement of the Company's annual or interim financial statements will not be prevented or detected. The Company's ability to file its periodic reports with the SEC in a timely manner may also be adversely affected by the existence of ineffective controls.

Table of Contents

A discussion of the material weaknesses that have been identified by management can be found in Item 9A of Part II of this 2004 Annual Report on Form 10-K/A. While remediation of these weaknesses has begun, R&G Financial has not yet fully implemented its plan for remedying the identified material weaknesses. For further information, refer to Item 9A Controls and Procedures Management's Report on Internal Controls Over Financial Reporting (Restated) Remediation of Material Weaknesses below.

The pink sheets market does not provide shareholders with a meaningful degree of liquidity.

The Company's common stock was delisted from the NYSE prior to the NYSE's opening on February 22, 2007 and now trades on the pink sheets, an electronic quotation service for securities traded over-the-counter. Trading on the pink sheets can be sporadic and does not provide any meaningful liquidity to investors. An investor may find it difficult to dispose of shares or obtain accurate quotations as to the market value of the common stock. While the Company plans to seek listing of its common stock on the NYSE once it becomes current in its SEC filing obligations and meets the NYSE's listing standards, the Company cannot provide assurance as to when or if it will meet those listing standards.

R&G Financial does not expect to be able to access the public capital markets until all of its filings with the SEC are up to date, including any amendments to previously filed reports.

R&G Financial anticipates that, once it is current in its filings with the SEC, it will be able to access the institutional investor market. However, R&G Financial will be unable to access the U.S. public securities markets until it has filed, and the SEC has declared effective, a new registration statement or post-effective amendments to existing registration statements under the Securities Act of 1933. This process may take several months or longer from the time R&G Financial becomes current in its filings with the SEC.

Until R&G Financial is current in its SEC filings, a holder of restricted securities within the meaning of Rule 144 of the Securities Act will be unable to sell such securities in reliance on Rule 144, unless such holder has held such securities for at least two years and is not an affiliate of R&G Financial for purposes of the U.S. federal securities laws.

There is a lack of public disclosure concerning R&G Financial.

R&G Financial has not yet filed with the SEC its quarterly reports on Form 10-Q for the fiscal quarters ended March 31, 2005, June 30, 2005, September 30, 2005, March 31, 2006, June 30, 2006, September 30, 2006, March 31, 2007, and June 30, 2007. The Company has not yet filed with the SEC its annual reports on Form 10-K for the fiscal years ended December 31, 2005 and December 31, 2006 and does not anticipate that it will be able to file its annual report on Form 10-K for the fiscal year ended December 31, 2007 by the applicable deadline. The Company expects to file these reports as soon as practicable after the date of this 2004 Annual Report on Form 10-K/A. Until R&G Financial files these quarterly and annual reports, there will be limited public information available concerning the Company's more recent results of operations and financial condition. The absence of more recent financial information may have a number of adverse effects on R&G Financial and its securities, including a decrease in the market price of the Company's securities and an increase in the volatility of such market price.

R&G Financial may fail to attract and retain key employees and management personnel.

R&G Financial's success has been and will continue to be influenced by its ability to attract and retain key employees and management personnel, including senior and middle management. R&G Financial's ability to attract and retain key employees and management personnel may be adversely affected as a result of the restatement and related risks and uncertainties.

Loss of certain licenses from government-sponsored entities would materially adversely impact the Company's mortgage business.

The mortgage banking business conducted by R&G Mortgage as of December 31, 2004 is subject to the rules and regulations of the Federal Housing Administration, or FHA, the Veterans Administration, or VA, FNMA, FHLMC, GNMA, HUD and the Rural Housing Service, or RHS, with respect to originating, processing, selling and servicing mortgage loans and the issuance and sale of mortgage-backed securities. Loss of licenses from either the FHA or the VA would prevent R&G Mortgage from originating FHA-insured or VA-guaranteed loans. Loss of seller-servicer licenses from FNMA or FHLMC would prevent R&G Mortgage from selling whole loans to these entities or securitizing pools of loans to these entities. Loss of its GNMA issuer/servicer license would prevent R&G Mortgage from securitizing loans into mortgage-backed securities through GNMA.

Table of Contents

As described above under Explanatory Note Subsequent Events Other Subsequent Events Status of Mortgage Banking Licenses, R&G Mortgage has received a number of notices regarding the status of its mortgage banking authorizations, and the Company is taking steps to address the issues posed by the actions described in those notices, including the potential authorization of Premier Bank to engage in certain of the above-described lending functions, the potential transfer of portions of R&G Mortgage's servicing operations to Premier Bank, subject to all necessary regulatory approvals, as well as the sale of its FNMA servicing portfolio to a FNMA-approved mortgage servicer by a deadline which has now been extended to November 30, 2007. If the Company is not successful in these efforts, such failure would have a material adverse effect on the Company.

Failure to consummate the sale of Crown Bank or any significant delay in the consummation of the transaction would have a material adverse effect on the Company's liquidity and financial condition and could result in banking regulators placing further restrictions on the Company's operations and its banking subsidiaries or taking actions that could have a material adverse effect on the value of the Company's preferred and common stock.

The Company's regulatory capital ratios have been adversely affected as a result of the restatement, in particular by the recharacterization as secured borrowings of various mortgage loan transfers that had initially been recorded as sales. In addition, the Company has experienced a number of difficulties that have had an adverse effect on its liquidity, such as a reduction in the Company's mortgage loan sale channels, a reduction in its access to capital and other funding sources as a result of its lack of current financial statements, and the incurrence of significant legal and accounting restatement-related expenses. The sale of Crown Bank to Fifth Third will strengthen the Company's regulatory capital ratios as a result of the reduction in the Company's consolidated total assets and will provide approximately \$89.0 million in liquidity to the holding company. The transaction is subject to the satisfaction of various conditions, as discussed above under Other Subsequent Events Restructuring and Divestitures, including the receipt of regulatory approvals by Fifth Third and the absence of certain material adverse developments relating to Crown Bank or its business.

Because of the deterioration in the Company's capital ratios and liquidity since the Company's restatement announcement, if the sale of Crown Bank is not consummated or if there is any significant delay in the consummation of the transaction, the Company's financial condition and liquidity would be materially adversely affected and banking regulators could place further restrictions on the operations of the Company and its banking subsidiaries or take actions that could have a material adverse effect on the value of the Company's preferred and common stock. As discussed above, the Orders require the Company to submit periodic capital and liquidity plans to the FRB and the FDIC, and the FRB could cease to grant permission to make monthly dividend payments on the Company's outstanding series of preferred stock and trust preferred securities if the FRB determines that the Company can no longer serve as a source of financial strength to its banking subsidiaries. Any such action by the banking regulators would have a material adverse effect on the Company's business and results of operations.

Risks Relating to R&G Financial's Business

Fluctuations in interest rates may impact R&G Financial's business.

The primary market risk affecting R&G Financial is interest rate risk, primarily fluctuations in interest rates. Changes in interest rates affect the following areas of the Company's business:

The number of mortgage loans originated and purchased;

The interest income earned on loans and securities;

The interest expense paid on deposits and borrowings;

The gain on sales of loans;

Table of Contents

The value of securities holdings, retained residual interests and derivative instruments that the Company may now or in the future hold;

The value of the Company's servicing assets; and

The level of prepayment of loans.

Increases in interest rates reduce demand for new mortgage loan originations and refinancings.

Higher interest rates increase the cost of mortgage loans to consumers and reduce demand for mortgage loans, which negatively impacts the Company's profits. Based on historical experience, the Company expects a decrease in demand for its mortgage loans as interest rates increase. Reduced demand for mortgage loans results in reduced loan originations and lower gain on sale of loans. Demand for refinancings is particularly sensitive to increases in interest rates.

Increases in short-term interest rates reduce net interest income.

The Company is liability sensitive, which means that, on average, its liabilities re-price and/or mature earlier than its assets. Thus, increases in short-term interest rates reduce net interest income, which is an important part of the Company's earnings. Net interest income is the difference between the interest the Company receives on its interest-earning assets and the interest the Company pays on its interest-bearing liabilities. Most of the Company's interest-earning assets, like its mortgage loans and mortgage-backed securities, are long-term assets. In contrast, a large portion of the Company's liabilities are short-term. When interest rates rise, the Company must pay more in interest on its short-term borrowings while interest earned on its long-term assets does not rise as quickly, which causes profits to decrease. This adverse impact on earnings is exacerbated when the slope of the yield curve flattens, that is, when short-term interest rates increase more than long-term rates.

Increases in long-term interest rates may reduce or eliminate gain on sale of mortgage loans.

If long-term interest rates increase between the time the Company commits to or establishes an interest rate on a mortgage loan and the time it sells the loan, the Company may realize a reduced gain or a loss on such sale.

Increases in interest rates may reduce the value of mortgage loans and securities holdings.

Increases in interest rates may reduce the value of the Company's financial assets and have an adverse impact on the Company's earnings and financial condition. The Company owns a substantial portfolio of mortgage loans, mortgage-backed securities and other debt securities, which have both fixed and adjustable interest rates. The market value of an obligation with a fixed interest rate generally decreases when prevailing interest rates rise, which may have an adverse effect on the Company's earnings and financial condition. In addition, the market value of an obligation with an adjustable interest rate can be adversely affected when interest rates increase due to a lag in the implementation of repricing terms as well as due to caps, which may limit the increase in the interest rate of an obligation.

Decreases in long-term interest rates may adversely affect the value of the Company's servicing assets.

Decreases in long-term interest rates lead to increases in the prepayment of mortgages by borrowers, which may reduce the value of the Company's servicing assets. The servicing assets are the estimated present value of the fees the Company expects to receive on the mortgages it services over their expected term. If prepayments increase above expected levels, the value of the servicing assets decreases because the amount of future fees expected to be received by the Company decreases. The Company may be required to recognize this decrease in value by taking a charge against its earnings, which would cause its profits to decrease.

In the last half of 2004, the FRB began tightening monetary policy and increasing the interest rates it charges to banks, which resulted in an increase in short term interest rates. The Company believes, based on historical experience, that the amount of prepayments and related impairment charges should decrease as long-term interest rates increase.

Table of Contents

The Company is exposed to credit risks from mortgage loans held pending sale and mortgage loans that have been sold subject to recourse arrangements.

From the time that the Company funds the mortgage loans it originates for third parties to the time the loans are sold or securitized into mortgage-backed securities, the Company is generally at risk of any mortgage loan defaults. In addition, with respect to the securitization or sale of non-conforming mortgage loans originated by the Company, the Company provides recourse in the event of mortgage loan defaults and foreclosures and consequently may suffer losses on these loans. The Company suffers losses on these loans when the proceeds from a foreclosure sale of the property underlying a defaulted mortgage loan are less than the outstanding principal balance of the loan and the costs of holding and disposing of the related property. At December 31, 2004, there were \$664.6 million of loans subject to such recourse provisions.

Defective and repurchased loans may harm the Company's liquidity and financial condition.

In connection with the sale and securitization of loans in the ordinary course of business, the Company makes a variety of customary representations and warranties regarding the Company and the loans being sold or securitized. The Company's obligations with respect to these representations and warranties are generally outstanding for the life of the loan, and they relate to, among other things, compliance with laws and regulations, underwriting standards, the accuracy of information in the loan documents and loan file and the characteristics and enforceability of the loan.

A loan that does not comply with these representations and warranties may take longer to sell, impact the Company's ability to obtain third-party financing for the loan, and be unsaleable or saleable only at a significant discount. If such a loan is sold before the Company detects non-compliance, the Company may be obligated to repurchase the loan and bear any associated loss directly, or it may be obligated to indemnify the purchaser against any such loss, either of which could reduce the Company's cash available for operations and liquidity.

The Company seeks to minimize its exposure to repurchases and losses from defective loans by using underwriting standards that ensure that loans are originated in accordance with the secondary market's requirements or by correcting flaws, if possible, and selling or re-selling such loans. The Company does not maintain a reserve for possible losses related to repurchases resulting from representation and warranty violations because it does not expect any such losses to be significant. However, no assurance can be given that losses associated with defective loans will not adversely impact its results of operations or financial condition.

Disruptions in the secondary mortgage market could adversely affect the Company's access to liquidity.

In connection with the restatement, R&G Financial added approximately \$2.0 billion in mortgage loans held for sale to its balance sheet as of December 31, 2004 as a result of the recharacterization as secured borrowings of certain mortgage loan transfers previously classified as sales. These loans were previously transferred by Premier Bank, Crown Bank and R&G Mortgage to other financial institutions and third-party investors and include both conforming and non-conforming mortgage loans. Certain of these loans possess adverse credit criteria.

The Company's ability to sell the loans described above at acceptable margins has been negatively affected by a number of factors, including the current interest rate environment, relative demands for such loans and mortgage-backed securities, the cost of credit enhancements, investor perceptions of such loans and mortgage-backed securities and the risks posed by such products. The current disruption of the secondary market has impaired the ability of the Company to sell the loans described above into the secondary market, and the Company's limited ability to sell such loans could have a material adverse effect on the Company's liquidity, results of operations and future financial condition.

R&G Financial must identify new loan sale channels for its non-conforming mortgage loan production.

R&G Financial has historically transferred a significant portion of its non-conforming loan production to local financial institutions in transactions characterized as sales, at relatively high gain-on-sale margins through the creation of floating rate IO strips. As part of the restatement, the Company concluded that certain mortgage loan sales did not qualify as sales under SFAS No. 140 and should have been recorded as secured borrowings. For further information, refer to Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations Summary of Accounting Adjustments by Category Accounting for Loan Transfers Loan Transfer Transactions Recharacterized as Secured Borrowings.

Table of Contents

Following the announcement of the restatement, the Company has not been able to sell its non-conforming loan production in the local market to the same extent as it had prior to the announcement. As a result, the Company has relied on secondary market sales of non-conforming loans to U.S. mainland financial institutions or other investors and sales of conforming loans to and securitizations of conforming and non-conforming loans through GSEs as its outlets for the sale of its mortgage loan production. The requirements for sale of non-conforming loans in the U.S. secondary market are stricter than those existing in the Puerto Rico market prior to the restatement announcement, which, in combination with the lack of public disclosure regarding R&G Financial and the uncertainties associated with the restatement process, has affected the Company's ability to sell non-conforming loans and has resulted in a significantly lower gain on sale margin for those loans. The Company has sought to diversify secondary market outlets for its non-conforming loan products both on the U.S. mainland and in Puerto Rico.

To mitigate the changing market conditions in the secondary mortgage market, the Company has implemented more stringent origination and underwriting guidelines to ensure that a substantial portion of the Company's loan production can be sold into the secondary market (including the sale or securitization programs supported by FNMA, GNMA or FHLMC) or are high quality loans to be held in the Company's investment portfolio. A prolonged period of secondary market illiquidity could result in the Company having to implement further mortgage guideline tightening, which would result in lower mortgage production volumes.

The Company is subject to default risk in connection with loan originations of its subsidiaries.

