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R&G FINANCIAL CORP  
Form 10-K  
April 01, 2002

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended: December 31, 2001  
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

66-0532217

-----  
(State or other jurisdiction  
of incorporation or organization)

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

280 Jesus T. Pinero Avenue  
Hato Rey, San Juan, Puerto Rico

00918

-----  
(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: Not Applicable

Securities registered pursuant to Section 12(g) of the Act:  
Class B Common Stock (par value \$.01 per share)

-----  
(Title of Class)

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.

As of February 28, 2002, the aggregate value of the 14,325,461 shares of Class B

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Common Stock of the Registrant issued and outstanding on such date, which excludes 919,461 shares held by all directors and

officers of the Registrant as a group, was approximately \$300.8 million. This figure is based on the last known trade price of \$21.00 per share of the Registrant's Class B Common Stock on February 28, 2002.

Number of shares of Class B Common Stock outstanding as of February 28, 2002: 15,244,922.

### DOCUMENTS INCORPORATED BY REFERENCE

List hereunder the following documents incorporated by reference and the Part of the Form 10-K into which the document is incorporated:

- (1) Portions of the Annual Report to Stockholders for the fiscal year ended December 31, 2001 are incorporated into Parts II and IV.
- (2) Portions of the definitive proxy statement for the Annual Meeting of Stockholders are incorporated into Part III.

### PART I

#### ITEM 1: BUSINESS

#### GENERAL

#### THE COMPANY

R&G Financial is a Puerto Rico chartered, financial holding company that operates R&G Mortgage Corp., the second largest mortgage company in Puerto Rico, and R-G Premier Bank, a Puerto Rico commercial bank. Through R&G Mortgage, we also operate The Mortgage Store of Puerto Rico, Inc., a Puerto Rico mortgage company, and through R-G Premier Bank, the Company operates Continental Capital Corp., a Huntington Station, New York mortgage banking company. The Company operates Home & Property Insurance Corp., a Puerto Rico insurance agency, and R-G Investments Corporation, a licensed broker-dealer.

In December 2001, R&G Financial, and its wholly owned subsidiary R&G Acquisition Holdings Corporation, a Florida corporation, entered into a definitive merger agreement pursuant to which the new subsidiary will acquire The Crown Group, Inc., a Florida corporation, and its wholly-owned savings bank subsidiary, Crown Bank, a Federal Savings Bank, hereinafter collectively referred to as "Crown." Crown, which had total assets of \$638 million, total deposits of \$404 million and stockholders' equity of \$69 million as of December 31, 2001, operates in the Tampa-St. Petersburg-Clearwater and Orlando metropolitan areas through 14 full-service offices.

The Orlando market is one of the fastest growing markets in Florida, both generally and for Hispanics in particular, and provides the Company with what management believes is a cost effective way to access the Hispanic markets in the United States, while providing a strong platform for further expansion in Florida. Crown's balance sheet is complimentary to that of the Company and is predominantly secured by real estate. In addition, the acquisition will allow the Company to access lower cost funding in Florida as compared to Puerto Rico. For the quarter ended September 30, 2001, Crown's cost of deposits was 4.26% as compared to the Company's cost of deposits of 4.75% as of such date.

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Under the terms of the merger agreement, holders of Crown common stock will receive an aggregate of \$100.0 million in cash. The acquisition, which is expected to be accretive to the Company's earnings per share in 2002, is expected to close during the second quarter of 2002, pending the receipt of all requisite regulatory approvals and the approval of Crown's shareholders.

The Company is currently in its 30th year of operations and operates its business through its subsidiaries. The Company is primarily engaged in 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 and 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. The Company is also engaged in providing a full range of banking services, including commercial banking services, corporate real estate and business lending, residential construction lending, consumer lending and credit cards, offering a diversified range of deposit products and, to a lesser extent, trust and investment services through its private banking department and its broker-dealer.

The Company was organized in 1972 as R&G Mortgage Corp. and completed its initial public offering in 1996, following its reorganization as a bank holding company. As of December 31, 2001, the Company had total assets of \$4.7 billion, total deposits of \$2.1 billion and stockholders' equity of \$459.1 million. At December 31, 2001, the Company operated 65 branch offices (36 mortgage offices in Puerto

Rico, 4 mortgage offices in the United States and 25 bank branches, mainly located in the northeastern section of Puerto Rico).

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: (1) emphasizing the growth of its mortgage banking activities, including the origination and sale of mortgage loans, and growing its loan servicing operation; (2) expanding its retail banking franchise in order to achieve increased market presence and to increase core deposits; (3) enhancing its net interest income by increasing its loans held for investment, particularly single-family residential loans, and investment securities; (4) developing new business relationships through an increased emphasis on commercial real estate and commercial business lending; (5) diversifying its retail products and services, including an increase in consumer loan originations; (6) meeting the banking needs of its customers through, among other things, the offering of trust and investment services and insurance products; (7) expanding its operations in the United States; and, (8) emphasizing controlled growth, while pursuing a variety of acquisition opportunities when appropriate.

The senior management of the Company is comprised of five executives with an average of over 27 years of experience in the financial services industry. Victor J. Galan is the Company's Chairman and Chief Executive Officer, positions he has held since the Company's incorporation in 1996. Mr. Galan is also the founder and Chairman of R&G Mortgage, a position he has held since 1972. During 2001, the Company promoted Ramon Prats, Company's Vice Chairman, to the office of President. Mr. Prats formerly was Executive Vice President of R&G Mortgage, a position he held since 1980. Joseph R. Sandoval has been the Company's Chief Financial Officer since 1997. Previously, Mr. Sandoval was an accountant with a predecessor to PriceWaterhouseCoopers LLP. Mario Ruiz has been with R&G Financial subsidiaries since 1990 and is presently Executive Vice President of R-G Premier Bank. Mr. Ruiz previously served in various capacities

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for R&G Mortgage and The Mortgage Store of Puerto Rico, Inc. Steven Velez has been with R&G Mortgage since 1989 and is presently Executive Vice President of R&G Mortgage.

The Company's principal executive offices are located at 280 Jesus T. Pinero Avenue, San Juan, Puerto Rico 00918 and the Company's telephone number is (787) 758-2424.

### R&G MORTGAGE

Originations. 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 originates residential mortgage loans through The Mortgage Store of Puerto Rico, Inc., its wholly-owned subsidiary. Pursuant to agreements entered into between R&G Mortgage and R-G Premier Bank, non-conforming conventional single-family residential loans and consumer loans secured by real estate are also originated by R&G Mortgage for portfolio retention by R-G Premier Bank. R-G Premier Bank retains the nonconforming conventional single-family residential loans 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) or other underwriting technicalities at the time of origination. Jumbo loans may be packaged and sold in the secondary market, while loans with underwriting technicalities may be cured through payment experience and subsequently sold. Management believes that these loans are essentially of the same credit quality as conforming loans. During the years ended December 31, 2001, 2000 and 1999, R&G Financial originated a total of \$1.8 billion, \$1.1 billion and \$1.1 billion of residential mortgage loans, respectively. These aggregate originations include loans originated by R&G Mortgage directly for R-G Premier Bank of \$664.8 million, \$451.4 million and \$437.1 million during the years ended December 31, 2001, 2000 and 1999, respectively, or 36%, 43% and 41%, respectively, of total originations. The loans originated by R&G Mortgage for R-G Premier Bank are comprised primarily of conventional residential loans and, to a lesser extent, residential construction loans and consumer loans secured by real estate.

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Servicing. R&G Financial's servicing portfolio has grown significantly over the past several years. At December 31, 2001, R&G Financial's servicing portfolio totaled \$7.2 billion and consisted of a total of 113,070 loans. These amounts include R&G Mortgage's servicing portfolio, totaling \$6.7 billion, and Continental's servicing portfolio, totaling \$485.0 million, at December 31, 2001. At December 31, 2001, R&G Financial's servicing portfolio included \$1.0 billion of loans serviced for R-G Premier Bank, or 14.4% of the total servicing portfolio. Substantially all of the mortgage loans in R&G Financial's servicing portfolio are secured by single-family residences. R&G Mortgage generally retains the servicing function with respect to the loans which have been securitized and sold. Most of R&G Financial's mortgage servicing portfolio is comprised of mortgages secured by real estate located in Puerto Rico.

Securitizations. R&G Mortgage pools Federal Housing Administration, the "FHA," and Veterans Administration, the "VA," loans into mortgage-backed securities which are guaranteed by the Government National Mortgage Association, the "GNMA." These securities are sold to securities broker-dealers and other investors in Puerto Rico. Conventional loans may either be sold directly to agencies such as the Federal National Mortgage Association, the "FNMA," and the Federal Home Loan Mortgage Corporation, the "FHLMC," or to private investors, or may be pooled into FNMA or FHLMC mortgage-backed securities, which are generally sold to investors. During the years ended December 31, 2001, 2000 and 1999, R&G Financial sold \$1.1 billion, \$637.8 million and \$721.0 million of loans, respectively, as part of its mortgage banking activities, which includes loans

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securitized and sold, but does not include loans originated for R-G Premier Bank or loans securitized for other institutions.

### R-G PREMIER BANK

General. R-G Premier Bank's principal business consists of holding deposits from the general public and tax-advantaged funds from eligible Puerto Rico corporations and using them, together with funds obtained from other sources, to originate and purchase loans secured primarily by residential real estate in Puerto Rico, and to purchase mortgage-backed and other securities. R-G Premier Bank also is engaged in the business of originating FHA insured, VA guaranteed and privately insured first and second mortgage loans on residential real estate (one-to-four family) in the States of New York, New Jersey, Connecticut, North Carolina and Florida, through its wholly-owned subsidiary, Continental Capital Corp. To a lesser extent, but with increasing emphasis over the past few years, R-G Premier Bank also originates 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 R-G Premier Bank an opportunity to provide a greater range of financial services to its customers, R-G Premier Bank also offers trust services through its trust department.

Residential loans. At December 31, 2001, R&G Financial's loans receivable, net, totaled \$1.8 billion, which represented 38.6% of R&G Financial's \$4.7 billion of total assets. At such date, all but \$665,000 of R&G Financial's loans receivable were held by R-G Premier Bank. R-G Premier Bank's loan portfolio has historically been concentrated in loans secured by first mortgage liens on existing single-family residences. At December 31, 2001, \$1.0 billion, or 52.6% of R&G Financial's total loans held for investment, consisted of such loans, of which all but \$1.2 million consisted of conventional loans.