Each of Premier Bank, Crown Bank and R&G Mortgage (including their respective subsidiaries) are subject to the risk of loss from loan defaults and foreclosures with respect to the loans originated for their respective portfolios or which have been added to their balance sheets in connection with the restatement process, as described below. Notwithstanding the care with which loans are originated, industry experience indicates that a portion of such loans will become delinquent and a portion of the loans will require partial or entire charge-off. Regardless of the underwriting criteria utilized by Premier Bank, Crown Bank or R&G Mortgage, losses may be experienced as a result of various factors beyond each entity's control, including, among others, changes in market conditions affecting the value of collateral and problems affecting the credit of the borrower. Due to the concentration of Premier Bank's and R&G Mortgage's loans in Puerto Rico and the concentration of Crown Bank's loans in Florida, adverse economic conditions in Puerto Rico or Florida could result in a decrease in the value of the respective entity's loan portfolio and underlying collateral. Although loan delinquencies have historically been higher in Puerto Rico than in the continental United States, loan charge-offs have historically been lower than in the continental United States.

Each of Premier Bank and Crown Bank have established provisions for loan and lease losses, which are charged to operations, in order to maintain the allowance for loan and lease losses at a level which is deemed to be appropriate by management based upon an assessment of prior loss experience, the volume and type of lending being conducted, industry standards, past due loans, general economic conditions in their market area and other factors related to the collectibility of the loan portfolios. Although each bank's management utilizes its best judgment in projecting loan and lease losses, there can be no assurance that management has accurately estimated the level of future loan and lease losses or that either bank will not have to increase its provisions for loan and lease losses in the future as a result of increases in non-performing loans or for other reasons beyond the control of either bank. Any such increase in either bank's provisions for loan and lease losses with respect thereto could have a negative impact on the Company's future financial condition or results of operations.

Mortgage loans held for sale in the secondary market by Premier Bank, Crown Bank and R&G Mortgage are carried at the lower of cost or estimated market value, computed in the aggregate. The Company includes in its estimate of market value a component that reflects the default risk associated with the loans. The amount by which cost exceeds market value is accounted for as a valuation allowance. Changes in the valuation allowance are included in the determination of income in the period in which the change occurs, and any such changes in the valuation allowance with respect to such loans could have a negative impact on the Company's future financial condition or results of operations. For further information, refer to Explanatory Note Subsequent Events Other Subsequent Events Sale of Mortgage Loan Portfolio.

Table of Contents

As described above, in connection with the restatement process, R&G Financial added approximately \$2.0 billion in mortgage loans held for sale to its balance sheet as of December 31, 2004 as a result of the recharacterization as secured borrowings of certain mortgage loan transfers previously classified as sales.

The Company's exposure to larger credit risk will increase as a consequence of the increase in the Company's construction and commercial lending activities.

Each of the Company's banking subsidiaries has increased its emphasis on residential construction, commercial real estate and commercial business lending, which is likely to increase their overall credit risk. Banks generally charge higher interest rates on commercial mortgage and business loans and residential construction loans than on residential mortgage loans because larger loan and lease losses are expected in commercial and residential construction loans. Commercial mortgage and business loans and residential construction loans are generally considered to be riskier than residential mortgage loans because they may have larger outstanding balances to a single borrower or group of related borrowers. In addition, the borrower's ability to repay a commercial mortgage and business loan or a residential construction loan may depend, in the case of a commercial mortgage or business loan, on the successful operation of the business or the property securing the loan and, in the case of a construction loan, on the successful completion and sale or operation of the project. The properties securing these loans are also more difficult to dispose of in foreclosure. If Premier Bank or Crown Bank experiences loan and lease losses that are higher than its allowance for loan and lease losses, the Company's profits and financial condition would be adversely affected. Enhanced regulatory focus on commercial lending could adversely impact this business line.

The Company is subject to risks in servicing loans for others.

The Company is also affected by mortgage loan delinquencies and defaults on mortgage loans that the Company services for third parties. Under certain types of servicing contracts, the servicer must advance all or part of the scheduled payments to the owner of the mortgage loan, even when mortgage loan payments are delinquent. Also, to protect their liens on mortgaged properties, owners of mortgage loans usually require the servicer to advance mortgage and hazard insurance and tax payments on schedule even though sufficient escrow funds may not be available. The servicer will generally recover its advances from the mortgage owner or from liquidation proceeds when the mortgage loan is foreclosed. However, in the interim, the servicer must absorb the cost of funds advanced during the time the advance is outstanding, and there is a risk that the Company may not recover such advances if it does not follow the foreclosure/claims and diligence process provided for in the regulations or servicing guidelines established by the applicable mortgage banking regulator or counterparty. Further, the servicer must bear the increased costs of attempting to collect on delinquent or defaulted mortgage loans. In addition, if a default is not cured, the mortgage loan will be cancelled as a result of foreclosure proceedings. As a consequence, the Company is required to forego servicing income from the time such loan becomes delinquent.

The Company's interest rate risk management strategy may not be effective.

The Company enters into freestanding derivative instruments to manage its exposure to interest rate risk caused by changes in interest rates. Derivatives used by the Company include interest rate swaps, interest rate caps and options. Derivatives are generally either privately negotiated over-the-counter, or OTC, or standard contracts transacted through regulated exchanges. OTC contracts generally consist of swaps, caps and options. Exchange-traded derivatives include futures and options. Interest rate swap agreements involve the exchange of fixed and floating rate interest payment obligations without the exchange of the underlying principal. Interest rate caps and floors are option-like contracts that require the writer to pay the purchaser at specified future dates the amount, if any, by which a specified market interest rate exceeds the fixed cap rate or falls below the fixed floor rate, applied to a notional principal amount. The option writer receives a premium for bearing the risk of unfavorable interest rate changes. The derivative instruments that the Company may utilize also have their own risks, which include (1) market risk, which consists of the risk that the market value of such derivative instruments may fall; (2) credit or default risk, which consists of the risk of insolvency or other inability of the counterparty to a particular transaction to perform its obligations thereunder; and (3) legal risk, which consists of the risk that the Company is unable to enforce certain terms of such instruments. All or any of such risks could expose the Company to losses. Consequently, the Company's profitability may be adversely affected during any period as a result of the use of derivatives.

Table of Contents

For financial reporting purposes, the Company's general policy is to account for derivative instruments on a marked-to-market basis with gains or losses charged to current operations as they occur. Derivative contracts with positive fair value are reported as assets and contracts with negative fair values are reported as liabilities, after the application of netting arrangements, with unrealized gains and losses recorded in the Company's consolidated statements of income. The Company recognized pre-tax losses of \$2.9 million on such derivatives during the year ended December 31, 2004.

Under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, as subsequently amended, of SFAS No. 133, the Company may designate a derivative as (1) a hedge of the fair value of a recognized fixed rate asset or liability or an unrecognized firm commitment, or fair value hedge, (2) an accounting hedge of a forecasted transaction or of the variability of future cash flows of a floating rate asset or liability, or cash flow hedge, or (3) non-hedge. Changes in the fair value of a derivative instrument that is highly effective and that is designated and qualifies as a fair value hedge, along with change in fair value on the hedged asset or liability that is attributable to the hedged risk (including gains or losses on firm commitments), are recorded in current-period earnings. Changes in the fair value of a derivative instrument that is highly effective and that is designated and qualifies as a cash flow hedge are recorded in other comprehensive income in the stockholders' equity section of the consolidated statements of financial condition until earnings are affected by the variability of cash flows (e.g., when periodic settlements on a variable-rate asset or liability are recorded in earnings). 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. As of December 31, 2004, the Company did not qualify any of its derivatives as either fair value hedges or cash flow hedges.

The Company is exposed to greater risk because a significant portion of its business is concentrated in Puerto Rico, which has experienced an economic slowdown.

The Company's business activities and credit exposures have historically been concentrated with customers in Puerto Rico. An extended economic slowdown in Puerto Rico, adverse political or economic developments in Puerto Rico or natural disasters, such as hurricanes, affecting Puerto Rico could result in a downturn in loan originations, an increase in the level of nonperforming assets, an increase in the rate of foreclosure losses on mortgage loans and a reduction in the value of the Company's loans and loan servicing portfolio, all of which would adversely affect the Company's profitability.

Beginning in 2005 and continuing during 2006, a number of key economic indicators suggested that the economy of Puerto Rico was slowing down. According to the Puerto Rico Planning Board, Puerto Rico is currently in the midst of a recession that started in March 2006. In general, the Puerto Rico economy is experiencing a trend of decreasing growth and ended the first half of fiscal year 2007 with minimal momentum, primarily due to weaker manufacturing, softer consumption and decreased government investment in construction.

The economic concerns and uncertainty in the private and public sectors resulting from the economic slowdown in Puerto Rico may also have an adverse effect on the credit quality of the Company's loan portfolios, as delinquency rates are expected to increase in the short term, until the economy stabilizes. In addition, a potential reduction in consumer spending may also impact growth in other interest and non-interest revenue sources of the Company.

While the acquisition and subsequent growth of Crown Bank has facilitated a diversification of overall lending concentration, Crown Bank is subject to similar concentration risks in the Florida and Georgia markets in which it operates.

On May 20, 2007, the Company entered into a stock purchase agreement with Fifth Third pursuant to which the Company agreed to sell Crown Bank, as described above under Explanatory Note Subsequent Events Other Subsequent Events Restructuring and Divestitures.

The Company's origination business could be adversely affected if the Company cannot maintain access to stable funding sources.

The Company's business requires continuous access to various funding sources. While Premier Bank and Crown Bank are able to fund their operations through deposits as well as through longer-term borrowings from the FHLB and other alternative sources, the business of R&G Mortgage has been significantly dependent upon short-term borrowings under warehousing lines of credit. Some of these warehousing lines of credit require the maintenance of minimum levels of net worth and debt service and limit the amount of indebtedness and dividends that may be declared.

Table of Contents

As previously disclosed, under the credit agreements for these facilities, R&G Mortgage is required to maintain its mortgage banking licenses and is subject to certain financial covenants. In addition, both the Company and R&G Mortgage are required to deliver audited financial statements to the lenders. The Company and R&G Mortgage have failed to comply with some of these requirements, including delivery of audited financial statements. During the restatement process, R&G Mortgage has obtained certain waivers of default under its credit facilities both of which expired on October 31, 2007. The lenders have continued making advances under the warehousing facilities, but R&G Mortgage has agreed not to make any further draws under the working capital facilities at this time.

The Company is in the process of negotiating short-term extensions of these credit facilities but can give no assurance R&G Mortgage will be able to obtain such extensions under either or both of its credit facilities, or to obtain the further waivers that the Company would need if it is able to obtain such extensions. If the lenders under either of the credit agreements cease making advances under the warehousing facilities, accelerate or demand payment of any outstanding amounts or fail to grant extensions of the credit facilities, the consequences would be material to the Company's liquidity and operating flexibility.

The Company's loan portfolio has increased significantly in recent years and many of the Company's commercial real estate and commercial construction loans are relatively unseasoned, and defaults on such loans could adversely affect the Company's financial condition and results of operations.

The Company's loans and leases receivable, net portfolio has grown significantly in recent years, from \$1.1 billion at December 31, 2000 to \$3.9 billion at December 31, 2004. While 79.56% of the Company's loans and leases receivable, net portfolio continues to be secured by residential properties, an increasing amount of the Company's loan portfolio is comprised of commercial mortgages and commercial construction and development loans.

At December 31, 2004, the Company's real estate construction and development loan category and the commercial mortgages portion of the real estate mortgages category of the Company's loans and leases receivable, net portfolio amounted to an aggregate of \$1.3 billion or 33.7% of the Company's loans and leases receivable, net portfolio. Because such loans are relatively unseasoned, many of the loans may be too new to demonstrate problems. The Company attempts to mitigate these risks in commercial real estate lending through stringent underwriting criteria and in the case of construction and development loans, by limiting originations to primarily residential properties. As a result of the worsening economic conditions in Puerto Rico described above, the Company, like its competitors, has experienced increased defaults and delinquencies in this area since 2004, and no assurance can be given that a further increase in delinquencies and defaults will not occur. Defaults on these loans could negatively affect the Company's financial condition and results of operations.

The Company is subject to numerous laws and significant regulation and the failure to comply with these laws and regulations could adversely affect the Company.

R&G Financial, as a bank holding company (registered as a financial holding company from 2000 to 2007) organized as a Puerto Rico corporation, and its various subsidiaries, are each subject to federal and local governmental supervision and regulation. There are laws and regulations which restrict transactions between the Company and its various subsidiaries.

The Sarbanes-Oxley Act and the related rules and regulations promulgated by the SEC and the NYSE have increased the scope, complexity and cost of the Company's corporate governance reporting and disclosure practices. The Sarbanes-Oxley Act imposes a variety of civil and criminal penalties with respect to any violations of such act and the related rules and regulations.

The USA Patriot Act of 2001, or Patriot Act, and the Bank Secrecy Act, or BSA, contain anti-money laundering and financial transparency laws. The regulations under such acts include standards for verifying client identification at account opening and rules designed to prevent money laundering and to identify parties that may be involved in terrorism. In connection with the BSA and other matters, and as a result of an examination of Crown Bank that was conducted by the OTS in the first half of 2006, the Board of Directors of Crown Bank consented to the issuance of the Crown Order on October 3, 2006. As a result of that examination, the OTS determined that Crown Bank in the conduct of its business had violated various laws and regulations, including the BSA and OTS regulations governing the filing of suspicious activity reports, or SARs, and that OTS had engaged in certain unsafe and unsound banking practices. The Crown Order required Crown Bank to file with the OTS within prescribed time periods updated plans and reports as specified in the Crown Order. Among other things, Crown Bank was required to comprehensively review its program for compliance with the BSA and related regulations and SAR regulations and take any required corrective actions resulting from such review as well as certain actions specified in the Crown Order. Crown Bank's management was apprised of the OTS regulatory criticisms of its BSA compliance program at the time of the on-site regulatory examination in 2006 and immediately implemented corrective actions. Crown Bank's management believes that it has substantially addressed all of the criticisms set forth in the regulatory examination of its BSA compliance program. Refer to Explanatory Note Subsequent Events Other Subsequent Events Regulatory Orders for further details regarding the Crown Order and Regulation in this Item 1 for further information on various regulations to which the Company and its subsidiaries are subject.

Table of Contents

Any change in such regulations, whether by applicable regulators or as a result of legislation subsequently enacted by the Congress of the United States or the applicable local legislatures, could have a substantial impact on the Company's operations and profitability.

Competition with other financial institutions could adversely affect the Company's profitability.

The Company faces substantial competition in originating loans and in attracting deposits. The competition in originating loans comes principally from other United States, Puerto Rico and foreign banks, mortgage banking companies, consumer finance companies, insurance companies and other institutional lenders and purchasers of loans. A number of institutions with which the Company competes have significantly greater assets, capital, name recognition and other resources. In addition, many of the Company's competitors are not subject to the same federal regulation that governs the Company's business. As a result, many of the Company's competitors have advantages in conducting certain businesses and providing certain services. Increased competition could require the Company to increase the rates it offers on deposits or lower the rates it charges on loans, which could adversely affect the Company's profitability.

The concentration of ownership in the Company's stock and disparate voting rights may leave minority stockholders with little control over R&G Financial.

Shares of the Company's Class A common stock are entitled to two votes per share and shares of the Company's Class B Common Stock are entitled to one vote per share. At December 31, 2004, Víctor J. Galán, then Chairman of the Board, owned all of the Company's outstanding Class A common stock, representing 42.2% of both classes of the Company's outstanding common stock and was entitled to exercise 59.3% of the outstanding voting rights. As a result, Mr. Galán has the power to elect and remove all of R&G Financial's Board of Directors and management and to determine the outcome of substantially all other matters to be decided by a vote of stockholders. Mr. Galán's interests may not necessarily always be consistent with the interests of all other stockholders. Any future offerings of Class A common stock will dilute the voting power of the Class B Common Stock.

Certain provisions in the Company's certificate of incorporation and bylaws have the effect of making it more difficult to change the Company's Board of Directors, and may make the Company's Board of Directors less responsive to stockholder control.

In addition to the amount of common stock controlled by the Company's former Chairman of the Board described immediately above, certain provisions of the Company's certificate of incorporation and bylaws have the effect of making it more difficult to effect change in the composition of the Company's Board of Directors, and may make the Board of Directors less responsive to stockholder control. The Company's certificate of incorporation provides that the members of its Board of Directors are divided into three classes as nearly equal as possible. At each annual meeting of stockholders, one-third of the members of the Board of Directors will be elected for a three-year term, and the other directors will remain in office until their three-year terms expire. Therefore, control of the Company's Board of Directors cannot be changed in one year, and at least two annual meetings must be held before a majority of the members of the Company's Board of Directors can be changed. These provisions also may tend to discourage attempts by third parties to acquire the Company because of the additional time and expense involved and a greater possibility of failure, and, as a result, may adversely affect the price that a potential purchaser would be willing to pay for the Company's capital stock, thereby reducing the amount a stockholder might realize in, for example, a tender offer for the Company's capital stock.

Table of Contents

Banking Operations

General. The Company provides a full range of banking services through its banking subsidiaries, Premier Bank and Crown Bank, including residential, commercial and personal loans and a diversified range of deposit products. Premier Bank also provides private banking, trust and other financial services to its customers.

R&G Financial's banking business consists principally of holding deposits from the general public and using them, together with funds obtained from other sources, to originate and purchase loans secured primarily by residential real estate, and to purchase mortgage-backed and other securities. To a lesser extent, but with increasing emphasis over the past few years, R&G Financial's banking subsidiaries also originate construction loans and loans secured by commercial real estate, as well as consumer and personal loans and commercial business loans. Such loans offer higher yields, are generally for shorter terms and offer the Company an opportunity to provide a greater range of financial services to its customers. Premier Bank also offers trust services through its trust department. To date, Premier Bank has engaged in business solely in Puerto Rico. Currently, Crown Bank conducts business from its Florida and Georgia locations, and as of December 31, 2004, also had leasing operations in Arizona, California and Tennessee, along with a mortgage division in Virginia. Prior to the 2005 Continental disposition, Continental originated retail construction and commercial loans in New York, New Jersey, Connecticut, North Carolina and Florida. On May 20, 2007, the Company entered into an agreement with Fifth Third pursuant to which the Company agreed to sell Crown Bank. Refer to the discussion below under **Explanatory Note** **Subsequent Events** **Other Subsequent Events** **Restructuring and Divestitures**.

At December 31, 2004, R&G Financial's loans and leases receivable, net, totaled \$3.9 billion, which represented 32.42% of R&G Financial's \$11.9 billion of total assets. At December 31, 2004, the real estate mortgages category amounted to \$2.5 billion or 65.68%, the real estate construction and development category amounted to \$536.5 million or 13.87%, the commercial and financial category amounted to \$566.7 million or 14.65%, the installment category amounted to \$159.4 million or 4.12% and the lease financing category amounted to \$108.6 million or 2.81%, respectively, of the loans and leases receivable, net portfolio.

Mortgage Banking

Originations. The Company, through its mortgage banking subsidiary R&G Mortgage, was the second largest originator and servicer of mortgage loans on single-family residences in Puerto Rico as of December 31, 2004. R&G Mortgage is primarily engaged in the business of originating first and second mortgage loans on single-family residential properties secured by real estate. R&G Mortgage also originated residential mortgage loans through The Mortgage Store, its wholly owned subsidiary, prior to the 2006 merger of The Mortgage Store into R&G Mortgage. Pursuant to agreements entered into between R&G Mortgage and Premier Bank, R&G Mortgage originates non-conforming conventional residential and consumer loans secured by real estate for Premier Bank under a type of agreement commonly referred to as **table funding**. Table funding is a common arrangement in the mortgage banking industry by which a mortgage banker provides certain loan origination activities, while another financial institution funds the loan at closing. In the case of R&G Mortgage and Premier Bank, R&G Mortgage performs most of the origination activities, such as advertising, interviewing processing and closing, while Premier Bank undertakes the underwriting decisions and, if the loan closes, funds the loan. The non-conforming conventional single-family residential loans are referred to as such because these loans generally do not satisfy resale guidelines of purchasers in the secondary mortgage market, primarily because of size (in the case of **jumbo** loans), level of down payment, income requirements, suitability of properties or other underwriting criteria (mostly related to documentation requirements) at the time of origination. As a result of these characteristics, Premier Bank typically retains these loans. However, from time to time, the Company may sell or securitize some of these loans should the need arise for asset-liability management or other considerations. Jumbo loans may be packaged and sold in the secondary market, while loans that are non-conforming for underwriting reasons may be cured through payment experience and subsequently sold. Based on the Company's prior experience with these types of loans, management believes that these loans are essentially of the same credit quality as conforming loans. During the years ended December 31, 2004, 2003 and 2002, R&G Financial originated a total of \$2.3 billion, \$2.8 billion and \$2.0 billion of residential mortgage loans, respectively. These aggregate originations include loans originated by R&G Mortgage under its table funding arrangement with Premier Bank of \$1.3 billion, \$1.3 billion and \$811.8 million during the years ended December 31, 2004, 2003 and 2002, respectively, or 55%, 45% and 41%, respectively, of total mortgage loan originations.

Table of Contents

R&G Mortgage and Premier Bank are parties to various agreements, referred to as the Affiliated Transactions Agreements, that address how each would conduct itself in specifically delineated affiliated transactions. The Affiliated Transaction Agreements include a Master Production Agreement, a Master Purchase, Servicing and Collections Agreement, referred to as the Master Purchase Agreement or MPSCA, a Master Custodian Agreement, a Securitization Agreement and a Data Processing Computer Service Agreement.

Pursuant to the Master Production Agreement, Premier Bank determines its loan production targets and goals, referred to as the Loan Production Goals and R&G Mortgage assists Premier Bank to reach its Loan Production Goals by, among other things: (i) advertising, promoting and marketing to the general public (ii) interviewing prospective borrowers and initial processing of loan applications, consistent with Premier Bank's underwriting guidelines and Loan Production Goals previously established and (iii) providing personnel and facilities with respect to the execution of any loan agreement approved by Premier Bank. In exchange for these services, Premier Bank remits to R&G Mortgage a percentage of the processing or originating fees charged to the borrowers under loan agreements, as set forth in the agreements. Refer to Lending Activities from Banking Operations—Originations, Purchases and Sales of Loans.

Servicing. R&G Financial's servicing portfolio has grown significantly over the past several years. The majority of the servicing portfolio consists of originated or purchased loans that the Company has securitized and sold but for which it has retained the servicing rights (refer to Securitizations below). At December 31, 2004, R&G Financial's servicing portfolio totaled \$11.4 billion and consisted of a total of 145,003 loans. These amounts include R&G Mortgage's servicing portfolio, totaling \$8.5 billion, Premier Bank's servicing portfolio, totaling \$17.9 million, and Crown Bank's servicing portfolio, totaling \$2.9 billion, at December 31, 2004. At December 31, 2004, R&G Financial's servicing portfolio included \$3.2 billion of loans owned by Premier Bank, \$754.8 million of loans owned by R&G Mortgage and \$874.6 million of loans owned by Crown Bank, or 28%, 7% and 8%, of the total servicing portfolio, respectively. Nearly all servicing of loans owned by Premier Bank and R&G Mortgage is performed by R&G Mortgage. Crown Bank services all loans it owns. Substantially all of the mortgage loans in R&G Financial's servicing portfolio are secured by single-family residences. R&G Financial generally retains the servicing function with respect to the loans that have been securitized and sold. Refer to Explanatory Note—Subsequent Events—Restructuring and Divestitures for information regarding the sale of Crown Bank's servicing portfolio.

The MPSCA was entered into by and between R&G Mortgage and Guaynabo Federal Savings Bank (predecessor to Premier Bank) on February 16, 1990, as amended. The MPSCA provided for the transfer by Premier Bank to R&G Mortgage of all rights, title and interest in and to the servicing rights of all mortgage loans in Premier Bank's mortgage loan portfolio in exchange for cash consideration, with the amount of such consideration being based on several factors, including type of mortgage loan, time to maturity and outstanding principal balance. In addition, a monthly servicing fee was payable by Premier Bank to R&G Mortgage, with the fee varying depending on the type of mortgage loans and outstanding principal balance. Pursuant to the MPSCA, as amended, R&G Mortgage agreed to pay the consideration to Premier Bank when Premier Bank sold the mortgage loans, be it on a securitized or whole loan basis.

The regulatory capital amounts and ratios of Premier Bank consider as an asset of Premier Bank an account receivable from R&G Mortgage amounting to \$38.7 million and \$26.5 million at December 31, 2004 and 2003, respectively. This receivable arose as a result of a restatement adjustment to account for the transfer of the servicing rights contemplated under the MPSCA. Prior to the restatement, the Company treated the MPSCA as an executory contract and did not recognize a transfer of servicing rights to R&G Mortgage. For further information regarding Premier Bank's regulatory capital ratios, refer to Item 7—Management's Discussion and Analysis of Financial Condition and Results of Operations—Summary of Restatement Results—Effect of Restatement on Balance Sheet and Regulatory Capital.

The termination of the MPSCA was approved by the respective companies' boards of directors on October 19, 2007, subject to regulatory approval. If approved by the regulators, the termination of the MPSCA would result in the account receivable of Premier Bank from R&G Mortgage being settled for its outstanding balance and the servicing rights being eliminated as a separate asset with the corresponding value being reattached to the value of the related mortgage loans in Premier Bank's portfolio. In addition, subject to the required regulatory approval, a new servicing agreement would be entered into that would provide for the continuing performance of servicing functions by R&G Mortgage for a monthly fee.

The Company cannot predict whether regulatory approval will be granted to effect the termination of the MPSCA in the manner proposed, nor the possible consequences that might ensue from any adverse determination by the federal regulators concerning the proposed termination of the MPSCA or the accounting for the account receivable resulting from the restatement adjustment.

Sale of loans and securitization activities. R&G Financial pools FHA and VA loans into mortgage-backed securities that are guaranteed by GNMA. Most of the securities are sold to securities broker-dealers and other investors in Puerto Rico. Conventional loans may either be sold directly to agencies such as FNMA and FHLMC or to private investors, or may be pooled into FNMA or FHLMC mortgage-backed securities, that are generally sold to investors. During the years ended December 31, 2004, 2003 and 2002, R&G Financial sold approximately \$824.9 million, \$1.3 billion and \$935.7 million of loans respectively, as part of its mortgage banking activities, excluding loans originated for Premier Bank by R&G Mortgage.

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Under the Securitization Agreement, R&G Mortgage provides securitization services with respect to the pooling of some of Premier Bank's mortgage loans into mortgage-backed securities or completing all documentation for loan sales in the secondary market. With respect to securitization services rendered, Premier Bank pays a securitization fee of 25 basis points. The Master Custodian Agreement provides for Premier Bank to be the custodial agent for R&G Mortgage for certain documentation related to the issuance by R&G Mortgage of GNMA, FNMA or FHLMC mortgage-backed certificates. In consideration of these services, Premier Bank receives a fee for each mortgage included in a mortgage-backed certificate per year for which it acts as custodian, as set forth in the Master Custodian Agreement. Refer to Mortgage Banking Activities Loan Originations, Purchases and Sales of Loans. For further information regarding the status of the Company's subsidiaries mortgage banking licenses, refer to Explanatory Note Subsequent Events Other Subsequent Events Status of Mortgage Banking Licenses.

Page 32

Table of Contents

Market Area and Competition

R&G Financial provides services and products primarily in Puerto Rico. The Company faces substantial competition for the origination of mortgage loans in Puerto Rico from other mortgage banks and from major commercial banks, including local offices of banks headquartered in the United States, Spain and Canada.

Crown Bank provides services and products through its Florida operations. In addition, Crown Bank's leasing division has operations in Arizona, Florida, California, Georgia, Tennessee and South Carolina while an additional mortgage division is based in Virginia. Crown Bank faces substantial competition from other banks, thrifts and other financial institutions in the provision of its services and products.

Regulation

The Company operates its businesses under a variety of federal, state and Puerto Rico laws and regulations. As a bank holding company (and a financial holding company from 2000 to 2007), it is subject to the rules of the FRB and the OCFI. Among other things, the Company is required to meet minimum capital requirements, and its activities are limited to those that are determined to be financial in nature or incidental or complementary to a financial activity.

Premier Bank is subject to extensive regulation and examination by the FDIC and by the OCFI, and Crown Bank is subject to extensive regulation and supervision by the OTS. This regulation and supervision establishes a comprehensive framework of activities in which the Company's banking subsidiaries can engage. The FDIC and the OTS are required to take prompt corrective action if a given bank does not meet its minimum capital requirements. The FDIC and the OTS have established five capital tiers to implement this requirement from well capitalized to critically undercapitalized. A bank's capital tier will depend on various capital measures and other qualitative factors and will subject it to specific requirements. As of December 31, 2004, Premier Bank met the capital measures for being well capitalized under the regulations. However, as a result of certain restatement adjustments affecting Crown Bank, Crown Bank had not met, as of December 31, 2004, certain of the capital adequacy requirements to which it is subject. For further information, refer to Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations Summary of Restatement Results. During 2005, Crown Bank received capital contributions from the Company which allowed it to meet the minimum ratios for capital adequacy purposes, and Crown Bank was classified as well capitalized as of December 31, 2006.

The Company's mortgage banking business is subject to the rules of the FHA, VA, GNMA, FNMA, FHLMC and the Department of Housing and Urban Development with respect to originating, processing, selling and servicing mortgage loans. In addition to these rules, the Company's Puerto Rico mortgage operations are subject to the rules of the OCFI and Continental is subject to the rules of the OTS. Among other things, all of these rules prohibit discrimination, establish underwriting guidelines, require credit reports, fix maximum loan amounts and in some cases, fix maximum interest rates.

For more information about the rules and regulations to which R&G Financial and its subsidiaries are subject, refer to the Regulation section below.

Lending Activities from Banking Operations

General. At December 31, 2004, R&G Financial's total loans outstanding totaled \$7.4 billion, which is 62% of the Company's \$11.9 billion of total assets. Total loans outstanding are composed of \$3.9 billion of loans and leases receivable, net, which are held for investment, \$1.1 billion of mortgage loans held for sale, pledged with creditors' right to repledge, and \$2.4 billion of other mortgage loans held for sale.