Construction loans. R-G Premier Bank has been active in originating loans to construct single-family residences. At December 31, 2001, retail construction loans amounted to \$50.8 million, or 2.7% of R&G Financial's total loans held for investment, while commercial construction and land acquisition loans amounted to \$221.5 million in the aggregate, or 11.6% of total loans held for investment. R-G Premier Bank intends to continue to increase its involvement in single-family residential construction lending. Such loans afford R-G Premier Bank the opportunity to increase the interest rate sensitivity of its loan portfolio.

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Commercial loans. R-G Premier Bank also originates mortgage loans secured by commercial real estate, primarily office buildings, retail stores, warehouses and general purpose industrial space. At December 31, 2001, \$327.9 million, or 17.1% of R&G Financial's total loans held for investment, consisted of such loans. As of such date, R-G Premier Bank's commercial real estate loan portfolio consisted of approximately 1,202 loans with an average principal balance of \$273,000. Finally, R-G Premier Bank also offers commercial business loans, including working capital lines of credit, inventory and accounts receivable loans, equipment financing (including equipment leases), term loans, insurance premium loans and loans guaranteed by the Small Business Administration and various consumer loans. At December 31, 2001, consumer loans, which are primarily secured by real estate, amounted to \$181.2 million, or 9.5% of total loans held for investment, and commercial business loans amounted to \$92.2 million, or 4.8% of total loans held for investment.

### REGULATION

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We operate our businesses under a variety of federal, state and Puerto Rico laws and rules. As a financial holding company, we are subject to the rules of the Board of Governors of the Federal Reserve System and Office of the Puerto Rico Commissioner of Financial Institutions, the "OCFI" Among other things, we are required to meet minimum capital requirements, and our activities are limited to those that are determined to be financial in nature or incidental or complimentary to a financial activity.

R&G Mortgage's mortgage banking business is subject to the rules of the FHA, VA, GNMA, FNMA, FHLMC, Department of Housing and Urban Development, OCFI and state regulatory authorities with respect to originating, processing, selling and servicing mortgage loans. Among other things, these rules prohibit discrimination, establish underwriting guidelines, require credit reports, fix maximum loan amounts and, in some cases, fix maximum interest rates.

R-G Premier Bank is subject to the rules of the OCFI and the Federal Deposit Insurance Corporation, or "FDIC." Among other things, R-G Premier Bank is subject to requirements on the type and amount of credit it may extend to its affiliates, including a requirement that most of such credit be fully secured, and if there were any "liquidation or other resolution" of R-G Premier Bank, deposits and administrative expenses would be afforded a priority over general unsecured claims. In addition, the FDIC is required to take "prompt corrective action" if R-G Premier Bank does not meet minimum capital requirements. The FDIC has 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, 2001, R-G Premier Bank met the capital measures for being "well capitalized" under the FDIC's regulations.

### MORTGAGE BANKING ACTIVITIES

Loan Originations, Purchases and Sales. During the years ended December 31, 2001, 2000 and 1999, R&G Financial originated a total of \$1.8 billion, \$1.1 billion and \$1.1 billion of residential mortgage loans, respectively. These aggregate originations include loans originated by R&G Mortgage directly for the Bank of \$664.8 million, \$451.4 million and \$437.1 million during the years ended December 31, 2001, 2000 and 1999, respectively of such originations, or 36%, 43% and 41% respectively, of total originations. The loans originated by R&G Mortgage for the Bank are comprised primarily of conventional residential loans and, to a lesser extent, consumer loans secured by real estate.

R&G Financial is engaged to a significant extent in the origination of FHA-insured and VA-guaranteed single-family residential loans which are primarily securitized into GNMA mortgage-backed securities and sold to institutional and/or private investors in the secondary market. During the years ended December 31, 2001, 2000 and 1999, R&G Financial originated \$482.7 million, \$307.1 million and

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\$288.8 million, respectively, of FHA/VA loans, which represented 26.4%, 29.2% and 27.3% respectively, of total loans originated during such respective periods.

R&G Financial also originates conventional single-family residential loans which are either insured by private mortgage insurers or do not exceed 80% of the appraised value of the mortgaged property. During the years ended December 31, 2001, 2000 and 1999, R&G Financial originated \$1.3 billion, \$699.7 million and \$738.6 million, respectively, of conventional single-family residential mortgage loans. Substantially all conforming conventional

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single-family residential loans are securitized and sold in the secondary market, while substantially all non-conforming conventional single-family residential loans are originated by R&G Mortgage on behalf of the Bank and either held by the Bank in its portfolio or subsequently securitized by R&G Mortgage and sold in the secondary market. All non-conforming conventional loans originated by R&G Mortgage through The Mortgage Store are held by The Mortgage Store in its portfolio or subsequently sold in the secondary market.

Non-conforming loans generally consist of loans which, primarily because of size or other underwriting technicalities which may be cured through seasoning, do not satisfy the guidelines for resale of FNMA, FHLMC, GNMA and other private secondary market investors at the time of origination. Management believes that these loans are essentially of the same credit quality as conforming loans. During the years ended December 31, 2001, 2000 and 1999, non-conforming conventional loans represented approximately 48%, 53% and 52%, respectively, of R&G Financial's total volume of mortgage loans originated, substantially all of which were originated by R&G Mortgage on behalf of the Bank. During the years ended December 31, 2001, 2000 and 1999, 94.1%, 83.8% and 86.6% of loans originated by R&G Mortgage on behalf of the Bank consisted of single-family residential loans during such respective periods. R&G Mortgage originates single-family residential, construction and commercial real estate loans on behalf of the Bank pursuant to the terms of a Master Production Agreement between R&G Mortgage and the Bank. See "- Lending Activities of the Bank - 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 loans and VA 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%. 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. Residential mortgage loan applications are attributable to walk-in customers, existing customers and 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.

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R&G Mortgage also purchases FHA loans 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

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network and, to a lesser extent, purchases from third parties. Purchases of loans from other mortgage bankers in the wholesale loan market is generally limited to FHA loans and VA loans and such purchases provide R&G Mortgage with a source of low cost production that allows R&G Mortgage to continue to increase the size of its servicing portfolio. R&G Mortgage purchased \$29.3 million, \$145.9 million and \$307.8 million of loans from third parties during the years ended December 31, 2001, 2000 and 1999, respectively.

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

	Year Ended December	
	2001	2000
	(Dollars in Thousands)	
<b>Loans Originated For the Bank:</b>		
Conventional loans(1):		
Number of loans.....	\$ 6,355	4,929
Volume of loans.....	\$655,151	\$407,461
FHA/VA loans:		
Number of loans.....	--	--
Volume of loans.....	--	--
Consumer loans(2):		
Number of loans.....	485	1,807
Volume of loans.....	\$9,658	\$43,943
Total loans:		
Number of loans.....	6,840	6,736
Volume of loans.....	\$664,809	\$451,404
Percent of total volume.....	36%	38%
<b>Loans Originated For Third Parties:</b>		
Conventional loans(1):		
Number of loans.....	6,791	3,377
Volume of loans.....	\$679,190	\$292,283
FHA/VA loans:		
Number of loans.....	4,823	3,241
Volume of loans.....	\$482,721	\$307,128
Total loans:		
Number of loans.....	11,614	6,618
Volume of loans.....	\$1,161,911	\$599,411
Percent of total volume.....	63%	50%
Total loan originations		
	\$1,826,720	\$1,050,815
	=====	=====
<b>Loans Purchased For R&amp;G Mortgage:</b>		
Number of loans (3).....	371	1,627
Volume of loans.....	\$29,342	\$145,881
Percent of total volume.....	1%	12%
Total loan originations and purchases		
	\$1,856,062	\$1,196,696
	=====	=====
<b>GNMA Pools Purchased for R&amp;G Mortgage:</b>		
Volume of loans	--	--



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	Year Ended December	
	2001	2000
	(Dollars in Thousands)	
Loans Sold To Third Parties(4):		
Conventional loans(1):		
Number of loans.....	6,124	3,937
Volume of loans.....	\$603,542	\$332,930
FHA/VA loans:		
Number of loans.....	3,365	4,167
Volume of loans.....	\$513,366	\$367,868
Total loans:		
Number of loans.....	9,489	8,104
Volume of loans.....	\$1,116,908	\$700,798
Percent of total volume.....	61%	59%
Adjustments:		
Loans originated for the Bank.....	\$ (664,809)	\$ (451,404)
Loan amortization.....	(31,802)	(18,544)
Increase in loans held for sale.....	\$ 42,543	\$ 25,950
Average Initial Loan Origination Balance:		
The Bank:		
Conventional loans(1).....	\$103	\$83
FHA/VA loans.....	--	--
Third Parties:		
Conventional loans(1).....	\$100	\$87
FHA/VA loans.....	100	95
Total		
Conventional loans(1).....	\$102	\$84
FHA/VA loans.....	100	95
Refinancings(5):		
The Bank.....	57%	56%
Third Parties.....	50%	29%

- 
- (1) Includes non-conforming loans.
  - (2) All of such loans were secured by real estate.
  - (3) Includes \$27.1 million, \$63.0 million and \$123.2 million of loans purchased from another institution, and securitized and sold to the same financial institution during 2001, 2000 and 1999, respectively.
  - (4) Includes loans converted into mortgage-backed securities.
  - (5) As a percent of the total dollar volume of mortgage loans originated by R&G Mortgage for the Bank (excluding consumer loans) or third parties, as the case may be. In the case of the Bank, refinancings do not necessarily represent refinancings of loans previously held by the Bank.

All loan originations, regardless of whether originated through the Company or purchased from third parties, must be underwritten in accordance with R&G Financial's underwriting criteria, including loan-to-appraised value ratios, borrower income qualifications, debt ratios and credit history, investor requirements, 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, while operating out of its loan offices, make underwriting decisions independent of the Company's mortgage loan origination personnel.

Typically, when a mortgage loan is originated, the borrower pays an origination fee. These fees are generally in the range of 0% to 7% 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 may charge additional fees depending upon market conditions and regulatory considerations as well as the Company's objectives concerning mortgage loan origination volume and pricing. 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. Generally accepted accounting principles ("GAAP") require that general operating expenses incurred in originating mortgage loans be charged to current expense. Direct origination costs and origination income must be deferred and amortized using the interest method, until the repayment or sale of the related mortgage loans. Historically, the value of servicing rights which result from R&G Financial's origination activities has exceeded the net costs attributable to such activities.