Loans and leases receivable, net. At December 31, 2004, R&G Financial's loans and leases receivable, net totaled \$3.9 billion, which is 32% of R&G Financial's \$11.9 billion of total assets. At December 31, 2004, substantially all of R&G Financial's loans and leases receivable, net were held by its banking subsidiaries Premier Bank and Crown Bank. Historically, a substantial portion of R&G Financial's lending activities has been the origination of residential real estate mortgage loans. Accordingly, the principal category of loans in R&G Financial's loans and leases receivable, portfolio is real estate mortgage loans, which is composed of mortgages secured by both commercial and residential real estate and consumer loans secured by real estate. Residential real estate mortgage loans are mostly comprised of conventional loans that are principally secured by first liens on single-family residences. Residential real estate conventional mortgage loans are loans that are neither insured by the FHA nor partially guaranteed by the VA. At December 31, 2004, \$1.3 billion of R&G Financial's first mortgage single-family residential loans consisted of conventional loans. The other principal categories of loans in R&G Financial's loans and leases receivable, net portfolio are commercial and financial, real estate construction and development, installment and lease financing loans.

Table of Contents

Mortgage loans held for sale. At December 31, 2004, R&G Financial has \$1.1 billion of mortgage loans held for sale with creditors' right to repledge. In addition, R&G Financial has \$2.4 billion of other mortgage loans held for sale. Of the total amount of mortgage loans held for sale, \$2.0 billion are being reflected in the accompanying Consolidated Financial Statements as a result of the restatement process and as part of the Company's re-evaluation of all purported mortgage loan sales transactions entered into by the Company and certain other financial institutions. For further information regarding the Company's mortgage banking business, refer to "Mortgage Banking Activities" below.

Loans and Leases Receivable, Net Portfolio Composition. The following table sets forth the composition of R&G Financial's loans and leases receivable, net portfolio by type of loan at the dates indicated. Except as noted in the footnotes to the table, all of the loans are held by banking subsidiaries of R&G Financial. An explanation of each category set forth in the table below is provided later in this Item 1.

(Dollars in Thousands)	2004		December 31, 2003		2002	
	Amount (As Restated)	Percent	Amount (As Restated)	Percent	Amount (As Restated)	Percent
Commercial and financial (1)	\$ 566,712	14.5%	\$ 306,889	10.5%	\$ 315,365	13.4%
Real estate - construction and development (2)	536,517	13.7%	329,916	11.2%	273,592	11.7%
Real estate - mortgages	2,540,259	64.9%	2,080,746	70.9%	1,583,384	67.5%
Installment	159,444	4.1%	155,078	5.3%	128,935	5.5%
Lease financing (3)	108,566	2.8%	61,673	2.1%	43,901	1.9%
Gross loans and leases (4)	3,911,498	100%	2,934,302	100%	2,345,177	100%
Allowance for loan and lease losses	(44,045)		(30,648)		(27,805)	
Total loans and leases receivable, net (5)	\$ 3,867,453		\$ 2,903,654		\$ 2,317,372	

(Dollars in Thousands)	2001		December 31, 2000	
	Amount (As Restated)	Percent	Amount (As Restated)	Percent
Commercial and financial (1)	\$ 133,051	10.1%	\$ 121,788	11.2%
Real estate - construction and development (2)	174,031	13.2%	107,646	9.9%
Real estate - mortgages	896,754	68.0%	767,642	70.4%
Installment	94,067	7.1%	68,986	6.3%
Lease financing (3)	20,412	1.6%	24,909	2.2%
Gross loans and leases (4)	1,318,315	100%	1,090,971	100%
Allowance for loan and lease losses	(16,218)		(11,640)	
Total loans and leases receivable, net (5)	\$ 1,302,097		\$ 1,079,331	

- (1) Commercial and financial loans include loans receivable from financial institutions, amounting to \$345.4 million, \$173.1 million, \$214.7 million, \$50.0 million and \$77.7 million at December 31, 2004, 2003, 2002, 2001 and 2000, respectively, which were previously classified in the real estate - mortgages (\$306.8 million, \$139.3 million, \$214.7 million, \$50.0 million and \$77.7 million at December 31, 2004, 2003, 2002, 2001 and 2000, respectively) and real estate - construction and development (\$38.6 million and \$33.8 million at December 31, 2004 and 2003, respectively) categories. These loan transfers were initially considered purchases of mortgage and commercial real estate loans and of construction loan participations but did not qualify as sales by the transferor under SFAS No. 140. See Note 1 to the Consolidated Financial Statements for additional information.

Table of Contents

- (2) Includes \$250,000, \$665,000 and \$1.2 million of loans held by R&G Mortgage at December 31, 2002, 2001 and 2000, respectively.
- (3) Includes \$7.2 million, \$5.2 million, \$4.5 million, \$235,000 and \$96,000 of unearned income at December 31, 2004, 2003, 2002, 2001 and 2000, respectively.
- (4) Includes \$14.6 million, \$13.0 million, \$9.6 million, \$5.0 million and \$3.2 million of net deferred fees and \$11.3 million, \$8.7 million, \$1.3 million, \$797,000 and (\$10.9) million of net unamortized premiums (discounts) at December 31, 2004, 2003, 2002, 2001 and 2000, respectively.
- (5) Does not include mortgage loans held for sale of \$3.5 billion, \$2.3 billion, \$1.2 billion, \$1.1 billion and \$928.9 million at December 31, 2004, 2003, 2002, 2001 and 2000, respectively.

Contractual Principal Repayments and Interest Rates. The following table sets forth certain information at December 31, 2004 regarding the dollar amount of loans maturing in the commercial and financial and real estate construction and development loans categories of R&G Financial's loans and leases receivable, net portfolio, based on the contractual terms to maturity. Loans having no stated schedule of repayments and no stated maturity are reported as due in one year or less.

(Dollars in Thousands)	Due 1	Due 1-5	Due 5 or more	Total (1)
	Year or Less	years after December 31, 2004	years after December 31, 2004	
	(As Restated)	(As Restated)	(As Restated)	(As Restated)
Commercial and financial (2)	\$ 193,646	\$ 76,442	\$ 296,624	\$ 566,712
Real estate construction and development	532,757	3,760		536,517
Total	\$ 726,403	\$ 80,202	\$ 296,624	\$ 1,103,229

(1) Amounts have not been adjusted for the allowance for loan and lease losses.

(2) Includes \$345.4 million of loans receivable from financial institutions.

The following table sets forth the dollar amount of the commercial and financial and real estate construction and development loan categories of R&G Financial's loans and leases receivable, net portfolio at December 31, 2004 that have fixed, floating or adjustable interest rates:

(Dollars in Thousands)	Fixed rate	Floating or adjustable rate	Total(1)
	(As Restated)	(As Restated)	(As Restated)
Commercial and financial(2)	\$ 194,816	\$ 371,896	\$ 566,712
Real estate construction and development	122,639	413,878	536,517
Total	\$ 317,455	\$ 785,774	\$ 1,103,229

(1) Amounts have not been adjusted for the allowance for loan and lease losses.

(2) Includes \$345.4 million of loans receivable from financial institution.

Table of Contents

Scheduled contractual amortization of loans does not reflect the expected term of R&G Financial's entire loans and leases receivable, net portfolio. The average life of loans and leases is substantially less than their contractual terms because of prepayments and due-on-sale clauses that give R&G Financial the right to declare a conventional loan immediately due and payable in the event, among other things, that the borrower sells the real property subject to the mortgage and the loan is not repaid. The average life of mortgage loans tends to increase when current mortgage loan rates are higher than rates on existing mortgage loans and, conversely, decrease when rates on existing mortgage loans are higher than current mortgage loan rates (due to refinancing of adjustable-rate and fixed-rate loans at lower rates). Under the latter circumstance, the weighted average yield on loans decreases as higher-yielding loans are repaid or refinanced at lower rates.

Substantially all of the loans in the real estate mortgages, installment and lease financing categories of the Company's loans and leases receivable, net portfolio are fixed rate loans with contractual maturities over one year.

Originations, Purchases and Sales of Loans. The following table sets forth loan originations, purchases and sales from banking operations for the periods indicated:

(Dollars in Thousands)	Year Ended December 31,		
	2004 (As Restated)	2003 (As Restated)	2002 (As Restated)
Loan originations:			
Real estate mortgages originated by R&G Mortgage (1):	\$ 1,295,507	\$ 1,283,308	\$ 811,773
Other loans originated:			
Commercial and financial	360,946	117,512	180,719
Real estate construction and development (2)	700,110	320,027	143,356
Real estate mortgages (3)	850,032	608,799	388,072
Installment	119,786	144,735	130,492
Lease financing	89,023	46,420	28,294
Total other loans originated	2,119,897	1,237,493	870,933
Loans and participations purchased	520,282	269,745	90,132
Total loans originated and purchased	3,935,686	2,790,546	1,772,838
Loans sold	(95,809)		(350,021)
Loan participations sold	(79,626)	(13,946)	(11,839)
Loan principal (reductions)	(1,587,094)	(1,228,758)	(776,723)
Loans acquired in connection with acquisition of Crown Bank			483,457
Loans converted to securities	(37,146)		(187,612)
Net increase	\$ 2,136,011	\$ 1,547,842	\$ 930,100

(1) Originated by R&G Mortgage on behalf of Premier Bank under their table funding agreement.

(2) Includes \$29.7 million and \$32.2 million originated by Continental in 2003 and 2002, respectively.

(3) Originated by Premier Bank and Crown Bank.

Table of Contents

R&G Financial, through its banking subsidiaries (or through R&G Mortgage on behalf of Premier Bank), originates mortgage loans secured by both commercial and residential mortgages (the latter secured by both first and second mortgage liens), consumer loans secured by real estate, as well as construction and development loans (for residential real estate) commercial and financial loans and installment loans.

R&G Mortgage assists Premier Bank in meeting its loan production targets and goals by, among other things, (i) advertising, promoting and marketing Premier Bank's mortgage products to the general public, (ii) interviewing prospective borrowers and conducting the initial processing of the requisite loan applications consistent with Premier Bank's underwriting guidelines, and (iii) providing personnel and facilities with respect to the execution of loan agreements approved by Premier Bank. R&G Mortgage performs the foregoing services on behalf of Premier Bank with respect to residential mortgage loans, some commercial real estate loans and consumer loans secured by real estate. R&G Mortgage receives from Premier Bank 75% of the applicable loan origination fee, if any, with respect to mortgage loans originated by R&G Mortgage on behalf of Premier Bank and commissions of 2% of unpaid principal balance on consumer loans secured by real estate. As of December 31, 2004, for loans originated without a loan origination fee, R&G Mortgage did not receive compensation for origination services rendered. During the years ended December 31, 2004, 2003 and 2002, R&G Mortgage received \$16.8 million, \$17.7 million and \$13.0 million, respectively, of loan origination fees with respect to loans originated by R&G Mortgage on behalf of Premier Bank. These fees are eliminated in consolidation in R&G Financial's Consolidated Financial Statements. Refer to Regulation R&G Financial Limitations on Transactions with Affiliates.

R&G Financial, through Premier Bank and Crown Bank, originates commercial real estate loans, consumer loans secured by real estate, commercial and financial loans and installment loans. Applications for commercial real estate, commercial and financial and unsecured installment loans are taken at all branch offices of the Company's banking subsidiaries, and may be approved by lending officers of each banking subsidiary within designated limits. These limits are established and modified from time to time to reflect an individual loan officer's expertise and experience. All loans in excess of an individual loan officer's designated limits are referred to an officer with the requisite authority. In addition, as of December 31, 2004, Premier Bank's Management Credit Committee was authorized to approve commercial unsecured, secured and real estate loans not exceeding \$2 million, \$3 million and \$5 million, respectively, and the Executive Committee of the Board of Directors of Premier Bank was authorized to approve all commercial unsecured loans up to \$15 million and all commercial secured and real estate loans up to the legal lending limit. In the case of Crown Bank, all loans over \$1.0 million require approval by Crown Bank's Credit Committee and Board of Directors. Management of R&G Financial believes that its relatively centralized approach to approving loan applications ensures strict adherence to its underwriting guidelines, while still allowing the Company to approve loan applications on a timely basis.

The subsidiaries of R&G Financial also purchased loans from unrelated financial institutions. Such loan purchases are underwritten pursuant to the same guidelines as direct loan originations. The Company originally reported that, during the years ended December 31, 2004, 2003 and 2002, Premier Bank purchased \$207.2 million, \$7.1 million and \$236.2 million of loans, respectively, and that Crown Bank purchased \$399.9 million and \$423.7 million of loans during the years ended December 31, 2004 and 2003, respectively. These numbers have been restated as a result of (i) the recharacterization of certain bulk purchases of loans as secured loans, and (ii) the inclusion of \$29.6 million and \$4.9 million for the year ended December 31, 2004 and 2003, respectively, to correct a presentation error in the previously reported data. As restated, during the years ended December 31, 2004, 2003 and 2002, Premier Bank purchased \$35.5 million, \$7.1 million and \$90.1 million of loans, respectively, and Crown Bank purchased \$484.8 million and \$262.6 million of loans during the years ended December 31, 2004 and 2003, respectively. Crown Bank did not purchase any such loans during the year ended December 31, 2002.

Based on the analysis performed by the Company, it was determined that the existence of certain provisions in various of the Company's mortgage loan sale documents and side agreements were incompatible with the requirements for accounting for the transactions as sales. The Company also determined that certain generally simultaneous mortgage loan sales and purchases lacked contemporaneous documentation to substantiate the business purpose of these transactions in light of the timing and similarity of the purchase and sale amounts, and other terms of the transactions. As a result, the Company concluded that certain mortgage loan sales did not qualify as sales under SFAS No. 140 and should have been recorded as secured borrowings. For further information, refer to Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations Restatement of Previously Issued Financial Statements Background to Restatement and Summary of Accounting Adjustments by Category Accounting for Loan Transfers Loan Transfer Transactions Recharacterized as Secured Borrowings, as well as Item 9A Controls and Procedures Management's Report on Internal Controls Over Financial Reporting (Restated). During the years ended December 31, 2004 and 2002, loans sold from banking operations were \$95.8 million and \$350.0 million, respectively. There were no such sales during the year ended December 31, 2003. These loans, which were primarily non-conforming loans at the time of origination, were generally sold in pools of loans in privately negotiated transactions with FNMA and FHLMC or other private parties.

Table of Contents

R&G Mortgage services all residential mortgage loans held in Premier Bank's portfolio retained by Premier Bank, except for a few pools of loans purchased from other financial institutions which retained the servicing. In addition, Premier Bank collects mortgage loan payments on all loans serviced by R&G Mortgage on behalf of Premier Bank. Finally, R&G Mortgage provides securitization services with respect to loan sales and pooling of some of Premier Bank's mortgage loans into mortgage-backed securities. Refer to Mortgage Banking Activities.

Real Estate Mortgage Loans.