R&G Financial customarily sells most of the loans that it originates, except for those originated on behalf of the Bank pursuant to a Master Production Agreement with R&G Mortgage. See "-Lending Activities of the Bank - Origination, Purchases and Sales of Loans." The loans originated by R&G Mortgage (including FHA loans, VA loans and conventional loans) are secured by real property located in Puerto Rico. During the years ended December 31, 2001, 2000 and 1999, R&G Financial sold \$1.1 billion, \$637.8 million and \$721.0 million of loans, respectively, which includes loans securitized and sold but does not include loans originated by R&G Mortgage on behalf of the Bank or loans securitized for other institutions. With respect to such loan sales, \$375.1 million or 33.6%, \$270.8 million or 42.5% and \$271.9 million or 37.7% consisted of GNMA-guaranteed mortgage-backed securities of FHA loans or VA loans packaged into pools of \$1 million or more (\$2.5 million to \$5 million for GNMA serial notes) by R&G Mortgage. These securities were sold through the Bank's Trust Department or indirectly through securities broker-dealers.

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 which it originates or purchases and also provides income by increasing the

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value and marketability of the loans.

Mortgage loans that do not conform to GNMA, FNMA or FHLMC requirements (so-called "non-conforming loans") are generally originated on behalf of the Bank by R&G Mortgage and either retained in the Bank's portfolio, sold to financial institutions or other private investors or securitized into "private label" CMOs through grantor trusts or other mortgage conduits and sold through securities broker-dealers. Non-conforming loans consist of jumbo loans or loans that do not satisfy all requirements of FNMA, FHLMC and GNMA at the time of origination of the loan (such as missing tax returns, slightly higher

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loan-to-value ratios, etc.). R&G Mortgage and the Bank have made no sales of CMOs in securitization transactions during the last three fiscal years. When such transactions were made, either the Bank or R&G Mortgage retained the residual certificates issued by the respective trusts as well as the subordinate certificates issued in such transactions. As of December 31, 2001, R&G Mortgage held residual certificates issued in CMO transactions involving R&G Mortgage and the Bank with a fair value of \$3.2 million. In addition, the Bank held CMO subordinated certificates and residual certificates from one of its issues with a fair value of \$7.6 million at December 31, 2001. See "- Investment Activities."

While R&G Financial's exchanges of mortgage loans into agency securities and sales of mortgage loans are generally made on a non-recourse basis, the Company also engages in the sale or exchange of mortgage loans on a recourse basis. In the past, recourse sales often involved the sale of non-conforming loans to FNMA, FHLMC and local financial institutions. R&G Financial estimates the fair value of the retained recourse obligation at the time mortgage loans are sold. As of December 31, 2001, R&G Financial had reserves for possible losses related to its recourse obligations of \$1.3 million. At December 31, 2001, R&G Mortgage had loans in its servicing portfolio with provisions for recourse in the principal amount of approximately \$552.4 million, as compared to \$680.5 million and \$646.3 million as of December 31, 2000 and 1999, respectively. Of the recourse loans existing at December 31, 2001, approximately \$260.0 million in principal amount consisted of loans sold to FNMA and FHLMC and converted into mortgage-backed securities of such agencies, and approximately \$292.4 million in principal amount consisted of non-conforming loans sold to other private investors.

**Loan Servicing.** R&G Financial acquires servicing rights through its mortgage loan originations (including originations on behalf of the Bank) and purchases from third parties. The Company generally retains the rights to service mortgage loans sold, which it has originated or purchased, 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 0.25% to 0.50% of the declining outstanding principal balance of the loans serviced plus any late charges. 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 0.5% to 1.0% of 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, 2001, R&G Financial's servicing portfolio totaled \$7.2 billion and consisted of a total of 113,070 loans. These amounts

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include R&G Mortgage's servicing portfolio totaling \$6.7 billion and Continental's servicing portfolio totaling \$485.0 million at December 31, 2001. At December 31, 2001, R&G Financial's servicing portfolio included \$1.0 billion of loans serviced for the Bank or 14.4% of the total servicing portfolio. Substantially all of the mortgage loans in R&G Financial's servicing portfolio are secured by single (one-to-four) family residences. Most of R&G Financial's mortgage servicing portfolio is comprised of mortgages secured by real estate located in Puerto Rico.

R&G Mortgage services loans held in the Bank's loan portfolio (including single-family residential loans retained by the Bank and certain commercial real estate loans), although R&G Mortgage does not actually acquire such servicing rights. Once loans are sold, the Bank retains the servicing rights to such loans; R&G Mortgage continues to service the loans on behalf of the Bank. The Bank pays R&G Mortgage servicing fees with respect to the loans serviced by R&G Mortgage on behalf of the Bank. In addition, the Bank processes payments of all loans originated by R&G Mortgage on behalf of the Bank. In connection therewith, R&G Mortgage pays the Bank a fee equal to between \$0.50 and \$1.00 per loan. See "- Regulation - R&G Financial - Limitations on Transactions with Affiliates."

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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.

	Year Ended December	
	2001	2000
	(Dollars in Thousand)	
Composition of Servicing Portfolio at End of Period:		
Conventional and other mortgage loans(1).....	\$4,070,074	\$3,447,383
FHA/VA loans.....	3,154,497	3,186,676
	\$7,224,571	\$6,634,059
	\$7,224,571	\$6,634,059
Activity in the Servicing Portfolio:		
Beginning servicing portfolio.....	\$6,634,059	\$6,177,511
Add: Loan originations and purchases.....	1,887,582	1,280,898
Servicing of portfolio loans acquired (3).....	4,936	31,404
Less: Sale of servicing rights(4).....	(211,603)	(213,959)
Run-offs(5).....	(1,090,403)	(641,795)
	7,224,571	\$6,634,059
	7,224,571	\$6,634,059
Number of loans serviced(6).....	113,070	110,874

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Average loan size(6).....	\$	64	\$	60
Average servicing fee rate(6).....		0.499		0.483%

- 
- (1) Includes non-conforming loans.
  - (2) At the dates shown, \$1.0 billion, included \$1.0 billion and \$1.1 billion of loans serviced for the Bank, respectively, which constituted 14.4%, 15.6% and 17.3% of the total servicing portfolio, respectively.
  - (3) Includes \$496.5 million related to the servicing portfolio acquired as part of the Company's acquisition of Continental in October 1999.
  - (4) Includes loans sold, servicing released, by Continental totaling \$211.6 million, \$172.9 million and \$55.5 million in 2001, 2000 and 1999, respectively.
  - (5) Run-off refers to regular amortization of loans, prepayments and foreclosures.
  - (6) At December 31, 2001, R&G Mortgage was servicing 10,961 loans for the Bank with an average loan size of approximately \$93,000 and at an average servicing rate of 0.20%. Amounts include late and other miscellaneous charges.

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The following table sets forth certain information at December 31, 2001 regarding the number of, and aggregate principal balance of, the mortgage loans serviced by R&G Financial for the Bank and for third parties at various mortgage interest rates.

Mortgage Interest Rate	At December 31, 2001			
	Loans Serviced for the Bank		Loans Serviced for Third Parties	
	Number of Loans	Aggregate Principal Balance	Number of Loans	Aggregate Principal Balance
	(Dollars in Thousands)		(Dollars in Thousands)	
Less than 7.00%	1,078	\$ 125,014	14,150	\$1,032,507
7.00% - 7.49%	3,835	405,236	21,049	1,505,293
7.50% - 7.99%	2,745	264,189	26,115	1,667,009
8.00% - 8.49%	1,180	115,293	14,321	847,886
8.50% - 8.99%	1,053	80,153	13,725	674,940
9.00% - 9.49%	391	22,318	4,660	195,512
9.50% - 9.99%	400	14,739	3,700	108,893
10.00% - 10.49%	111	4,605	1,293	45,029
10.50% - 10.99%	272	8,199	867	28,318
11.00% or more	117	3,577	2,008	75,861
	11,182	\$1,043,323	101,888	\$6,181,248

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The amount of principal prepayments on mortgage loans serviced by R&G Financial was \$180.3 million, \$176.3 million and \$162.6 million for the years ended December 31, 2001, 2000 and 1999 respectively. This represented approximately 2.5%, 2.7% and 2.6% of the aggregate principal amount of mortgage loans serviced during such periods. 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.

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, 2001, 2000 and 1999, the monthly average amount of funds advanced by R&G Financial under such servicing agreements was \$7.4 million, \$5.8 million and \$5.5 million, respectively. Funds advanced by R&G Financial pursuant to these arrangements are generally recovered by R&G Financial within 30 days.

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, 2001, R&G Financial held \$106.7 million of such escrow funds, \$101.9 million of which were deposited in the Bank and \$4.8 million of which were deposited with other financial institutions. The escrow funds deposited with the Bank lower its overall cost of funds and is a means of compensating it for processing mortgages checks received by R&G Mortgage, 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. See "- 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

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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, 2001, R&G Financial was servicing mortgage loans with an aggregate principal amount of \$552.4 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 in Puerto Rico 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

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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. See Note 1 to R&G Financial's Notes to Consolidated Financial Statements for a discussion of SFAS No. 140 and the treatment of servicing rights, incorporated by reference into Item 8 hereof.

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

	Year Ended December 31,				
	2001		2000		Number of Loans
	Number of Loans	Percent of Servicing Loans	Number of Loans	Percent of Servicing Portfolio	
Loans delinquent for:					
30-59 days.....	5,995	5.30%	5,336	4.81%	5
60-89 days.....	1,746	1.54	1,547	1.40	1
90 days or more.....	2,678	2.37	2,300	2.07	2
	-----	-----	-----	-----	-----
Total delinquencies(1).....	10,419	9.21%	9,183	8.28%	9
	=====	=====	=====	=====	=====
Foreclosures pending(2).....	2,056	1.82%	1,845	1.66%	1
	=====	=====	=====	=====	=====

(1) Includes at December 31, 2001 an aggregate of \$112.5 million of delinquent loans serviced by R&G Mortgage for the Bank, or 1.56% of the total servicing portfolio and \$21.3 million of delinquent loans held in R&G Mortgage's own portfolio.

(2) At December 31, 2001, the Bank had foreclosures pending on \$28.1 million of loans being serviced by R&G Mortgage, which constituted 0.39% of the servicing portfolio. R&G Mortgage had foreclosures pending on \$4.8 million of loans it is servicing for its own portfolio at December 31, 2001.