Single-Family Residential Real Estate Loans. Historically, a substantial portion of R&G Financial's lending activities has been the origination of residential real estate mortgage loans secured by first mortgage liens on existing single-family residences. At December 31, 2004, \$1.4 billion or 35% of R&G Financial's loans and leases receivable, net portfolio consisted of such loans, of which \$6.5 million consisted of FHA-insured or VA-guaranteed loans. Premier Bank's first mortgage single-family residential loans consist primarily of fixed-rate loans with terms of between 15 and 30 years. The Puerto Rico residential mortgage market has not been receptive to long-term adjustable rate mortgage loans.

R&G Financial's first mortgage single-family residential loans typically do not exceed 80% of the appraised value of the security property (100% for certain qualifying new home purchases). Pursuant to underwriting guidelines adopted by its Board of Directors, R&G Financial's subsidiaries may lend up to 95% of the appraised value of the property securing a first mortgage single-family residential loan if private mortgage insurance with respect to the top 25% of the principal amount of the loan is provided.

The Company also originates loans secured by second mortgages on single-family residential properties. At December 31, 2004, \$50.8 million or 1.31% of R&G Financial's loans and leases receivable, net portfolio consisted of second mortgage loans on single-family residential properties. R&G Financial offers such second mortgage loans in amounts up to \$125,000 for a term not to exceed 15 years. The loan-to-value ratio of second mortgage loans generally is limited to 75% of the property's appraised value (including the first mortgage).

Real Estate-Secured Consumer Loans. At December 31, 2004, real estate-secured consumer loans totaled \$50.1 million or 1.29% of R&G Financial's loans and leases receivable, net portfolio. R&G Financial offers real estate-secured consumer loans in amounts up to 75% of the appraised value of the property, including the amount of any existing prior liens. Such loans generally have shorter terms and higher interest rates than other mortgage loans. Real estate secured consumer loans generally have a maximum term of 10 years, which may be extended at management's sole discretion in certain circumstances, and an interest rate that is set at a fixed rate based on market conditions. The loans are secured with a first or second mortgage on the property, including loans where another institution holds the first mortgage. Most of the Company's secured consumer loans have been primarily obtained through newspaper advertising, although such loans are also obtained from existing and walk-in customers. At December 31, 2004, \$2.6 million of such loans were classified as non-performing.

Commercial Real Estate Loans. The Company also originates mortgage loans secured by commercial real estate. At December 31, 2004, \$765.4 million or 19.79% of R&G Financial's loans and leases receivable, net portfolio consisted of such loans. At December 31, 2004, \$20.2 million of R&G Financial's commercial real estate loans were classified as non-performing.

The Company's commercial real estate loans are primarily secured by office buildings, retail stores, warehouses and general purpose industrial space. Although terms vary, commercial real estate loans originated by Premier Bank generally are amortized over a period of a maximum of 15 years and those originated by Crown Bank generally are amortized over a period of 10 to 20 years, and have maturities of 5 to 7 years and 3 to 10 years, respectively. Generally, R&G Financial originates these loans with adjustable interest rates tied to index rates such as LIBOR, Prime or FHLB plus a margin. Repricing on such loans may occur on a monthly, quarterly or other basis, depending on how the index rate changes and on the terms negotiated at the time of origination. Such loans generally have a floor but no ceiling on the amount by which the rate of interest may adjust over the term of the loan. Loan-to-value ratios on the Company's commercial real estate loans are generally limited to 80%. As part of the criteria for underwriting commercial real estate loans, R&G Financial generally requires a debt coverage ratio (the ratio of net cash from operations before payment of debt service to debt service) of the borrower of 1.20 or more. It is also the Company's policy to seek additional protection to mitigate any weaknesses identified in the underwriting process. Additional protection may be provided through mortgage insurance, secondary collateral and personal guarantees from the principals of the borrower.

Table of Contents

Commercial real estate lending involves different and significant risks when compared to single-family residential lending because such loans typically involve large loan balances to single borrowers and the payment experience on such loans is typically dependent on the successful operation of the project or the borrower's business. These risks can also be significantly affected by supply and demand conditions in the local market for apartments, offices, warehouses or other commercial space. R&G Financial attempts to minimize its risk exposure by limiting the extent of its commercial real estate lending. In addition, as described above, the Company imposes stringent loan-to-value ratios, requires conservative debt coverage ratios and continually monitors the operation and physical condition of the collateral. Although the Company has begun to increase its emphasis on commercial real estate lending, management does not currently anticipate that the commercial real estate loans portfolio will grow significantly as a percentage of the total loan portfolio. As of December 31, 2004, no significant industry concentration exists among the borrowers composing the Company's commercial real estate loan portfolio.

Real Estate Construction and Development Loans. This category includes retail construction loans, or spot loans, commercial construction and development loans and land acquisition loans. At December 31, 2004, spot loans amounted to \$128.8 million or 3% of R&G Financial's loans and leases receivable, net portfolio, while commercial construction and development loans amounted to \$407.7 million or 11% of R&G Financial's loans and leases receivable, net portfolio.

Premier Bank and Crown Bank offer spot loans to individual borrowers for the purpose of constructing single-family residences. Substantially all of the Company's construction lending to individuals is originated on a construction/permanent mortgage loan basis. Construction/permanent loans are made to individuals who hold a contract with a general contractor acceptable to the Company to construct their personal residence. The construction phase of the loan provides for monthly payments on an interest-only basis at a designated fixed rate for the term of the construction period, which generally does not exceed nine months. In the case of Crown Bank, the permanent loan is made at then-market rates, while Premier Bank grants the permanent loan at 50 basis points above the rate at which the spot loan was originally granted. The Company's construction/permanent loan program has been successful due to its ability to offer borrowers a single closing and, consequently, reduced costs.

R&G Financial also originates construction loans to developers of single-family residential properties. At December 31, 2004, R&G Financial had entered into commitments to fund residential construction loans to develop single-family residences with an aggregate principal balance of \$184.3 million. Commitments for future funding of approximately \$43.8 million are included in such amount. In addition, at December 31, 2004, R&G Financial had loans to develop commercial properties with an aggregate principal balance of \$48.6 million.

At December 31, 2004, R&G Financial had made land acquisition loans with an aggregate balance of \$118.1 million that were made in connection with projects to construct single-family residences. On those projects for which R&G Financial would not finance the construction loan, R&G Financial expects to enter into agreements with the financial institutions providing the interim construction loan pursuant to which R&G Financial is to be paid a percentage of the proceeds from each home as it is released upon completion and sale. R&G Financial expects to finance the construction loan on some of these projects.

R&G Financial intends to continue to increase its involvement in single-family residential construction lending. Such loans decrease the interest rate sensitivity of its loan portfolio, as construction loans are generally variable rate loans tied to short-term indexes, primarily LIBOR and prime rates. Construction and land acquisition lending is generally considered to involve a higher level of credit risk as compared to permanent single-family residential lending, due to the concentration of principal in a limited number of loans and borrowers and the effects of general economic conditions on real estate developers and managers. Moreover, a construction loan can involve additional risks because of the inherent difficulty in estimating both a property's value at completion of the project and the estimated costs (including interest) of the project. The nature of these loans is such that they are generally more difficult to evaluate and monitor. The Company has taken steps to minimize the foregoing risks by, among other things, limiting its construction lending primarily to residential construction for single family primary home occupancy. The Company has adopted underwriting guidelines that impose stringent loan-to-value, debt service and other requirements for loans that are believed to involve higher elements of credit risk and by working with builders with whom it has established relationships or knowledge thereof. At December 31, 2004, of R&G Financial's \$128.8 million of retail construction loans, \$1.2 million were classified as non-performing. As of such date, of R&G Financial's \$407.7 million of commercial construction and development loans, approximately \$881,000 were classified as non-performing.

Table of Contents

Commercial and Financial Loans.

Commercial Business Loans. The Company offers commercial business loans, including working capital lines of credit, inventory and accounts receivable loans, term loans and loans guaranteed by the Small Business Administration. Depending on the collateral pledged to secure the extension of credit, maximum loan-to-value ratios are 75%, with exceptions permitted to a maximum of 80%. Loan terms may vary from one to 15 years. The interest rates on such loans are generally variable and are indexed to the prime rate plus a margin. The Company also generally obtains personal guarantees from the principals of the borrowers. At December 31, 2004, commercial business loans amounted to \$221.2 million or 6% of the Company's loans and leases receivable, net portfolio. Although the Company has begun to increase its emphasis on commercial business lending, management does not currently anticipate that its portfolio of commercial business loans will grow significantly as a percentage of the total loan portfolio.

Commercial Loans to Financial Institutions and Other Private Investors. This category includes loans receivable from financial institutions and other private investors, which were previously classified in the real estate mortgages (\$306.8 million at December 31, 2004) and real estate construction and development (\$38.6 million at December 31, 2004) categories. These loan transfers were initially considered purchases of mortgage and commercial real estate loans and of construction loan participations but did not qualify as sales by the transferor under SFAS No. 140. Such loans amounted to 9% of the Company's loan and leases receivable, net portfolio at December 31, 2004.

Installment Loans. At December 31, 2004, \$159.4 million or 4% of R&G Financial's loans and leases receivable, net portfolio consisted of installment loans. This amount is composed mostly of credit cards and other unsecured loans to consumers, but the Company also offers consumer loans secured by deposit accounts. Although R&G Financial has begun to increase its emphasis on consumer lending, management does not currently anticipate that its portfolio of consumer loans will grow significantly as a percentage of the total loan portfolio.

R&G Financial's unsecured consumer loans consisted principally of credit card receivables and personal loans. At December 31, 2004, credit card receivables, all held by Premier Bank, totaled \$67.3 million, and personal loans amounted to \$67.9 million. Most credit cards are offered to targeted customers, which include referrals (cross selling) from other segments or divisions of the Company. The Company has established minimum FICO (Fair Isaac & Company) scores as underwriting criteria for these loans. R&G Financial also offers loans secured by deposit accounts. These loans amounted to \$24.2 million at December 31, 2004. Such loans are originated generally for up to 90% of the account balance, with a hold placed on the account restricting the withdrawal of the account balance.

Consumer loans generally have shorter terms and higher interest rates than mortgage loans but generally involve more credit risk than mortgage loans because, of the type and nature of the collateral and, in certain cases, the absence of collateral. In addition, consumer lending collections are dependent on the borrower's continuing financial stability, and thus are more likely to be adversely effected by job loss, divorce, illness and personal bankruptcy. In many cases, any repossessed collateral for a defaulted consumer loan will not provide an adequate source of repayment of the outstanding loan balance because of improper repair and maintenance of the underlying property. The remaining deficiency may not warrant further substantial collection efforts against the borrower. As a matter of policy, R&G Financial charges off any unsecured consumer loan delinquent over 120 days. At December 31, 2004, approximately \$1.1 million of installment loans were classified as non-performing.

Lease Financing Loans. At December 31, 2004, \$108.6 million or 3% of R&G Financial's loans and leases receivable, net portfolio consisted of lease financing loans. Such loans consisted principally of loans to individuals and/or corporations to finance the acquisition of motor vehicles or business equipment. Depending on the collateral supplied, the maximum loan-to-value ratio is 75%, with exceptions allowed to a maximum of 80%. R&G Financial's lease financing loans are primarily variable rate loans with terms of up to 15 years. At December 31, 2004, approximately \$199,000 of lease financing loans were classified as non-performing.

Table of Contents

Asset Quality. When a borrower fails to make a required payment on a loan, R&G Financial attempts to cure the deficiency by contacting the borrower and seeking payment. Contacts are generally made between the 10th and 15th day after a payment is due. In most cases, deficiencies are cured promptly. If a delinquency extends beyond 15 days, the loan and payment history is reviewed and efforts are made to collect the outstanding debt. While R&G Financial generally prefers to work with borrowers to resolve such problems, when the account becomes 90 days delinquent in the case of mortgage loans, R&G Financial institutes foreclosure or other proceedings, as necessary, to minimize any potential loss. In the case of consumer loans, the Company refers the file to a collection agency for collection action after 60 days' delinquency.

Loans secured by real estate are placed on non-accrual status when, in the judgment of management, the probability of collection of interest is deemed to be insufficient to warrant further accrual. When a loan is placed on non-accrual status, previously accrued but unpaid interest is deducted from interest income. As a matter of policy, R&G Financial does not accrue interest on loans that are 90 days or more past due that are secured by real estate, except for certain residential mortgage loans in which the probability of collection of interest is deemed sufficient to warrant accrual. The Company generally does not accrue interest on consumer loans past due over 90 days.

Real estate acquired by the Company as a result of foreclosure or by deed-in-lieu of foreclosure is classified as real estate owned until sold. Pursuant to AICPA Statement of Position No 92-3, or SOP 92-3, that provides guidance on determining the balance sheet treatment of foreclosed assets in annual financial statements, the Company carries foreclosed assets at the lower-of-net realizable value-or-cost. After the date of acquisition, all costs incurred in maintaining the property are expensed and costs incurred for the improvement or development of such property are capitalized up to the extent of their net realizable value.

The following table sets forth the amounts and categories of R&G Financial's non-performing loans that are both held for investment and held for sale at the dates indicated. R&G Financial did not have any troubled debt restructurings during any of the periods presented. Except as otherwise indicated in the footnotes to the table, the non-performing assets are assets of the Company's banking subsidiaries.

(Dollars in Thousands)	2004 (As Restated)	2003 (As Restated)	December 31, 2002 (As Restated)	2001 (As Restated)	2000 (As Restated)
Non-accruing loans:					
Commercial and financial	\$ 2,612	\$ 2,610	\$ 1,865	\$ 4,186	\$ 1,032
Real estate construction and development	2,120	2,424	1,512	871	487
Real estate mortgages (1) (2)	220,442	175,369	166,603	127,948	103,432
Installment	814	833	802	303	1,186
Lease financing	199	240	765	1,687	788
Total	226,187	181,476	171,547	134,995	106,925
Accruing loans greater than 90 days delinquent:					
Commercial and financial	651	382	261	462	420
Real estate construction and development					
Real estate mortgages	531		104		
Installment	329	422	667	428	360
Lease financing					
Total accruing loans greater than 90 days delinquent	1,511	804	1,032	890	780

Table of Contents

(Dollars in Thousands)	December 31,				
	2004 (As Restated)	2003 (As Restated)	2002 (As Restated)	2001 (As Restated)	2000 (As Restated)
Total non-performing loans	227,698	182,280	172,579	135,885	107,705
Real estate owned, net (3)	21,810	19,441	15,677	10,284	9,314
Other repossessed assets	15	220	292	362	583
	21,825	19,661	15,969	10,646	9,897
Total non-performing assets	\$ 249,523	\$ 201,941	\$ 188,548	\$ 146,531	\$ 117,602
Total non-performing loans as a percentage of total loans	3.09%	3.51%	4.96%	5.57%	5.36%
Total non-performing assets as a percentage of total assets	2.09%	2.27%	2.83%	2.92%	3.11%

- (1) Includes \$2.6 million, \$4.3 million, \$4.6 million, \$6.1 million and \$6.4 million in consumer loans, respectively, held by Premier Bank secured by first and second mortgages on residential real estate at December 31, 2004, 2003, 2002, 2001 and 2000, respectively.
 - (2) Includes approximately \$142.8 million, \$108.1 million, \$102.8 million, \$96.4 million and \$67.3 million in residential real estate mortgages held in the Company's held for sale portfolio at December 31, 2004, 2003, 2002, 2001 and 2000, respectively.
 - (3) Real estate owned, net acquired in connection with the acquisition of Crown Bank in 2002 amounted to \$5.1 million.
- Non-performing loans amounted to \$227.7 million at December 31, 2004, as compared to \$182.3 million at December 31, 2003. The increase in the aggregate amount of non-performing loans during 2004 of \$45.4 million is primarily due to an increase in real estate mortgages non-performing loans in the process of foreclosure. An aggregate of \$221.0 million or 97% of non-performing loans held at December 31, 2004 consisted of real estate mortgage loans. The additional gross interest income that would have been recognized during 2004, 2003 and 2002 had these loans been accruing interest amounted to approximately \$13.8 million, \$12.1 million and \$12.2 million, respectively. Interest income included in net income was not available for segregation and disclosure. Because of the nature of the collateral securing these loans, R&G Financial has historically recognized a low level of loan charge-offs. R&G Financial's aggregate charge-offs amounted to 0.35% during 2004, as compared to 0.46% during 2003. Loan delinquencies have historically been higher in Puerto Rico than in the United States, but loan charge-offs have historically been lower in Puerto Rico than in the United States.