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

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foreclosures ("REO") related to R&G Mortgage's mortgage banking business arise 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, 2001, 2000 and 1999, R&G Mortgage held REO with a book value of approximately \$2.8 million, \$1.3 million and \$128,000 respectively. Sales of REO resulted in losses to R&G Mortgage of \$442,000 during the year ended December 31, 2001, and gains of \$168,000 and \$209,000 for the years ended December 31, 2000 and 1999, respectively. There is no liquid secondary market for the sale of R&G Mortgage'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, 2001. R&G Mortgage, however, incurs about \$3,000 per loan foreclosed in interest and legal charges during the time between payment by R&G Mortgage and FHA or VA reimbursement. For the years ended December 31, 2001, 2000 and 1999, total expenses related to FHA or VA loans foreclosed amounted to \$337,000, \$235,000 and \$35,000, respectively. Although FNMA and FHLMC 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 which may not be recouped. Such nonrecouped expenses have to date been immaterial.

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

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### LENDING ACTIVITIES FROM BANKING OPERATIONS

General. At December 31, 2001, R&G Financial's loans receivable, net totaled \$1.8 billion, which represented 38.6% of R&G Financial's \$4.7 billion of total assets. At December 31, 2001, all but \$665,000 of R&G Financial's loans receivable were held by the Bank. The principal category of loans in R&G Financial's portfolio are conventional loans which are secured by first liens on single-family residences. Conventional residential real estate loans are loans which are neither insured by the FHA nor partially guaranteed by the VA. At December 31, 2001, all but \$1.2 million 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 receivable, net portfolio are second mortgage residential real estate loans, construction loans, commercial real estate loans, commercial business loans and consumer loans.

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Loan Portfolio Composition. The following table sets forth the composition of R&G Financial's loan portfolio by type of loan at the dates indicated. Except as noted in the footnotes to the table, all of the loans are held in the Bank's loan portfolio.

December 31,

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	2001		2000	
	Amount	Percent	Amount	Percent
	(Dollars in Thousands)			
Residential real estate - first mortgage.....	\$ 1,006,073	52.59%	\$1,005,033	58.43%
Residential real estate - second mortgage.....	33,321	1.74	27,419	1.59
Retail construction.....	50,767	2.65	47,698	2.77
Commercial construction and land acquisition(2).....	221,537	11.58	137,640	8.00
Commercial real estate.....	327,891	17.14	270,459	15.72
Commercial business.....	92,157	4.82	59,120	3.44
Consumer loans:				
Loans secured by deposits.....	26,176	1.37	26,926	1.57
Real estate secured consumer loans.....	83,509	4.37	100,357	5.83
Unsecured consumer loans.....	71,507	3.74	45,563	2.65
Total loans receivable.....	1,912,938	100%	1,720,615	100%
Less:				
Allowance for loan losses.....	(17,428)		(11,600)	
Loans in process.....	(92,935)		(78,163)	
Deferred loan fees.....	20		909	
Unearned interest.....	(207)		(85)	
	(110,550)		(88,939)	
Loans receivable, net(3).....	\$ 1,802,388		\$1,631,276	

	December 31,		
	1998		
	Amount	Percent	Amount
Residential real estate - first mortgage	\$ 735,795	66.87%	\$ 476,729
Residential real estate - second mortgage	18,634	1.69	17,831
Retail construction	23,280	2.12	13,367
Commercial construction and land acquisition(2)	15,353	1.39	5,785
Commercial real estate	117,151	10.65	81,722
Commercial business	46,532	4.23	39,128
Consumer loans:			
Loans secured by deposits	17,225	1.56	12,472
Real estate secured consumer loans	85,055	7.73	81,252
Unsecured consumer loans	41,381	3.76	50,103
Total loans receivable	1,100,406	100.00%	778,389
Less:			
Allowance for loan losses	(8,055)		6,772)
Loans in process	(18,170)		(6,218)
Deferred loan fees	(166)		172

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Unearned interest	(347)	(512)
	-----	-----
	(26,738)	(13,330)
	-----	-----
Loans receivable, net(3)	\$ 1,073,668	\$ 765,059
	=====	=====

- 
- (1) Includes \$33.9 million of residential real estate - first mortgage loans which are held by R&G Mortgage at December 31, 1997.
  - (2) Includes \$665,000, \$1.2 million, \$545,000, \$249,000 and \$682,000 of construction loans held by R&G Mortgage at December 31, 2001, 2000, 1999, 1998 and 1997, respectively
  - (3) Does not include mortgage loans held for sale of \$236.4 million, \$95.7 million, \$77.3 million, \$117.1 million and \$46.9 million at December 31, 2001, 2000, 1999, 1998 and 1997, respectively, of R&G Mortgage, the Bank and/or Continental.

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Contractual Principal Repayments and Interest Rates. The following table sets forth certain information at December 31, 2001 regarding the dollar amount of loans maturing in R&G Financial's total loan 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.

	Due 1 year or less	Due 1-5 years after December 31, 2001	Due 5 or more years after December 31, 2001
	-----	-----	-----
	(In Thousands)		
Residential real estate.....	\$ 142	\$ 3,261	\$1,035,991
Retail construction.....	50,767	--	--
Commercial real estate(2).....	166,117	267,596	115,715
Commercial business.....	54,449	32,625	5,083
Consumer:			
Loans on savings.....	15,564	10,169	443
Real estate secured consumer loans.....	2,300	7,942	73,267
Unsecured consumer loans.....	32,433	30,695	8,379
	-----	-----	-----
Total(3).....	\$321,772	\$352,288	\$1,238,878
	=====	=====	=====

- 
- (1) Amounts have not been reduced for the allowance for loan losses, loans in process, deferred loan fees or unearned interest.
  - (2) Includes \$221.5 million of commercial construction and land acquisition loans.
  - (3) Does not include mortgage loans held for sale.

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The following table sets forth the dollar amount of total loans due after one year from December 31, 2001, as shown in the preceding table, which have fixed interest rates or which have floating or adjustable interest rates.

	Fixed rate -----	Floating or adjustable-rate ----- (In Thousands)
Residential real estate.....	\$1,039,394	\$ --
Retail construction.....	50,765	--
Commercial real estate(1).....	94,476	454,952
Commercial business.....	34,976	57,181
Consumer:		
Loans on savings.....	26,176	--
Real estate secured consumer loans.....	83,509	--
Unsecured consumer loans.....	71,507	--
	-----	-----
Total.....	\$1,400,805 =====	\$512,132 =====

(1) Includes \$221.5 million of commercial construction and land acquisition loans.

Scheduled contractual amortization of loans does not reflect the expected term of R&G Financial's loan portfolio. The average life of loans is substantially less than their contractual terms because of prepayments and, with respect to conventional loans originated for the Bank after February 1994, due-on-sales clauses, which 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 lower 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.

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

	Year Ended December -----	
	2001	2000

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(Dollars in Thousands)

Loan originations:		
Loans originated by R&G Mortgage:		
Residential mortgages.....	\$ 625,798	\$ 378,398
Commercial mortgages.....	--	--
Residential construction.....	29,353	29,063
Consumer loans.....	9,658	43,943
	-----	-----
Total loans originated by R&G Mortgage.....	664,809	451,404
	-----	-----
Other loans originated:		
Commercial real estate.....	213,215	150,329
Commercial business.....	59,074	48,060
Construction and development.....	171,026(1)	127,473
Consumer loans:		
Loans on deposit.....	48,730	45,474
Real estate secured consumer loans.....	--	--
Unsecured consumer loans.....	63,702	32,517
	-----	-----
Total other loans originated.....	555,747	403,853
	-----	-----
Loans purchased.....	61,359	128,824
	-----	-----
Total loans originated and purchased.....	1,281,915	984,081
	-----	-----
Loans sold.....	(130,716)	(105,653)
Loan participations sold.....	(52,886)	--
Loan principal reductions.....	(474,162)	(359,760)
	-----	-----
Net increase before other items, net.....	624,151	518,668
	-----	-----
Loans securitized and transferred to mortgage-backed securities.....	(421,645)	(410,453)
	-----	-----
Net increase in loan portfolio.....	\$ 202,506	\$ 108,215
	=====	=====

(1) Includes \$34.6 million originated by Continental.

R&G Financial, through the Bank, originates for both investment and sale mortgage loans secured by residential real estate (secured by both first and second mortgage liens) as well as construction loans (for residential real estate), commercial real estate loans, commercial business loans and consumer loans.

R&G Mortgage assists the Bank in meeting its loan production targets and goals by, among other things, (i) advertising, promoting and marketing to the general public; (ii) interviewing prospective borrowers and conducting the initial processing of the requisite loan applications, consistent with the Bank's underwriting guidelines; and (iii) providing personnel and facilities with respect to the execution of loan agreements approved by the Bank. R&G Mortgage performs the foregoing loan origination services on behalf of the Bank with respect to residential mortgage loans, some commercial real estate loans and construction loans. R&G Mortgage receives from the Bank 75% of the applicable loan origination fee with respect to loans originated by R&G Mortgage on behalf of the Bank. During the years ended December 31, 2001, 2000 and 1999, R&G Mortgage received \$10.3 million, \$8.1 million and \$7.5 million, respectively, of loan origination fees with respect to loans originated by R&G

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Mortgage on behalf of the Bank. These fees are eliminated in consolidation in R&G Financial's Consolidated Financial Statements. See "- Regulation - R&G Financial - Limitations on Transactions with Affiliates."

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The Bank originates commercial real estate, commercial business and consumer loans. Applications for commercial real estate, commercial business and unsecured consumer loans are taken at all of the Bank's branch offices and may be approved by various lending officers of the Bank within designated limits, which are established and modified from time to time to reflect an individual's expertise and experience. All loans in excess of an individual's designated limits are referred to an officer with the requisite authority. In addition, the Management Credit Committee is authorized to approve all loans not exceeding \$5.0 million, and the Executive Committee of the Board of Directors is authorized to approve all loans exceeding \$5.0 million. All loans originated or purchased by the Bank must be approved by one of the three committees set forth above. Management of the Bank believes that its relatively centralized approach to approving loan applications ensures strict adherence to the Bank's underwriting guidelines while still allowing the Bank to approve loan applications on a timely basis.

The Bank also purchases conventional loans secured by first liens on single-family residential real estate from unrelated financial institutions. Such loan purchases are underwritten by the Bank pursuant to the same guidelines as direct loan originations. Loans purchased by the Bank are from time to time securitized by R&G Mortgage and sold by the Bank. During the years ended December 31, 2001, 2000 and 1999, the Bank purchased \$61.4 million, \$128.8 million and \$279.5 million of loans, respectively.

During the years ended December 31, 2001, 2000 and 1999, loans sold from banking operations were \$130.7 million, \$105.7 million and \$133.7 million. These loans, which were primarily nonconforming loans at the time of origination, were generally sold in packages in privately negotiated transactions with FNMA and FHLMC.

The Bank sells to R&G Mortgage the servicing rights to all first and second mortgage loans secured by residential properties which are or will become part of the Bank's loan portfolio once the Bank has a commitment to sell the loans. R&G Mortgage services all other loans held in the Bank's portfolio (including single-family residential loans retained by the Bank, commercial real estate, commercial business and consumer loans (although R&G Mortgage does not actually acquire such servicing rights)). In addition, the Bank processes payments on all loans serviced by R&G Mortgage on behalf of the Bank. Finally, R&G Mortgage renders securitization services with respect to the pooling of some of the Bank's mortgage loans into mortgage-backed securities. See "- Mortgage Banking Activities."

Single-Family Residential Real Estate Loans. The Bank has historically concentrated its lending activities on the origination of loans secured by first mortgage liens on existing single-family residences. At December 31, 2001, \$1.0 billion or 52.6% of R&G Financial's total loans held for investment consisted of such loans, of which all but \$1.2 million consisted of conventional loans. The Bank's first mortgage single-family residential loans consist exclusively of fixed-rate loans with terms of between 15 and 30 years. As evidenced by this statistic, the Puerto Rico residential mortgage market has not been receptive to long-term adjustable rate mortgage loans.

The Bank's first mortgage single-family residential loans typically do not exceed 80% of the appraised value of the security property. Pursuant to

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underwriting guidelines adopted by the Board of Directors, the Bank can lend up to 95% of the appraised value of the property securing a first mortgage single-family residential loan provided the Bank obtains private mortgage insurance with respect to the top 25% of the loan.

The Bank also originates loans secured by second mortgages on single-family residential properties. At December 31, 2001, \$33.4 million or 1.7% of R&G Financial's total loans held for investment consisted of second mortgage loans on single-family residential properties. The Bank offers such second mortgage loans in amounts up to \$125,000 for a term not to exceed 15 years. The loan-to-

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value ratio of second mortgage loans generally is limited to 75% of the property's appraised value (including the first mortgage).

Construction Loans. The Bank has been active in originating loans to construct single-family residences. These construction lending activities generally are conducted throughout Puerto Rico, although loans are concentrated in areas contiguous to Bank branches. At December 31, 2001, retail construction ("spot") loans amounted to \$50.8 million or 2.7% of R&G Financial's total loans held for investment, while commercial construction and land acquisition loans amounted to \$221.5 million or 11.6% of total loans held for investment.

The Bank offers "spot" loans to individual borrowers for the purpose of constructing single-family residences. Substantially all of the Bank'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 Bank 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. Thereafter, the permanent loan is made at then market rates, provided that such rate shall not be more than 2% greater than the interim construction rate. R&G Mortgage's construction loan department approves the proposed contractors and administers the loan during the construction phase. The Bank's construction/permanent loan program has been successful due to its ability to offer borrowers a single closing and, consequently, reduced costs. At December 31, 2001, the Bank's construction loan portfolio included 441 construction/permanent loans with an aggregate principal balance of \$50.8 million.

The Bank also originates construction loans to developers to develop single family residential properties. The Bank has organized a Construction Loan Department to work primarily with real estate developers. At December 31, 2001, the Bank had 20 residential construction loans outstanding to develop single-family residences with an aggregate principal balance of \$145.2 million. Commitments for future funding approximate \$61.3 million. In addition, the Bank had 8 loans to develop commercial properties with an aggregate principal balance of \$30.6 million. All loans are performing in accordance with their terms at December 31, 2001.

In addition to the foregoing, at December 31, 2001, the Bank had 35 land acquisition loans with outstanding balances ranging from \$81,000 to \$10.7 million, and an aggregate balance of \$35.7 million, which were made in connection with projects to construct single-family residences. The Bank and the financial institution which made the interim construction loan have entered into an agreement pursuant to which the Bank is to be paid a percentage of the proceeds from each home as it is released upon construction and sale. The Bank expects to make the permanent construction loan on some of these projects. The

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Bank has also made a working capital/pre-development loan with an outstanding principal balance of \$10 million at December 31, 2001 which is secured by land.

The Bank intends to continue to increase its involvement in single-family residential construction lending. Such loans afford the Bank the opportunity to increase the interest rate sensitivity of its loan portfolio. Construction lending is generally considered to involve a higher level of 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 Bank has taken steps to minimize the foregoing risks by, among other things, limiting its construction lending primarily to residential properties. In addition, the Bank has adopted underwriting guidelines which impose stringent loan-to-value (80% with respect to single-family residential real estate), debt service and other requirements for loans which are believed to involve higher elements of

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credit risk and by working with builders with whom it has established relationships or knowledge thereof. At December 31, 2001, \$871,000 of the Bank's retail construction loans were classified as non-performing. As of such date, no commercial construction or land acquisition loans were non-performing.

Commercial Real Estate Loans. The Bank also originates mortgage loans secured by commercial real estate. At December 31, 2001, \$327.9 million or 17.1% of R&G Financial's total loans held for investment consisted of such loans. As of such date, the Bank's commercial real estate loan portfolio consisted of approximately 1,202 loans with an average principal balance of \$273,000. At December 31, 2001, \$16.9 million of the Bank's commercial real estate loans were classified as nonperforming.

Commercial real estate loans originated by the Bank are primarily secured by office buildings, retail stores, warehouses and general purpose industrial space. Although terms vary, commercial real estate loans generally are amortized over a period of 7-15 years and have maturity dates of five to seven years. The Bank will originate these loans with interest rates which adjust monthly in accordance with a designated prime rate plus a margin, which generally is negotiated at the time of origination. Such loans will have a floor but no ceiling on the amount by which the rate of interest may adjust over the loan term. Loan-to-value ratios on the Bank's commercial real estate loans are currently limited to 80% or lower. As part of the criteria for underwriting commercial real estate loans, the Bank generally requires a debt coverage ratio (the ratio of net cash from operations before payment of debt service to debt service) of 1.20 or more. It is also the Bank's general policy to seek additional protection to mitigate any weaknesses identified in the underwriting process. Additional coverage may be provided through mortgage insurance, secondary collateral and/or personal guarantees from the principals of the borrower.

Commercial real estate lending entails different and significant risks when compared to single-family residential lending because such loans typically involve large loan balances to single borrowers and because 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. The Bank attempts to minimize its

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risk exposure by limiting the extent of its commercial lending generally. In addition, the Bank imposes stringent loan-to-value ratios, requires conservative debt coverage ratios, and continually monitors the operation and physical condition of the collateral. Although the Bank has begun to increase its emphasis on commercial real estate lending, management does not currently anticipate that its portfolio of commercial real estate loans will grow significantly as a percentage of the total loan portfolio.

**Commercial Business Loans.** The Bank offers commercial business loans, including working capital lines of credit, inventory and accounts receivable loans, equipment financing (including equipment leases), term loans, insurance premiums 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% or less, 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 a designated prime rate, plus a margin. The Bank also generally obtains personal guarantees from the principals of the borrowers. At December 31, 2001, commercial business loans amounted to \$92.2 million or 4.8% of total loans held for investment. Although the Bank 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.

**Consumer Loans.** The Bank originates real estate secured consumer loans. Such loans generally have shorter terms and higher interest rates than other mortgage loans. At December 31, 2001, \$181.2 million or 9.5% of the Bank's total loans held for investment consisted of consumer loans. This amount is comprised mostly of real estate secured consumer loans (which are originated by R&G Mortgage), but the Bank also offers loans secured by deposit accounts, credit card loans and other secured and unsecured

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consumer loans. Most of the Bank's consumer loans are secured and have been primarily obtained through newspaper advertising, although loans are also obtained from existing and walk-in customers. Although the Bank has begun to increase its emphasis on collateralized consumer lending, management does not currently anticipate that its portfolio of consumer loans will grow significantly as a percentage of the total loan portfolio.

The Bank currently offers loans secured by deposit accounts, which amounted to \$26.2 million at December 31, 2001. 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. The Bank offers real estate secured loans in amounts up to 75% of the appraised value of the property, including the amount of any existing prior liens. Real estate secured consumer loans have a maximum term of 10 years, which may be extended within the sole discretion of the Bank, and an interest rate which is set at a fixed rate based on market conditions. The Bank secures the loan with a first or second mortgage on the property, including loans where another institution holds the first mortgage. At December 31, 2001, real estate secured consumer loans totaled \$83.5 million. At December 31, 2001, credit card receivables totaled \$27.9 million.

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



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provide an adequate source of repayment of the outstanding loan balance because of improper repair and maintenance of the underlying security. The remaining deficiency may not warrant further substantial collection efforts against the borrower. At December 31, 2001, \$6.1 million of consumer loans were classified as non-performing, of which \$5.8 million were secured by real estate.

**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 loan. 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 does institute foreclosure or other proceedings, as necessary, to minimize any potential loss. In the case of consumer loans, the Bank refers the file for collection action after 60 days.

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 such a loan is placed on non-accrual status, previously accrued but unpaid interest is deducted from interest income. As a matter of policy, the Bank does not accrue interest on loans past due 90 days or more which are secured by real estate. The Bank generally takes the same position in the case of consumer loans.

Real estate acquired by the Bank as a result of foreclosure or by deed-in-lieu of foreclosure are classified as real estate owned until sold. Pursuant to a statement of position ("SOP 92-3"), which provides guidance on determining the balance sheet treatment of foreclosed assets in annual financial statements, there is a rebuttable presumption that foreclosed assets are held for sale and such assets are recommended to be carried at the lower of fair value minus estimated costs to sell the property, or cost (generally the balance of the loan on the property at the date of acquisition). 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 Bank's accounting for its real estate owned complies with the guidance set forth in SOP 92-3.

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The following table sets forth the amounts and categories of R&G Financial's non-performing assets at the dates indicated. R&G Financial did not have any troubled debt restructurings at any of the periods presented. Except as otherwise indicated in the footnotes to the table, the non-performing assets are assets of the Bank.