As of December 31, 2004, non-performing residential real estate loans increased by \$49.9 million or 33% from December 31, 2003 to December 31, 2004. The average loan balance on non-performing residential mortgage loans amounted to approximately \$78,000 at December 31, 2004. As of such date, 1,446 loans with an aggregate balance of \$124.7 million (including 85 consumer loans secured by real estate with an aggregate balance of \$1.4 million) were in the process of foreclosure. The total delinquency ratio (including loans past due less than 90 days) on residential mortgages of banking subsidiaries, excluding consumer loans secured by real estate, decreased from 6% in 2003 to 5% in 2004. The Company's loss experience on such portfolio has been minimal over the last several years.

Non-performing commercial real estate loans decreased by approximately \$4.3 million, or 17%, from \$24.5 million at December 31, 2003 to \$20.2 million at December 31, 2004. The decrease in non-performing commercial real estate loans is attributable to a decrease of approximately \$5.0 million of such loans in Premier Bank, partially offset by an increase of approximately \$673,000 in Crown Bank, as certain borrowers brought their loans current during the year ended December 31, 2004. The number of loans delinquent over 90 days amounted to 102 loans at December 31, 2004, with an average balance of approximately \$199,000. The largest non-performing commercial real estate loan as of December 31, 2004 had a balance of \$2.4 million.

Table of Contents

As of December 31, 2004, non-performing commercial and financial loans include three loans with an aggregate balance of \$1.1 million which are 90% guaranteed by the Small Business Administration and other commercial and financial loans with an aggregate balance of \$1.5 million. These loans have a combined average loan size of approximately \$104,000. The largest non-performing commercial business loan as of December 31, 2004 had a \$786,000 balance.

As of December 31, 2004, non-performing real estate construction and development loans amounted to \$2.1 million, non-performing installment loans amounted to \$1.1 million and non-performing lease financing loans amounted to \$199,000, as compared to \$2.4 million, \$1.3 million and \$240,000 as of December 31, 2003, respectively.

Potential problem loans. Potential problem loans consist of loans for which management has concerns about the ability of an obligor to comply with repayment terms because of market conditions or the obligor's potential operating or financial difficulties. Management monitors these loans closely and reviews their performance on a regular basis. As of December 31, 2004, the Company had \$17.6 million in loans of this type which are not included in either of the non-accrual or 90 days past due categories.

Loan concentrations. At December 31, 2004, R&G Financial's five largest loans-to-one borrower and their related entities amounted to \$200.0 million, \$75.5 million, \$50.7 million, \$51.9 million and \$38.5 million. As of December 31, 2004, all such loans were performing. This includes secured loans to two local financial institutions that were originally accounted for as mortgage loan purchases, as further described above in Explanatory Note Subsequent Events Other Subsequent Events Restructuring of Certain Prior Mortgage Loan Transfers and below in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations Background to Restatement.

Allowance for loan and lease losses. The allowance for loan and lease losses is maintained at levels that are adequate to absorb probable credit losses inherent in the loan and lease portfolio as of the date of the consolidated financial statements. The Company has developed policies and procedures for assessing the adequacy of the allowance for loan and lease losses that reflect the assessment of credit risk considering all available information. It is the policy of the Company to maintain an allowance for estimated losses on loans and leases held for investment based on a number of quantitative and qualitative factors. These factors include levels and trends of past due and non-accrual loans, levels and trends in assets classifications, change in volume and mix of loans and collateral value. Quantitative factors used to assess the adequacy of the allowance for loan and lease losses are established based upon management's assessment of the credit risk in the portfolio, historical loan and lease loss experience and the Company's loan underwriting policies as well as management's judgment and experience. The Company periodically reviews the assumptions and formulas by which additions are made to the specific and general valuation allowances for losses in an effort to refine such allowances in light of the current status of the factors described above. In developing this assessment, the Company relies on estimates and exercises judgment in assessing credit risk. Depending on changes in circumstances, future assessments of credit risk may yield materially different results from the estimates, and such differences may require an increase or a decrease in the allowance for loan and lease losses. The allowance for loan and lease losses is subject to review by banking regulators. The Company's primary bank regulators conduct regular examinations of the allowance for loan and lease losses and make assessments regarding the adequacy and the methodology employed in its determination.

The allowance for loan and lease losses is increased by provisions for loan and lease losses. Losses are charged and recoveries are credited to the allowance account at the time the loss is assessed or recovery is received.

The Company employs estimation tools for measuring credit risk that are used in developing an appropriate allowance for loan and lease losses. The allowance for loan and lease losses consists of (i) a formula-based component for the loan and lease portfolio (excluding impaired commercial loans) including an adjustment for historical loss variability, (ii) specific allowances for impaired commercial loans and (iii) an unallocated component. The factors supporting the allowance for loan and lease losses do not diminish the fact that the entire allowance for loan and lease losses is available to absorb losses in the loan portfolio. The Company's principal focus, therefore, is on the adequacy of the total allowance for loan and lease losses.

Table of Contents

The formula-based component of the allowance for loan and lease losses is based on estimates of the average losses observed for the loan and lease portfolio. Average losses are computed using the annualized historical rate at which loans have defaulted. The formula-based loss component includes additional amounts to establish reasonable ranges that consider observed historical variability in losses. Factors the Company may consider in setting these amounts include, but are not limited to, industry-specific data, portfolio-specific risks or concentrations, and macroeconomic conditions.

Specific allowances for loans and leases are established for impaired loans. Evaluation of impairment applies to all loans, uncollateralized as well as collateralized, except for (i) large groups of smaller-balance homogeneous loans that are collectively evaluated for impairment, such as credit card, residential mortgage, and consumer installment loans, (ii) loans that are measured at fair value or at the lower of cost or fair value, for example, in accordance with SFAS No. 65, or other specialized industry practice, and (iii) leases as defined in SFAS No. 13. A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. The Company considers commercial loans over \$500,000 for individual impairment evaluation. A specific allowance is established for the difference between the loan's carrying amount and, either, the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

The unallocated component of the Company's allowance for loan and lease losses is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio. The amount of this component and its relationship to the total allowance for loan and lease losses may change from one period to another.

Although management believes that it uses the best information available to make such determinations, future adjustments to the allowance may be necessary, and net earnings could be significantly affected, if circumstances differ substantially from the assumptions used in making the initial determinations. The Company's amount of future losses is susceptible to changes in economic, operating and other conditions, including changes in interest rates, that may be beyond the Company's control and future losses may exceed current estimates. The Company provides an allowance to absorb losses that are both probable and reasonably quantifiable as well as for those that are not specifically identified but can be reasonably estimated.

As a matter of policy, the Company charges off against its allowance for loan and lease losses unsecured consumer loans delinquent over 120 days.

The Company does not maintain an allowance for losses associated with its portfolio of loans held for sale. Rather, the credit risk inherent in that portfolio is factored into the lower of cost or market analysis in valuing those loans.

At December 31, 2004, R&G Financial's allowance for loan and lease losses related to its loans and leases receivable portfolio totaled \$44.0 million, which represented a \$13.4 million or 43.71% increase from the level maintained at December 31, 2003. At December 31, 2004, R&G Financial's loan and lease loss allowance represented approximately 1.13% of the loans and leases receivable portfolio and 51.87% of non-performing loans, excluding loans held for sale, as compared to 1.04% and 41.32% respectively at December 31, 2003. The increase in the allowance for loan and lease losses reflects the increase in the commercial real estate and residential construction categories of the Company's loans and leases receivable, net portfolio, which have higher inherent credit risk compared to residential loans, as discussed in more detail above.

Table of Contents

The following table sets forth an analysis of R&G Financial's allowance for loan and lease losses related to its loans and leases receivable, net portfolio during the periods indicated:

(Dollars in Thousands)	At and For the Year Ended December 31,				
	2004 (As Restated)	2003 (As Restated)	2002 (As Restated)	2001 (As Restated)	2000 (As Restated)
Balance at beginning of period:	\$ 30,648	\$ 27,805	\$ 16,218	\$ 11,640	\$ 8,991
Charge-offs:					
Commercial and financial	2,051	3,433	3,003	1,487	988
Real estate - construction and development		44			
Real estate - mortgages	3,462	3,177	3,715	1,167	506
Installment	5,436	4,871	3,391	2,489	1,940
Lease financing	2,698	2,065	2,578	1,579	805
Total charge-offs	13,647	13,590	12,687	6,722	4,239
Recoveries:					
Commercial and financial	498	341	514	45	77
Real estate - construction and development	15	25			
Real estate - mortgages	415	436	287	11	81
Installment	767	723	471	382	402
Lease financing	661	874	236	86	304
Total recoveries	2,356	2,399	1,508	524	864
Net charge-offs	11,291	11,191	11,179	6,198	3,375
Allowance for loan and lease losses acquired (1)			4,950		
Provision for loan and lease losses	24,688	14,034	17,816	10,776	6,024
Balance at end of period	\$ 44,045	\$ 30,648	\$ 27,805	\$ 16,218	\$ 11,640
Allowance for loan and lease losses as a percent of total loans and leases outstanding	1.13%	1.04%	1.19%	1.23%	1.07%
Allowance for loan and lease losses as a percent of non-performing loans and leases (excluding loans held for sale)	51.87%	41.32%	39.85%	41.04%	28.78%
Ratio of net charge-offs to average loans and leases outstanding (excluding loans held for sale)	0.34%	0.43%	0.53%	0.52%	0.26%

(1) Relates to acquired reserves in connection with the acquisition of Crown Bank in 2002.

Table of Contents

The following table sets forth information concerning the allocation of R&G Financial's allowance for loan and lease losses by loan category at the dates indicated:

(Dollars in Thousands)	December 31					
	2004		2003		2002	
	Amount (As Restated)	Percent	Amount (As Restated)	Percent	Amount (As Restated)	Percent
Commercial and financial	\$ 3,202	7.27%	\$ 2,535	8.27%	\$ 2,898	10.42%
Real estate construction and development	6,648	15.09%	2,548	8.32%	1,530	5.50%
Real estate mortgages	21,616	49.08%	17,017	55.53%	16,788	60.39%
Installment	7,538	17.11%	5,548	18.10%	4,415	15.88%
Lease financing	4,805	10.91%	2,913	9.50%	2,095	7.53%
Unallocated	236	0.54%	87	0.28%	79	0.28%
Total	\$ 44,045	100%	\$ 30,648	100%	\$ 27,805	100%

(Dollars in Thousands)	2001				2000	
	Amount (As Restated)		Percent		Amount (As Restated)	
	Amount (As Restated)	Percent	Amount (As Restated)	Percent	Amount (As Restated)	Percent
Commercial and financial	\$ 1,548	9.54%	\$ 1,237	10.63%		
Real estate construction and development	816	5.03%	401	3.45%		
Real estate mortgages	8,353	51.51%	5,818	49.98%		
Installment	3,601	22.21%	2,688	23.09%		
Lease financing	1,859	11.46%	1,419	12.19%		
Unallocated	41	0.25%	77	0.66%		
Total	\$ 16,218	100%	\$ 11,640	100%		

Mortgage Banking Activities

Loan Originations, Purchases and Sales. R&G Mortgage's loan origination business is focused on the origination of loans secured by residential real estate. During the years ended December 31, 2004, 2003 and 2002, R&G Financial originated a total of \$2.3 billion, \$2.8 billion and \$2.0 billion of residential mortgage loans, respectively. These aggregate originations include loans originated by R&G Mortgage directly for Premier Bank of \$1.3 billion, \$1.3 billion and \$811.8 million during the years ended December 31, 2004, 2003 and 2002, respectively, or 55%, 45% and 41%, respectively, of total originations. The loans originated by R&G Mortgage for Premier Bank are composed mostly of conventional residential loans and, to a lesser extent, consumer loans secured by real estate along with a small number of non-conventional residential loans.

R&G Financial generally classifies mortgage loans between those that are guaranteed or insured by the FHA, VA or RHS and those that are not. The latter type of loans are referred to as conventional loans. Conventional loans that meet the underwriting requirements for sale or exchange under standard FNMA, FHLMC or GNMA programs are referred to as conforming loans.

R&G Mortgage is engaged in the origination of FHA-insured and VA-guaranteed single-family residential loans that are primarily securitized into GNMA mortgage-backed securities and sold to institutional and private investors in the secondary market. During the years ended December 31, 2004, 2003 and 2002, R&G Financial originated \$175.7 million, \$358.9 million and \$365.2 million, respectively, of FHA/VA loans, which represented 8%, 13% and 19%, respectively, of total loans originated during such respective periods.

Table of Contents

R&G Financial also originates conventional single-family residential loans. During the years ended December 31, 2004, 2003 and 2002, R&G Financial originated \$2.2 billion, \$2.5 billion and \$1.6 billion, respectively, of conventional single-family residential mortgage loans. Substantially all conforming conventional single-family residential loans are securitized and sold in the secondary market, while a substantial portion of non-conforming conventional single-family residential loans are originated by R&G Mortgage (either directly or through The Mortgage Store, prior to its merger into R&G Mortgage) on behalf of Premier Bank and either held by Premier Bank in its portfolio or subsequently securitized by R&G Mortgage and sold in the secondary market from time to time.

Non-conforming loans generally consist of loans which, primarily because of size or other underwriting technicalities (mostly related to documentation requirements), do not satisfy the guidelines for resale of FNMA, FHLMC, and GNMA at the time of origination. In connection with mortgage operations, during the years ended December 31, 2004, 2003 and 2002, non-conforming conventional loans represented approximately 63%, 52% and 54%, respectively, of R&G Financial's total volume of mortgage loans originated, most of which were originated by R&G Mortgage on behalf of Premier Bank. During the years ended December 31, 2004, 2003 and 2002, 95.2%, 96.3% and 94.1% of loans originated by R&G Mortgage on behalf of Premier Bank consisted of non-conforming conventional single-family residential loans during such respective periods. R&G Mortgage originates single-family residential, construction and commercial real estate loans on behalf of Premier Bank pursuant to the terms of a Master Production Agreement between R&G Mortgage and Premier Bank. Refer to Lending Activities from Banking Operations Origination, Purchase and Sale of Loans.