	December 31,		
	2001	2000	1999
	(Dollars in Thousand)		
Non-accruing loans:			
Residential real estate(1).....	\$50,358	\$79,234	\$47,413
Residential construction.....	871	487	478

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Commercial real estate.....	16,945	11,881	9,005
Commercial business.....	3,105	1,414	1,255
Consumer unsecured.....	303	1,186	802
Other.....	--	--	61
	-----	-----	-----
Total.....	71,582	94,202	59,014
	-----	-----	-----
Accruing loans greater than 90 days delinquent:			
Residential real estate.....	--	--	--
Residential construction.....	--	--	--
Commercial real estate.....	--	--	--
Commercial business.....	462	420	63
Consumer.....	428	360	274
	-----	-----	-----
Total accruing loans greater than 90 days delinquent.....	890	780	337
	-----	-----	-----
Total non-performing loans.....	72,472	94,982	59,351
	-----	-----	-----
Real estate owned, net of reserves.....	10,061	9,056	5,852
Other repossessed assets.....	362	583	466
	-----	-----	-----
	10,423	9,639	6,318
	-----	-----	-----
Total non-performing assets	\$82,895	\$104,621	\$65,669
	=====	=====	=====
Total non-performing loans as a percentage of total loans (2)	3.79%	5.52%	3.66%
	=====	=====	=====
Total non-performing assets as a percentage of total assets	1.78%	2.96%	2.26%
	=====	=====	=====

(1) Includes \$5.8 million, \$6.1 million, \$5.3 million, \$2.6 million and \$1.1 million consumer loans held by the Bank secured by first and second mortgages on residential real estate at December 31, 2001, 2000, 1999, 1998 and 1997, respectively. Also includes \$7.3 million, \$17.6 million, \$5.9 million, \$4.3 million and \$2.8 million residential real estate loans secured by first mortgages held by R&G Mortgage at December 31, 2001, 2000, 1999, 1998 and 1997, respectively.

(2) While the ratio of non-performing loans to total loans decreased from 5.52% to 3.79% from December 31, 2000 to December 31, 2001, the ratio was nevertheless larger than it would otherwise have been due to significant loan securitizations during 2001 and 2000, which reduced the amount of loans considered in the calculation of the ratio. Without giving effect to loan securitizations, at December 31, 2001 and 2000, the ratio of non-performing loans to total loans would have been 2.75% and 4.46%, respectively.

Non-performing loans amounted to \$72.5 million at December 31, 2001, as compared to \$95 million at December 31, 2000. The decrease in non-performing loans during 2001 is due to the sale of approximately \$67.8 million of non-performing residential mortgage loans to certain investors during the fourth quarter of 2001. An aggregate of \$50.4 million or 69.5% of non-performing loans consisted of

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residential mortgage loans. Because of the nature of the collateral, R&G Financial has historically recognized a low level of loan charge-offs. R&G Financial's aggregate charge-offs amounted to 0.32% during 2001, as compared to 0.17% during 2000. Although loan delinquencies have historically been higher in Puerto Rico than in the United States, loan charge-offs have historically been lower than in the United States.

Non-performing residential loans decreased by \$28.9 million or 36.4% from December 31, 2000 to December 31, 2001. The average loan balance on non-performing mortgage loans amounted to \$54,000 at December 31, 2001. As of such date, 572 loans with an aggregate balance of \$35.7 million (including 133 consumer loans secured by real estate with an aggregate balance of \$2.7 million) were in the process of foreclosure. The total delinquency ratio (including loans past due less than 90 days) on residential mortgages of the Bank, excluding consumer loans secured by real estate, decreased from 8.55% in 2000 to 6.40% in 2001. The Company's loss experience on such portfolio has been minimal over the last several years.

Non-performing commercial real estate loans increased by \$5.0 million or 42.6% from \$11.9 at December 31, 2000 to \$16.9 million at December 31, 2001. The number of loans delinquent over 90 days amounted to 120 loans at December 31, 2001, with an average balance of \$141,000. The largest non-performing commercial real estate loan as of December 31, 2001 had a balance of \$758,000.

Non-performing commercial business loans consist of 77 loans. Such loans include 11 loans with an aggregate balance of \$322,000 which are 90% guaranteed by the Small Business Administration, 58 commercial leases amounting to \$1.7 million and 8 other commercial business loans with an aggregate balance of \$1.1 million. These loans have a combined average loan size of \$40,000. The largest non-performing commercial business loan as of December 31, 2001 had a \$517,000 balance.

At December 31, 2001, R&G Financial's five largest loans-to-one borrower and their related entities had outstanding balances of \$32.8 million, \$24.9 million, \$18.7 million, \$16.7 million and \$13.9 million. All of such loan concentrations were performing December 31, 2001.

At December 31, 2001, R&G Financial's allowance for loan losses totaled \$17.4 million, which represented a \$5.8 million or 50.2% increase from the level maintained at December 31, 2000. At December 31, 2001, R&G Financial's allowance represented approximately 0.91% of the total loan portfolio and 24.05% of total non-performing loans, as compared to 0.67% and 12.21% at December 31, 2000. The increase in the allowance for loan losses reflected the increase in R&G Financial's commercial real estate and construction loan portfolio as well as the increase in R&G Financial non-performing loans during the year.

It is the policy of the Bank to maintain an allowance for estimated losses on loans and to increase such allowance when, based on management's evaluation, a loss becomes both probable and estimable (i.e., the loss is likely to occur and can be reasonably estimated). Major loans and major lending areas are reviewed periodically to determine potential problems at an early date. Also, management's periodic evaluation considers factors such as loss experience, current delinquency data, known and inherent risks in the portfolio, identification of adverse situations which may affect the ability of debtors to repay the loan, the estimated value of any underlying collateral and assessment of current economic conditions. Additions to the allowance are charged to income. Such provisions are based on management's estimated value of any underlying collateral, as applicable, considering the current and anticipated operating conditions of the borrower. Any recoveries are credited to the allowance.

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The following table sets forth an analysis of R&G Financial's allowance for loan losses during the periods indicated, of which \$16.1 million is maintained against the Bank's loan portfolio at December 31, 2001:

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	At and For the Year End		
	2001	2000	1999
	(Dollars in Thou		
Balance at beginning of period	\$11,600	\$8,971	\$8,05
Charge-offs:			
Residential real estate.....	72	38	1
Construction.....	--	--	--
Commercial real estate.....	1,090	468	35
Commercial business.....	2,899	1,539	1,54
Consumer.....	2,566	1,940	2,51
Other.....	--	--	--
Total charge-offs.....	6,627	3,985	4,44
Recoveries:			
Residential real estate.....	--	--	--
Commercial real estate.....	11	80	6
Commercial business.....	131	381	33
Consumer.....	382	402	42
Other.....	--	--	--
Total recoveries.....	524	863	83
Net charge-offs.....	6,103	3,122	3,61
Transferred reserves from R&G Mortgage.....	806	--	--
Allowance or loan losses acquired in Fajardo Federal acquisition.....	--	--	--
Provision for losses on loans.....	11,125	5,751	4,52
Balance at end of period.....	\$17,428	\$11,600	\$ 8,97
Allowance for loan losses as a percent of total loans outstanding.....	0.91%	0.67%	0.55
Allowance for loan losses as a percent of non-performing loans.....	24.05%	12.21%	15.11
Ratio of net charge-offs to average loans outstanding.....	0.32%	0.17%	.25

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The following table sets forth information concerning the allocation of R&G Financial's allowance for loan losses (which is maintained on the Bank's loan portfolio) by loan category at the dates indicated.

	December 31,			
	2001		2000	
	Amount	Percent of Loans in Each Category to Total Loans	Amount	Percent of Loans in E Category Total Lo
(Dollars in Thousands)				
Residential real estate.....	\$2,496	14.32%	\$ 1,278	11.0
Construction.....	800	4.59	432	3.7
Commercial real estate.....	7,371	42.29	4,880	42.0
Commercial business.....	2,253	12.93	1,321	11.3
Consumer.....	4,508	25.87	3,689	31.8
Total.....	\$17,428	100.00%	\$ 11,600	100.0

	December 31,		
	1998		
	Amount	Percent of Loans in Each Category to Total Loans	Amount
(Dollars in Thousand)			
Residential real estate.....	\$1,272	15.79%	\$593
Construction.....	46	0.57	7
Commercial real estate.....	2,655	32.96	1,386
Commercial business.....	1,033	12.82	806
Consumer.....	3,049	37.86	3,980
Total.....	\$8,055	100.00%	\$6,772

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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 and which is reviewed and approved annually by the respective Boards of Directors of the Bank

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and R&G Mortgage. The management of the securities portfolio is set in accordance with strategies developed by the Bank's Interest Rate Risk, Budget and Investments Committee ("IRRBICO").

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. At December 31, 2001, R&G Mortgage held GNMA and FHLMC mortgage-backed securities with a fair value of \$31.1 million which are classified as held for trading. Such securities generally remain in R&G Mortgage's portfolio for between 90 and 180 days. In addition, as of such date, R&G Mortgage held GNMA mortgage-backed securities with a fair value of \$389.6 million, which are classified as available for sale. At December 31, 2001, R&G Mortgage's CMO interest-only residuals and interest only strips, which are classified as available for sale, had an amortized cost of \$9.0 million and a fair value of \$8.3 million.

The Bank's Investment Policy authorizes the Bank to invest in U.S. Treasury obligations (with a maturity up to five years), U.S. Agency obligations, FNMA, GNMA and FHLMC mortgage-backed certificates, investment grade municipal obligations (with a maturity of up to five years), bankers' acceptances and Federal Home Loan Bank ("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), certificates of deposit in other financial institutions (including Eurodollar deposits), 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 derivative securities (with a weighted average life of less than ten years).

At December 31, 2001, the Bank's securities portfolio consisted of \$39.5 million of securities held for investments, consisting of \$8.1 million of tax-free mortgage-backed securities, \$7.7 million of other mortgage backed securities, and \$23.7 million of Puerto Rico Government obligations and other securities. In addition, at December 31, 2001, the Bank had a securities portfolio classified as available for sale with a fair value of \$1.7 billion, consisting of \$133.2 million of tax-free mortgage-backed securities, \$709.9 million of FHLMC and FNMA mortgage-backed securities, \$66.1 million of FHLB stock, \$234.8 million of CMOs certificates, \$7.1 million of CMO interest-only residuals and interest only strips, \$54.5 million corporate debt obligations and \$478.2 million of U.S. Government agency securities, the interest on which is tax-exempt to the Company.

The Bank's Treasury Department from time to time holds trading securities. At December 31, 2001, securities for trading held by the Bank totaled \$62.9 million, consisting of FHLMC mortgage-backed securities.

At December 31, 2001, \$440.9 million or 20% of R&G Financial's mortgage-backed and investment securities were pledged to secure various obligations of R&G Financial (excluding repurchase agreements).

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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. All of such securities are assets of the Bank, except as otherwise indicated in the footnotes below.

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	December 31,				
	-----				
	2001				
	-----				
	Carrying Value	Market Value	Weighted Average Yield	Carrying Value	Market Value
	-----				
	(Dollars in Thousands)				
Mortgage-backed securities:					
GNMA (1)					
Due within one year.....	\$ --	\$ --	--%	\$ 2	\$ --
Due from one-five years.....	--	--	--	--	--
Due from five-ten years.....	7,180	7,111	5.87	8,865	--
Due over ten years.....	37,043	37,092	6.27	1,845	--
FNMA					
Due within one year.....	--	--	--	--	--
Due from one-five years.....	--	--	--	--	--
Due from five-ten years.....	--	--	--	--	--
Due over ten years.....	7,594	7,910	7.06	8,947	--
FHLMC					
Due within one year.....	--	--	--	--	--
Due from one-five years.....	--	--	--	--	--
Due from five-ten years.....	--	--	--	--	--
Due over ten years.....	128	125	5.75	160	--
Investment securities:					
Puerto Rico Government obligations					
Due within one year.....	--	--	--	--	--
Due from one-five years.....	12,691	12,731	4.99	1,948	--
Due from five-ten years.....	10,896	11,059	5.95	1,755	--
Due over ten years.....	--	--	--	--	--
Other					
Due within one year.....	--	--	--	--	--
Due from one-five years.....	100	100	6.20	--	--
Due from five-ten years.....	--	--	--	--	--
Due over ten years.....	--	--	--	--	--
	-----	-----	-----	-----	-----
Total securities held for investment.....	\$ 75,632	\$76,128	6.05%	\$23,522	-----
	=====	=====	=====	=====	-----

(1) Includes \$36.1 million held by R&G Financial at December 31, 2001.

	December 31,		
	-----		
	1999		
	-----		
	Carrying Value	Market Value	Ave
	-----		

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(Dollars in Thousands)

Mortgage-backed securities:

GNMA		
Due within one year.....	\$ --	\$ --
Due from one-five years.....	15	16
Due from five-ten years.....	10,660	10,391
Due over ten years.....	2,133	2,074
FNMA		
Due within one year.....	--	--
Due from one-five years.....	--	--
Due from five-ten years.....	--	--
Due over ten years.....	10,252	10,644
FHLMC		
Due within one year.....	--	--
Due from one-five years.....	--	--
Due from five-ten years.....	--	--
Due over ten years.....	189	180
Investment securities:		
Puerto Rico Government obligations		
Due within one year.....	--	--
Due from one-five years.....	1,280	1,272
Due from five-ten years.....	4,158	4,132
Due over ten years.....	--	--
Other		
Due within one year.....	--	--
Due from one-five years.....	--	--
Due from five-ten years.....	--	--
Due over ten years.....	--	--
Total securities held for investment.....	----- \$28,687 =====	----- \$28,709 =====

The following table presents certain information regarding the composition and period to maturity of R&G Financial's held for trading and available for sale mortgage-backed and investment securities portfolio as of the dates indicated below.

	December 31,			
	----- 2001 -----			
	Amortized Cost ----	Fair Value -----	Weighted Average Yield -----	Amor C ----
	(Dollars in Thousa			
Mortgage-backed securities available for sale:				
GNMA				
Due within one year.....	\$ --	\$ --	--%	\$
Due from one-five years.....	50	50	8.49	1
Due from five-ten years.....	11,053	11,172	5.97	1
Due over ten years.....	513,508	511,639	6.52	58
FNMA mortgage-backed securities				
Due within one year.....	--	--	--	--
Due from one-five years.....	--	--	--	--
Due from five-ten years.....	538	549	6.50	--
Due over ten years.....	266,495	270,936	7.21	9



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FHLMC mortgage-backed securities

Due within one year.....	--	--	--	
Due from one-five years.....	73	74	8.93	
Due from five-ten years.....	1,265	1,292	6.60	
Due over ten years.....	435,662	437,026	6.74	43

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Collateralized mortgage obligations  
(CMO'S)

Due within one year.....	--	--	--	
Due from one-five years.....	--	--	--	
Due from five-ten years.....	9,497	9,562	6.00	
Due over ten years.....	221,159	220,222	6.01	

CMO residuals and other mortgage-backed securities

Due within one year.....	--	--	--	
Due from one-five years.....	9,897	9,627	15.00	1
Due from five-ten years.....	8,341	10,797	8.08	
Due over ten years.....	--	--	--	1

Investment securities available for sale

U.S. Treasury

Due within one year.....	--	--	--	
Due from one-five years.....	--	--	--	
Due from five-ten years.....	--	--	--	
Due over ten years.....	--	--	--	

U.S. Government & Agencies

Due within one year.....	9,600	9,807	5.78	
Due from one-five years.....	156,522	157,408	4.96	19
Due from five-ten years.....	307,110	310,938	6.10	11
Due over ten years.....	--	--	--	

Corporate debt obligations

Due within one year	--	--	--	
Due from one-five years	53,637	54,503	6.53	
Due from five-ten years	--	--	--	
Due over ten years	--	--	--	

FHLB stock.....

66,077	66,077	5.20	4
-----	-----	-----	-----
\$2,070,484	\$2,081,679	6.42	\$1,51
=====	=====	=====	=====

Securities held for trading:

GNMA certificates.....	\$18,152	\$18,152	5.80	\$1
FHLMC certificates.....	73,687	75,796	7.08	
	-----	-----	-----	-----
	\$91,839	\$93,948	6.84%	\$1
	=====	=====	=====	=====

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December 31

1999

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	Amortized Cost -----	Fair Value -----
Mortgage-backed securities available for sale		
GNMA		
Due within one year.....	\$ --	\$ --
Due from one-five years.....	--	--
Due from five-ten years.....	--	--
Due over ten years.....	570,749	563,533
FNMA mortgage-backed securities		
Due within one year.....	--	--
Due from one-five years.....	--	--
Due from five-ten years.....	741	719
Due over ten years.....	110,855	109,705
FHLMC mortgage-backed securities		
Due within one year.....	--	--
Due from one-five years.....	99	99
Due from five-ten years.....	1,891	1,841
Due over ten years.....	14,586	14,036
CMO residuals and other mortgage-backed securities		
Due within one year.....	--	--
Due from one-five years.....	8,886	8,886
Due from five-ten years.....	--	--
Due over ten years.....	11,823	13,886
Investment securities available for sale		
U.S. Treasury		
Due within one year.....	4,998	4,945
Due from one-five years.....	--	--
Due from five-ten years.....	--	--
Due over ten years.....	--	--
U.S. Government & Agencies		
Due within one year.....	--	--
Due from one-five years.....	133,956	130,950
Due from five-ten years.....	92,237	89,444
Due over ten years.....	--	--
Corporate debt obligations		
Due within one year.....	--	--
Due from one-five years.....	--	--
Due from five-ten years.....	--	--
Due over ten years.....	--	--
FHLB stock.....	32,825	32,825
	-----	-----
	\$983,646	\$970,869
	=====	=====
Securities held for trading:		
GNMA certificates.....	\$ 43,303	\$ 43,564
FHLMC certificates.....	--	--
	-----	-----
	\$ 43,303	\$ 43,564
	=====	=====

A substantial portion of R&G Financial's securities are held in mortgage-backed securities. Mortgage-backed securities (which also are known as mortgage participation certificates or pass-through certificates) represent a participation interest in a pool of single-family or multi-family mortgages, the principal and interest payments on which are passed from the mortgage originators, through intermediaries (generally U.S. Government agencies and government sponsored enterprises) that pool and repackage the participation interests in the form of securities, to investors such as R&G Financial. Such

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U.S. Government agencies and government sponsored enterprises, which guarantee the payment of principal and interest to investors, primarily include the FHLMC, the FNMA and the GNMA.

The FHLMC is a public corporation chartered by the U.S. Government and owned by the 12 Federal Home Loan Banks and federally-insured savings institutions. The FHLMC issues participation certificates backed principally by conventional mortgage loans. The FHLMC guarantees the timely

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payment of interest and the ultimate return of principal within one year. The FNMA is a private corporation chartered by the U.S. Congress with a mandate to establish a secondary market for conventional mortgage loans. The FNMA guarantees the timely payment of principal and interest on FNMA securities. FHLMC and FNMA securities are not backed by the full faith and credit of the United States, but because the FHLMC and the FNMA are U.S. Government-sponsored enterprises, these securities are considered to be among the highest quality investments with minimal credit risks. The GNMA is a government agency within HUD which is intended to help finance government-assisted housing programs. GNMA securities are backed by FHA-insured and VA-guaranteed loans, and the timely payment of principal and interest on GNMA securities are guaranteed by the GNMA and backed by the full faith and credit of the U.S. Government. Because the FHLMC, the FNMA and the GNMA were established to provide support for low- and middle-income housing, there are limits to the maximum size of loans that qualify for these programs. To accommodate larger-sized loans, and loans that, for other reasons, do not conform to the agency programs, a number of private institutions have established their own home-loan origination and securitization programs.

Mortgage-backed securities typically are issued with stated principal amounts, and the securities are backed by pools of mortgages that have loans with interest rates that are within a range and have varying maturities. The characteristics of the underlying pool of mortgage, i.e., fixed-rate or adjustable-rate, as well as prepayment risk, are passed on to the certificate holder. The life of a mortgage-backed pass-through security thus approximates the life of the underlying mortgages. Mortgage-backed securities generally increase the quality of R&G Financial's assets by virtue of the insurance or guarantees that back them, are more liquid than individual mortgage loans and may be used to collateralize borrowings or other obligations of R&G Financial.

R&G Financial's securities portfolio includes CMOs. CMOs have been developed in response to investor concerns regarding the uncertainty of cash flows associated with the prepayment option of the underlying mortgage and are typically issued by government agencies, government sponsored enterprises and special purpose entities, such as trusts, corporations or partnerships, established by financial institutions or other similar institutions. A CMO can be collateralized by loans or securities which are insured or guaranteed by the FNMA, the FHLMC or the GNMA. In contrast to pass-through mortgage-backed securities, in which cash flow is received pro rata by all security holders, the cash flow from the mortgages underlying a CMO is segmented and paid in accordance with a predetermined priority to investors holding various CMO classes. By allocating the principal and interest cash flows from the underlying collateral among the separate CMO classes, different classes of bonds are created, each with its own stated maturity, estimated average life, coupon rate and prepayment characteristics.