While R&G Financial makes available a wide variety of mortgage products designed to respond to consumer needs and competitive conditions, it currently emphasizes 15-year and 30-year conventional first mortgages and 15-year and 30-year FHA-insured, VA-guaranteed loans. Substantially all of such loans consist of fixed-rate mortgages. R&G Financial also offers second mortgage loans up to \$125,000 with a maximum term of 15 years. The maximum loan-to-appraised value ratio on second mortgage loans permitted by R&G Financial is generally 75% (including the amount of any first mortgage). In addition, R&G Financial also offers real estate secured consumer loans up to \$60,000 with a maximum term of 15 years. The maximum loan-to-appraised value ratio on real estate secured consumer loans permitted by R&G Financial is generally 80% (including the amount of any first and second mortgage loans). R&G Financial will secure such loans with either a first or second mortgage on the property.

The Company's loan origination activities in Puerto Rico are conducted out of R&G Mortgage offices and mortgage banking centers. In the continental United States, the Company's loan origination activities are conducted mainly through loan officers and solicitors, out of Crown Bank's branches and, prior to the 2005 Continental disposition, Continental's mortgage offices. Residential mortgage loan applications are attributable to walk-in customers, existing customers, advertising and promotion, referrals from real estate brokers and builders, loan solicitors and mortgage brokers.

Loan origination activities performed by the Company include soliciting, completing and processing mortgage loan applications and preparing and organizing the necessary loan documentation. Loan applications are examined for compliance with underwriting criteria and, if all requirements are met, the Company issues a commitment to the prospective borrower specifying the amount of the loan and the loan origination fees, points and closing costs to be paid by the borrower or seller and the date on which the commitment expires.

R&G Mortgage also purchases FHA and VA loans from other mortgage bankers for resale to institutional investors and other investors in the form of GNMA mortgage-backed securities. R&G Mortgage's strategy is to increase its servicing portfolio primarily through internal originations through its branch network and, to a lesser extent, through purchases from third parties. R&G Mortgage purchased \$213,000, \$32,000 and \$75,000 of loans from third parties during the years ended December 31, 2004, 2003 and 2002, respectively.

Table of Contents

The following table sets forth loan originations, purchases and sales by R&G Financial from its mortgage banking business for the periods indicated:

(Dollars in Thousands)	Year Ended December 31,		
	2004 (As Restated)	2003 (As Restated)	2002 (As Restated)
Loans Originated Under a Table Funding Arrangement For Premier Bank:			
Conventional loans (1):			
Number of loans	10,750	10,674	7,182
Volume of loans	\$ 1,289,445	\$ 1,281,323	\$ 809,141
FHA/VA loans:			
Number of loans			
Volume of loans			
Consumer loans (2):			
Number of loans	476	126	133
Volume of loans	\$ 6,062	\$ 1,985	\$ 2,632
Total loans:			
Number of loans	11,226	10,800	7,315
Volume of loans	\$ 1,295,507	\$ 1,283,308	\$ 811,773
Percent of total volume	55%	45%	41%
Loans Originated For Sale to Third Parties:			
Conventional loans (1):			
Number of loans	8,058	10,179	7,123
Volume of loans	\$ 873,082	\$ 1,193,565	\$ 782,782
FHA/VA loans:			
Number of loans	1,623	3,271	3,537
Volume of loans	\$ 175,693	\$ 358,906	\$ 365,172
Total loans:			
Number of loans	9,681	13,450	10,660
Volume of loans	\$ 1,048,775	\$ 1,552,471	\$ 1,147,954
Percent of total volume	45%	55%	59%
Total loan originations	\$ 2,344,282	\$ 2,835,779	\$ 1,959,727
Loans Purchased For R&G Mortgage:			
Number of loans	54	18	7
Volume of loans	\$ 4,159	\$ 797	\$ 440
Total loan originations and purchases	\$ 2,348,441	\$ 2,836,576	\$ 1,960,167

Table of Contents

(Dollars in Thousands)	Year Ended December 31,		
	2004 (As Restated)	2003 (As Restated)	2002 (As Restated)
Loans Sold (1):			
Conventional loans (2):			
Number of loans	6,537	7,890	5,898
Volume of loans	\$ 664,776	\$ 956,710	\$ 653,673
FHA/VA loans:			
Number of loans	1,429	2,588	1,656
Volume of loans	\$ 160,144	\$ 320,566	\$ 282,047
Total loans:			
Number of loans	7,966	10,478	7,554
Volume of loans	\$ 824,920	\$ 1,277,276	\$ 935,720
Percent of total volume	35%	45%	48%
Less adjustments:			
Loans originated for Premier Bank	1,295,507	1,283,308	811,773
Loans securitized and not sold	42,348	49,882	94,247
Loan amortization	137,204	68,095	8,710
Net increase	\$ 48,462	\$ 158,015	\$ 109,717
Average initial loan origination balance:			
Premier Bank:			
Conventional loans (2)	\$ 120	\$ 120	\$ 113
FHA/VA loans			
Third parties:			
Conventional loans (2)	\$ 108	\$ 117	\$ 110
FHA/VA loans	108	110	103
Total conventional loans (2)	\$ 115	\$ 119	\$ 111
FHA/VA Loans	108	110	103
Refinancing (3):			
Premier Bank	43%	52%	50%
Third parties	55%	68%	56%

(1) Includes loans converted into mortgage-backed securities.

(2) Includes non-conforming loans.

(3) As a percent of the total dollar volume of mortgage loans originated by R&G Mortgage for Premier Bank (excluding consumer loans) or third parties, as the case may be. In the case of Premier Bank, refinancings do not necessarily represent refinancing of loans previously held by Premier Bank.

All loan originations, regardless of whether originated by the Company or purchased from third parties, must be underwritten in accordance with R&G Financial's underwriting criteria, including loan-to-value ratios, borrower income qualifications, debt ratios, credit history, investor requirements, and necessary insurance and property appraisal requirements. R&G Financial's underwriting standards also comply with the relevant guidelines set forth by HUD, VA, FNMA, FHLMC, bank regulatory authorities, private mortgage investment conduits and private mortgage insurers, as applicable. The Company's underwriting personnel, although operating out of its loan offices, make underwriting decisions independent of the Company's mortgage loan origination personnel.

Table of Contents

Typically, when a mortgage loan is originated, the borrower pays an origination fee. These fees are generally in the range of 0% to 6% of the principal amount of the mortgage loan, and are payable at the closing of such loan. The Company receives these fees on mortgage loans originated through its retail branches. The Company incurs certain costs in originating mortgage loans, including overhead, out-of-pocket costs and, in some cases, where the mortgage loans are subject to a purchase commitment from private investors, related commitment fees. The volume and type of mortgage loans and of commitments made by investors vary with competitive and economic conditions (such as the level of interest rates and the status of the economy in general), resulting in fluctuations in revenues from mortgage loan originations. GAAP requires that general operating expenses incurred in originating mortgage loans be charged to current expenses. Direct origination costs and origination fee income must be deferred until the repayment or sale of the related mortgage loans.

R&G Financial sells most of the loans that it originates, except for those originated on behalf of Premier Bank pursuant to the Master Production Agreement between Premier Bank and R&G Mortgage. Refer to Banking Operations/Lending Activities Origination, Purchases and Sales of Loans. As part of the restatement process, the Company re-evaluated all the purported mortgage loan sales to determine if such transactions qualified for sale accounting in conformity with SFAS No. 140. Based on the analysis performed by the Company, it was determined that the existence of certain provisions in various of the Company's mortgage loan sale documents and side agreements were incompatible with the requirements for accounting for the transactions as sales. The Company concluded that certain mortgage loan sales did not qualify as sales under SFAS No. 140 and should have been recorded as secured borrowings. For further information, refer to Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations Restatement of Previously Issued Financial Statements Background to Restatement and Summary of Accounting Adjustments by Category Accounting for Loan Transfers Loan Transfer Transactions Recharacterized as Secured Borrowings, as well as Item 9A Controls and Procedures Management's Report on Internal Controls Over Financial Reporting (Restated). During the years ended December 31, 2004, 2003 and 2002, respectively, R&G Financial's loans sold were \$824.9 million, \$1.3 billion and \$935.7 million, including loans securitized and sold but not including loans originated by R&G Mortgage on behalf of Premier Bank.

FHA-insured and VA-guaranteed loans originated or purchased by the Company are generally packaged into pools of \$1 million or more (\$2.5 million to \$5 million for GNMA serial notes) by R&G Mortgage. These securities are generally sold either directly or indirectly through securities broker-dealers, Premier Bank's Trust Department or through R-G Investments, R&G Financial's broker-dealer prior to the sale of certain of its assets to UBS PR in 2006 and its subsequent liquidation and dissolution as discussed above in Explanatory Note .

Conforming conventional loans originated or purchased by the Company are generally sold directly to FNMA, FHLMC or private investors for cash or are grouped into pools of \$1 million or more in aggregate principal balance and exchanged for FNMA or FHLMC-issued mortgage-backed securities, which the Company sells to securities broker-dealers. In connection with any such exchanges, the Company pays guarantee fees to FNMA and FHLMC. The issuance of mortgage-backed securities provides R&G Financial with flexibility in selling the mortgages that it originates or purchases and also provides income by increasing the value and marketability of the loans. Mortgage loans that do not conform to GNMA, FNMA or FHLMC requirements, or non-conforming loans, are generally originated on behalf of Premier Bank by R&G Mortgage and either retained in Premier Bank's portfolio, sold to financial institutions or other private investors. For further information, refer to Explanatory Note Subsequent Events Other Subsequent Events Status of Mortgage Banking Licenses.

The Company engages in the sale or exchange of mortgage loans on both a recourse and non-recourse basis. Recourse sales often involve the sale of non-conforming loans to FNMA and FHLMC. R&G Financial estimates the fair value of the recourse obligation at the time mortgage loans are sold. At December 31, 2004, R&G Financial had loans in its servicing portfolio with provisions for recourse in the principal amount of approximately \$664.6 million, as compared to \$672.7 million and \$853.9 million as of December 31, 2003 and 2002, respectively. As of December 31, 2004, 2003 and 2002, R&G Financial had reserves for possible losses related to its recourse obligations of \$9.9 million, \$9.7 million and \$12.3 million, respectively. Historical losses on recourse obligations have not been significant.

Table of Contents

Loan Servicing. R&G Financial acquires servicing rights through its mortgage loan originations (including originations on behalf of Premier Bank) and mortgage loan purchases from third parties as well as bulk purchases of servicing rights. The Company generally retains the rights to service mortgage loans that it has originated or purchased and subsequently sold, and receives the related servicing fees. Loan servicing includes collecting principal and interest and remitting the same to the holders of the mortgage loans or mortgage-backed securities to which such mortgage loan relates, holding escrow funds for the payment of real estate taxes and insurance premiums, contacting delinquent borrowers, supervising foreclosures in the event of unremedied defaults and generally administering the loans. The Company receives annual loan servicing fees ranging from 25 to 50 basis points on the outstanding principal of the loans serviced plus any late charges and, in some cases, prepayment penalties. In general, the Company's servicing agreements are terminable by the investor for cause without penalty or after payment of a termination fee ranging from 50 to 100 basis points on the outstanding principal balance of the loans being serviced.

R&G Financial's servicing portfolio has grown significantly over the past several years. At December 31, 2004, R&G Financial's servicing portfolio totaled \$11.4 billion and consisted of a total of 145,003 loans. These amounts include R&G Mortgage's servicing portfolio totaling \$8.5 billion, Premier Bank's servicing portfolio totaling \$17.9 million which includes \$5.5 million of consumer real estate and \$12.4 million of other non-residential loans and Crown Bank's servicing portfolio totaling \$2.9 billion. At December 31, 2004, R&G Financial's servicing portfolio included \$3.2 billion of loans owned by Premier Bank, \$754.8 million of loans owned by R&G Mortgage and \$874.6 million of loans owned by Crown Bank, or 28%, 7% and 8%, respectively, of the total servicing portfolio, respectively. Nearly all servicing of loans owned by Premier Bank and R&G Mortgage is performed by R&G Mortgage. Crown Bank services all loans it owns. Substantially all of the mortgage loans in R&G Financial's servicing portfolio are secured by single (one-to-four) family residences. At December 31, 2004, approximately 75% of R&G Financial's mortgage servicing portfolio was composed of mortgages secured by real estate located in Puerto Rico. Refer to Explanatory Note Subsequent Events Restructuring and Divestitures for information regarding the sale of Crown Bank's servicing portfolio.

R&G Mortgage services all residential mortgage loans held in Premier Bank's loan portfolio, except for a few pools of loans purchased from other financial institutions (including single-family residential loans retained by Premier Bank and certain commercial real estate loans). Premier Bank pays R&G Mortgage servicing fees with respect to the loans serviced by R&G Mortgage on behalf of Premier Bank. In addition, Premier Bank collects payments on loans serviced by R&G Mortgage. In connection therewith, R&G Mortgage pays Premier Bank a fee of between \$0.50 and \$1.00 per loan. Refer to Regulation R&G Financial Limitations on Transactions with Affiliates.

R&G Financial's mortgage loan servicing portfolio is subject to reduction by reason of normal amortization, prepayments and foreclosure of outstanding mortgage loans. Additionally, R&G Financial may sell mortgage loan servicing rights from time to time.

The following table sets forth certain information regarding the total loan servicing portfolio of R&G Financial for the periods indicated:

(Dollars in Thousands)	At or for the Year Ended December 31,		
	2004 (As Restated)	2003 (As Restated)	2002 (As Restated)
Composition of Servicing Portfolio at End of Period:			
Conventional and other mortgage loans (1)	\$ 9,223,563	\$ 8,317,318	\$ 8,035,208
FHA/VA loans	2,180,740	2,625,503	2,956,736
Total servicing portfolio	\$ 11,404,303	\$ 10,942,821	\$ 10,991,944
Activity in the servicing portfolio:			
Beginning servicing portfolio	\$ 10,942,821	\$ 10,991,944	\$ 7,224,571
Add: Loan originations and purchases	2,918,983	2,935,327	2,204,275
Servicing of loans portfolio acquired (2)	3,495	1,008,231	4,325,499
Less: Sale of servicing rights (3)	(191,914)	(255,814)	(229,587)

Table of Contents

(Dollars in Thousands)	At or for the Year Ended December 31,		
	2004 (As Restated)	2003 (As Restated)	2002 (As Restated)
Run-off (4)	(2,269,082)	(3,736,867)	(2,532,814)
Ending servicing portfolio	\$ 11,404,303	\$ 10,942,821	\$ 10,991,944
Number of loans serviced	145,003	147,981	158,659
Average loan size	\$ 79	\$ 74	\$ 69
Average servicing fee rate	0.409%	0.431%	0.400%

- (1) Includes \$4.9 billion, \$3.3 billion, and \$2.0 billion of loans owned by R&G Financial as of December 31, 2004, 2003, and 2002, respectively.
- (2) Includes \$2.6 billion acquired in connection with the acquisition of Crown Bank in June 2002.
- (3) Includes loans sold, servicing released, by Continental totaling \$191.9 million, \$255.8 million and \$229.6 million in 2004, 2003 and 2002, respectively.
- (4) Run-off refers to regular amortization of loans, prepayments and foreclosures.

The following table sets forth certain information at December 31, 2004 regarding the number and aggregate principal balance of the mortgage loans serviced by R&G Financial for its loan portfolio and for third parties at various mortgage interest rates:

(Dollars in Thousands)	At December 31, 2004 Loans Serviced For Third Parties					
	Portfolio Loans Serviced		Parties		Total Loans Serviced	
	Number of Loans (As Restated)	Aggregate Principal Balance	Number of Loans (As Restated)	Aggregate Principal Balance	Number of Loans (As Restated)	Aggregate Principal Balance (As Restated)
Mortgage Interest Rate						
Less than 4.99%	826	\$ 169,883	4,855	\$ 355,116	5,681	\$ 524,999
5.00% - 5.49%	1,141	243,245	4,285	427,441	5,426	670,686
5.50% - 5.99%	7,722	1,139,731	9,071	868,932	16,793	2,008,663
6.00% - 6.49%	13,125	1,508,836	7,822	784,780	20,947	2,293,616
6.50% - 6.99%	10,004	994,777	12,960	982,937	22,964	1,977,714
7.00% - 7.49%	3,667	330,456	18,845	1,260,026	22,512	1,590,482
7.50% - 7.99%	2,446	183,341	18,056	965,830	20,502	1,149,171
8.00% - 8.49%	1,558	99,069	8,040	381,372	9,598	480,441
8.50% - 8.99%	1,646	89,044	7,544	298,442	9,190	387,486
9.00% - 9.49%	767	40,107	2,634	84,841	3,401	124,948
9.50% - 9.99%	771	25,993	2,066	49,987	2,837	75,980
10.00% or more	1,282	48,035	3,870	72,082	5,152	120,117
Total	44,955	\$ 4,872,517	100,048	\$ 6,531,786	145,003	\$ 11,404,303

The primary means used by R&G Mortgage to reduce the sensitivity of its servicing fee income to changes in interest and prepayment rates is the development of a strong internal origination capability that has allowed R&G Financial to continue to increase the size of its servicing portfolio even in times of high prepayments.

Table of Contents

Servicing agreements relating to the mortgage-backed securities programs of FNMA, FHLMC and GNMA, and certain other investors, require R&G Financial to advance funds to make scheduled payments of principal, interest, taxes and insurance, if such payments have not been received from the borrowers. During the years ended December 31, 2004, 2003 and 2002, the monthly average amount of funds advanced by R&G Financial under such servicing agreements was \$19.6 million, \$16.1 million and \$17.5 million, respectively. Funds advanced by R&G Financial pursuant to these arrangements are generally recovered by R&G Financial.

In connection with its loan servicing activities, R&G Financial holds escrow funds for the payment of real estate taxes and insurance premiums with respect to the mortgage loans it services. At December 31, 2004, R&G Financial held \$124.3 million of such escrow funds, \$72.0 million of which were deposited in Premier Bank, \$52.2 million of which were deposited in Crown Bank and \$101,000 of which were deposited with other financial institutions. The escrow funds on deposit at Crown Bank and Premier Bank lower the overall cost of funds, while the escrow funds deposited with other financial institutions serve as part of R&G Financial's compensating balances which permit the Company to borrow funds from such institutions (pursuant to certain warehouse lines of credit) at rates that are lower than would otherwise apply. Refer to Sources of Funds Borrowings.

The degree of risk associated with a mortgage loan servicing portfolio is largely dependent on the extent to which the servicing portfolio is non-recourse or recourse. In non-recourse servicing, the principal credit risk to the servicer is the cost of temporary advances of funds. In recourse servicing, the servicer agrees to share credit risk with the owner of the mortgage loans such as FNMA or FHLMC or with an insurer or guarantor. Losses on recourse servicing occur primarily when foreclosure sale proceeds of the property underlying a defaulted mortgage are less than the then-outstanding principal balance and accrued interest of such mortgage loan and the cost of holding and disposing of such underlying property. At December 31, 2004, R&G Financial was servicing mortgage loans with an aggregate principal amount of \$664.6 million on a recourse basis. During the last three years, losses incurred due to recourse servicing have not been significant.

R&G Financial's general strategy is to retain the servicing rights related to the mortgage loans it originates and purchases. Nevertheless, there is a market for servicing rights, which are generally valued in relation to the present value of the expected income stream generated by the servicing rights. Among the factors which influence the value of a servicing portfolio are servicing fee rates, loan balances, loan types, loan interest rates, the expected average life of the underlying loans (which may be reduced through foreclosure or prepayment), the value of escrow balances, delinquency and foreclosure experience, servicing costs, servicing termination rights of permanent investors and any recourse provisions. Although the Company may on occasion consider future sales of a portion of its servicing portfolio, management does not anticipate sales of servicing rights to become a significant part of its operations.

The market value of, and earnings from, R&G Financial's mortgage loan servicing portfolio may be adversely affected if mortgage interest rates decline and mortgage loan prepayments increase. In a period of declining interest rates and accelerated prepayments, income generated from the Company's mortgage loan servicing portfolio may also decline. Conversely, as mortgage interest rates increase, the market value of the Company's mortgage loan servicing portfolio may be positively affected. Refer to Note 3 to the Consolidated Financial Statements for a discussion of SFAS No. 140 and the treatment of servicing rights.

Mortgage Loan Delinquencies and Foreclosures. The following table shows the delinquency statistics for R&G Financial's servicing portfolio at the dates indicated:

	2004		December 31, 2003		2002	
	Number of Loans (As Restated)	Percent of Servicing Portfolio	Number of Loans (As Restated)	Percent of Servicing Portfolio	Number of Loans (As Restated)	Percent of Servicing Portfolio
Loans delinquent for:						
30 - 59 days	5,089	3.51%	5,106	3.45%	5,708	3.60%
60 - 89 days	1,601	1.10%	1,672	1.13%	1,696	1.07%
90 days or more	3,162	2.18%	3,559	2.41%	3,298	2.08%

Table of Contents

	2004		December 31, 2003		2002	
	Number of Loans (As Restated)	Percent of Servicing Portfolio	Number of Loans (As Restated)	Percent of Servicing Portfolio	Number of Loans (As Restated)	Percent of Servicing Portfolio
Total delinquencies (1)	9,852	6.77%	10,337	6.99%	10,702	6.75%
Foreclosures pending (2)	2,573	1.77%	2,345	1.58%	2,199	1.39%

- (1) Includes at December 31, 2004 an aggregate of \$162.2 million of delinquent loans serviced for Premier Bank, or 1.42% of the total servicing portfolio, \$31.6 million of delinquent loans held by Crown Bank, or 0.28% of the total servicing portfolio, and \$78.0 million of delinquent loans held by R&G Mortgage, or 0.68% of the total servicing portfolio.
- (2) At December 31, 2004, Premier Bank had foreclosures pending on \$64.4 million of loans being serviced by R&G Mortgage, which constituted 0.6% of the servicing portfolio. Crown Bank had foreclosures pending on \$1.3 million of loans it is servicing for its own portfolio, and R&G Mortgage had foreclosures pending on \$60.0 million of loans it is servicing for its own portfolio at December 31, 2004.

While delinquency rates in Puerto Rico are generally higher than in the mainland United States, these rates are not necessarily indicative of future foreclosure rates or losses on foreclosures. Real estate owned as a result of foreclosures, or REO, arises primarily through foreclosure on mortgage loans repurchased from investors either because of breach of representations or warranties or pursuant to recourse arrangements. As of December 31, 2004, 2003 and 2002, R&G Financial held REO with a book value of approximately \$21.8 million, \$19.4 million and \$15.7 million, respectively. Sales of REO resulted in gains to R&G Financial of \$3.7 million, \$2.8 million and \$400,000 during the years ended December 31, 2004, 2003 and 2002, respectively. There is no liquid secondary market for the sale of R&G Financial's REO.

With respect to mortgage loans securitized through GNMA programs, the Company is fully insured as to principal by the FHA and VA against foreclosure loans. As a result of these programs, foreclosure on these loans had generated no loss of principal as of December 31, 2004. Under GNMA guidelines, R&G Mortgage is obligated to pay the security holders and to deposit in the central custodial account funds sufficient to enable the depository to withdraw timely monthly payments of principal and interest. R&G Mortgage is also obligated to make the payment and deposit without regard to whether it will be able to recover those payments from liquidation proceeds, insurance proceeds or late payments. This process creates an exposure to R&G Mortgage to the extent that interest is advanced to the certificate holders in excess of the interest recovered from FHA upon filing and settlement of a claim. Losses could arise for any interest shortage when the mortgage loan is liquidated, as a result of the settlement of the FHA claim, from foreclosure proceeds or if the mortgage loan is repurchased from the pool. The Company has recorded a reserve for losses on GNMA servicing-related payments of \$5.6 million and \$11.0 million as of December 31, 2004 and 2003, respectively. Such reserve is included in other liabilities in the Consolidated Financial Statements.

Currently, Crown Bank only services conventional loans, as opposed to FHA/VA loans. In transactions with FNMA and FHLMC, they are obligated to reimburse the Company for principal and interest payments advanced by the Company as a servicer (except for recourse servicing). The funding of delinquent payments or the exercise of foreclosure rights involves costs to the Company some of which may not be recovered. Such unrecovered expenses have been expensed when incurred.

Any significant adverse general economic developments could result in an increase in defaults or delinquencies on mortgage loans that are serviced by the Company or held by the Company pending sale in the secondary mortgage market, thereby reducing the resale value of such mortgage loans.

Table of Contents

Investment Activities

General. R&G Financial's securities portfolio is managed by investment officers in accordance with a comprehensive written investment policy which addresses strategies, types and levels of allowable investments. The investment policy is reviewed and approved annually by the respective Boards of Directors of the Company's banking subsidiaries and the Company's Board of Directors. During 2004, the management of the securities portfolios of Premier Bank and Crown Bank was set in accordance with strategies developed by the Interest Rate Risk, Budget and Investments Committee and the Investment and Loan Committee, respectively. Beginning in late 2004, this strategic function has been performed by the Investment Committee and Asset/Liability Management Committee of each banking subsidiary.

As discussed under Mortgage Banking Activities, R&G Mortgage is primarily engaged in the origination of mortgage loans and the securitization of such loans into mortgage-backed and related securities and the subsequent sale of such securities to securities broker-dealers and other investors in the secondary market. As a result of R&G Mortgage's securitization activities, R&G Mortgage maintains a substantial portfolio of GNMA mortgage-backed securities. As of December 31, 2004, R&G Mortgage held tax-exempt GNMA mortgage-backed securities with a fair value of \$250.6 million, which are classified as available for sale. At December 31, 2004, R&G Mortgage's collateralized mortgage obligations, or CMOs, which are classified as available for sale, had an amortized cost of \$1.4 million and a fair value of \$926,000.

Under Premier and Crown Banks' Investment Policies, the Company's banking subsidiaries generally invest in U.S. Treasury obligations (with a maturity up to ten years), U.S. Agency obligations, FNMA, GNMA and FHLMC mortgage-backed certificates, investment grade municipal obligations (with a maturity of up to seven years), bankers' acceptances and FHLB notes (with a maturity of up to five years), investment grade commercial paper (with a maturity of up to 9 months), federal funds (with a maturity of six months or less), time deposits in other financial institutions (including Eurodollar deposits), reverse repurchase agreements (with a maturity of six months or less), investment grade corporate bonds (with a maturity of five years or less) and certain mortgage-backed securities (with a weighted average life of less than ten years).

At December 31, 2004, the securities portfolios of the Company's banking subsidiaries included \$58.6 million of securities held to maturity, consisting principally of \$3.4 million of GNMA mortgage-backed securities, \$4.0 million of FHLMC and FNMA mortgage-backed securities, and \$51.2 million of certain Puerto Rico Government obligations and other securities, all held by Premier Bank. At December 31, 2004, the securities portfolios of the Company's banking subsidiaries classified as available for sale had a fair value of \$3.3 billion, consisting principally of \$46.2 million of GNMA mortgage-backed securities, \$894.3 million of FHLMC and FNMA mortgage-backed securities, \$1.5 billion of CMOs, \$49.6 million corporate debt obligations and \$850.9 million of U.S. Government and Agency securities. A substantial amount of securities held by Premier Bank are held by the Company's international banking entity, for which interest income and gains on sales are tax-exempt.

Premier Bank's Treasury Department from time to time engages in certain trading activities. At December 31, 2004, securities held for trading held by Premier Bank totaled \$24.5 million, consisting of FHLMC mortgage-backed securities.

At December 31, 2004, \$409.7 million or 11% of R&G Financial's mortgage-backed and investment securities were pledged to secure various obligations of R&G Financial (excluding repurchase agreements).

Table of Contents

The following table presents certain information regarding the composition and period to maturity of R&G Financial's securities portfolio held to maturity as of the dates indicated below. The weighted average yield in the following table for both taxable and non-taxable obligations is calculated on an actual basis and not on a tax-equivalent basis. All of the securities in the following table are assets of the Company's banking subsidiaries:

(Dollars in Thousands)	2004		December 31,		2003		Weighted Average Yield (As Restated)
	Carrying Value (As Restated)	Fair Value (As Restated)	Weighted Average Yield (As Restated)	Carrying Value (As Restated)	Fair Value (As Restated)	Weighted Average Yield (As Restated)	
Mortgage-backed securities held to maturity:							
GNMA certificates: (1)							
Due from one to five years	\$ 2,431	\$ 2,519	5.47%	\$ 3,421	\$ 3,579		5.47%
Due from five to ten years	342	348	5.83%	452	471		5.81%
Due over ten years	17,222	17,281	6.15%	24,114	24,174		6.15%
FNMA certificates:							
Due over ten years	3,914	4,175	7.04%	4,786	5,015		7.03%
FHLMC certificates:							
Due over ten years	62	61	4.97%	79	78		4.97%
Other investment securities held to maturity:							
United States Agencies obligations: (2)							
Due from one to five years	2,500	2,467	2.02%	1,997	1,997		1.03%
Puerto Rico Agencies obligations:							
Due within one year	10,715	10,812	4.83%	558	567		5.85%
Due from one to five years	38,455	38,746	4.30%	31,846	33,088		4.91%
Due from five to ten years	2,000	2,005	4.10%	9,397	9,229		3.80%
Other Investments:							
Due from one to five years	100	100	6.20%	100	100		6.20%
Total	\$ 77,741	\$ 78,514	4.89%	\$ 76,750	\$ 78,298		5.23%

- (1) Includes \$16.6 million and \$23.4 million as of December 31, 2004 and December 31, 2003, respectively, held by R&G Financial at the parent company level.
- (2) Includes \$2.5 million and \$2.0 million as of December 31, 2004 and December 31, 2003, respectively, held by R&G Financial at the parent company level.

(Dollars in Thousands)	December 31,		Weighted Average Yield (As Restated)
	2002	2002	
	Carrying Value (As Restated)	Fair Value (As Restated)	
Mortgage-backed securities held to maturity:			
GNMA certi			