The FDIC has issued a statement of policy which states, among other things, that mortgage derivative products (including CMOs and CMO residuals) which possess average life or price volatility in excess of a benchmark fixed

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rate 30-year mortgage-backed pass-through security are "high-risk mortgage securities," are not suitable investments for depository institutions, and if considered "high risk" at purchase must be carried in the institution's trading account or as assets held for sale, and must be marked to market on a regular basis. In addition, if a security was not considered "high risk" at purchase but was later found to be "high risk" based on the tests, it may remain in the held-to-maturity portfolio as long as the institution has positive intent to hold the security to maturity and has a documented plan in place to manage the high risk. At December 31, 2001, the Bank's CMOs, and interest-only securities and residuals, which had a fair value of \$12.1 million, were designated as "high-risk mortgage securities" and classified as available for sale.

### SOURCES OF FUNDS

General. R&G Financial will consider various sources of funds to fund its investment and lending activities and evaluates the available sources of funds in order to reduce R&G Financial's overall

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funding costs. Deposits, reverse repurchase agreements, warehouse lines of credit, notes payable, FHLB advances, subordinated capital notes and sales, maturities and principal repayments on loans and securities have been the major sources of funds for use in R&G Financial's lending and investing activities and for other general business purposes.

Deposits. Deposits are the major sources of the Bank's funds for lending and other investment purposes. Consumer and commercial deposits are attracted principally from within the Bank's primary market area through the offering of a broad selection of deposit instruments, including passbook, NOW and Super NOW, checking and commercial checking and certificates of deposit ranging in terms from 7 days to 10 years. Included among these deposit products are \$874.5 million of certificates of deposit with balances of \$100,000 or more, which amounted to 42.4% of the Bank's total deposits at December 31, 2001. Deposit account terms vary according to the minimum balance required, the time periods the funds must remain on deposit and the interest rate, among other factors.

The Bank attempts to price its deposits in order to promote deposit growth. The Bank regularly evaluates the internal costs of funds, surveys rates offered by competing institutions, reviews the Bank's cash flow requirements for lending and liquidity and executes rate changes when deemed appropriate. The Bank does not obtain funds through brokers on a regular basis, although at December 31, 2001 it held \$154.2 million of deposits acquired from money desks in the United States.

The principal methods currently used by the Bank to attract deposit accounts include offering a wide variety of services and accounts and competitive interest rates. The Bank utilizes traditional marketing methods to attract new customers and savings deposits, including advertising.

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The following table presents the average balance of each deposit type and the average rate paid on each deposit type of the Bank for the periods indicated.

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	December 31,			
	2001		2000	
	Average Balance	Average Rate Paid	Average Balance	Average Rate Paid
	(Dollars in Thousands)			
Passbook.....	\$ 131,729	3.55%	\$ 113,660	3.73%
NOW and Super NOW accounts.....	188,545	3.75%	134,573	3.93
Checking.....	43,621	--	40,455	--
Commercial checking(1).....	165,541	--	110,937	--
Certificates of deposit.....	1,289,193	5.98%	1,106,294	6.43
	-----	----	-----	-----
Total deposits.....	\$1,818,629	4.89%	\$1,505,919	5.36%
	=====	====	=====	=====

(1) Includes \$101.9 million, \$91.8 million and \$92.4 million of escrow funds of R&G Mortgage at December 31, 2001, 2000 and 1999, respectively, maintained with the Bank.

The following table sets forth the maturities of the Bank's certificates of deposit having principal amounts of \$100,000 or more at December 31, 2001.

	Amount
	(In Thousands)
Certificates of deposit maturing:	
Three months or less.....	\$237,098
Over three through six months.....	220,142
Over six through twelve months.....	153,226
Over twelve months.....	264,029
	-----
Total.....	\$874,495
	=====

Borrowings. R&G Financial's business requires continuous access to various funding sources, both short and long-term. R&G Mortgage's primary source of short-term funds is through sales of securities to investment dealers under agreements to repurchase ("reverse repurchase agreements"). The Bank also from time to time utilizes reverse repurchase agreements when they represent a competitive short-term funding source.

In a reverse repurchase agreement transaction, R&G Financial will generally sell a mortgage-backed security agreeing to repurchase either the same or a substantially identical security on a specified later date (generally not more than 90 days) at a price less than the original sales price. The difference in the sale price and purchase price is the cost of the use of the proceeds. The mortgage-backed securities underlying the agreements are delivered to the dealers who arrange the transactions. For agreements in which R&G Financial has agreed to repurchase substantially identical securities, the dealers may sell, loan or otherwise dispose of R&G Financial's securities in the normal course of their operations; however, such dealers or third party custodians safe-keep the securities which are to be specifically repurchased by R&G Financial. Reverse

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repurchase agreements represent a competitive cost funding source for R&G Financial. Nevertheless, R&G Financial is subject to the risk that the lender may default at maturity and not return the collateral. The amount at risk is the value of the collateral which exceeds the balance of the borrowing. In order to minimize this potential risk, R&G Financial only deals with large, established investment brokerage firms when entering into these transactions.

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Reverse repurchase transactions are accounted for as financing arrangements rather than as sales of such securities, and the obligations to repurchase such securities is reflected as a liability in R&G Financial's Consolidated Financial Statements. As of December 31, 2001, R&G Financial had \$1.4 billion of reverse repurchase agreements outstanding, \$323.5 million of which represented borrowings of R&G Mortgage. At December 31, 2001, the weighted average interest rate on R&G Financial's reverse repurchase agreements amounted to 3.47%.

R&G Financial's loan originations are also funded by borrowings under various warehouse lines of credit provided by various commercial banks ("Warehouse Lines"). At December 31, 2001, R&G Financial was permitted to borrow under such Warehouse Lines up to \$253.4 million, \$162.0 million of which was drawn upon and outstanding as of such date. The Warehouse Lines are used by R&G Financial to fund loan commitments and must generally be repaid within 180 days after the loan is closed or when payment from the sale of the funded loan is received, whichever occurs first. Until such sale closes, the Warehouse Lines provide that the funded loan is pledged to secure the outstanding borrowings. The Warehouse Lines are also collateralized by a general assignment of mortgage payments receivable and an assignment of certain mortgage servicing rights. Certain of these warehousing lines of credit impose restrictions with respect to the maintenance of minimum levels of net worth and working capital and limitations on the amount of indebtedness and dividends which may be declared. Management of R&G Financial believes that as of December 31, 2001, it was in compliance with all of such covenants and restrictions and does not anticipate that such covenants and restrictions will limit its operations.

The interest rate on funds borrowed pursuant to the Warehouse Lines is based on Libor rates plus a negotiated amount. By maintaining compensating balances, R&G Financial is able to borrow funds under the Warehouse Lines at a lower interest rate than would otherwise apply. These compensating balances are comprised of a portion of the escrow accounts maintained by R&G Financial for principal and interest payments and related tax and insurance payments on loans its services. At December 31, 2001, the weighted average interest rate being paid by R&G Financial under its Warehouse Lines amounted to 2.98%.

Although the Bank's primary source of funds is deposits, the Bank also borrows funds on both a short and long-term basis. The Bank obtains both fixed-rate and variable-rate short-term and long-term advances from the FHLB of New York upon the security of certain of its residential first mortgage loans, securities and cash deposits, provided certain standards related to the credit-worthiness of the Bank have been met. FHLB of New York advances are available for general business purposes to expand lending and investing activities. Advances from the FHLB of New York are made pursuant to several different credit programs, each of which has its own interest rate and range of maturities. At December 31, 2001, the Bank had access to \$1.2 billion in advances from the FHLB of New York, and had 14 FHLB of New York advances aggregating \$464.1 million outstanding as of such date, which mature at various dates commencing in April 2, 2002 through March 2, 2011 and have a weighted average interest rate of 4.87%. At December 31, 2001, the Bank had pledged

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specific collateral aggregating \$643.9 million to the FHLB of New York under its advances program and to secure the letters of credit. The Bank maintains collateral with the FHLB of New York in excess of applicable requirements in order to facilitate any necessary additional borrowings by the Bank in the future.

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The following table sets forth certain information regarding the short-term borrowings of R&G Financial at or for the dates indicated.

	At or For the December
	2001
	(Dollars)
<b>R&amp;G Mortgage:</b>	
Securities sold under agreements to repurchase:	
Average balance outstanding .....	\$ 425,189
Maximum amount outstanding at any month-end during the period .....	472,782
Balance outstanding at end of period .....	402,835
Average interest rate during the period .....	5.24%
Average interest rate at end of period .....	3.47%
Notes Payable:	
Average balance outstanding .....	\$ 181,767
Maximum amount outstanding at any month-end during the period .....	238,475
Balance outstanding at end of period .....	180,565
Average interest rate during the period .....	4.38%
Average interest rate at end of period .....	3.03%
<b>The Bank:</b>	
FHLB of New York advances:	
Average balance outstanding .....	\$ 444,422
Maximum amount outstanding at any month-end during the period .....	523,000
Balance outstanding at end of period .....	464,125
Average interest rate during the period .....	5.36%
Average interest rate at end of period .....	4.87%
Securities sold under agreements to repurchase:	
Average balance outstanding .....	\$ 714,922
Maximum amount outstanding at any month-end during the period .....	1,073,484
Balance outstanding at end of period .....	1,073,484
Average interest rate during the period .....	4.41%
Average interest rate at end of period .....	3.50%
Notes Payable:	
Average balance outstanding .....	\$ 51,695
Maximum amount outstanding at any month-end during the period .....	67,410
Balance outstanding at end of period .....	27,270
Average interest rate during the period .....	5.01%
Average interest rate at end of period .....	3.11%

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### TRUST AND INVESTMENT SERVICES

R&G Financial also provides trust and investment services through the Bank's Trust Department. Services offered include custodial services, the administration of IRA accounts and the sale to investors of mortgage-backed securities guaranteed by GNMA. As of December 31, 2001, the Bank's Trust Department administered trust accounts with aggregate assets of \$64.5 million as of such date. In

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addition, during the year ended December 31, 2001, the Bank's Trust Department sold \$104.5 million of GNMA mortgage-backed securities. The Bank receives fees dependent upon the level and type of service provided. The administration of the Bank's Trust Department is performed by the Trust Committee of the Board of Directors of the Bank.

### BROKER-DEALER SERVICES

Beginning in the first quarter of 2002, R&G Financial's wholly-owned licensed broker-dealer subsidiary, R-G Investments Corporation commenced operations.

### PERSONNEL

As of December 31, 2001, R&G Financial (on a consolidated basis) had 1,522 full-time employees and 83 part-time employees. The employees are not represented by a collective bargaining agreement and R&G Financial believes that it has good relations with its employees.

### REGULATION

Set forth below is a brief description of certain laws and regulations which, together with the descriptions of laws and regulations contained elsewhere herein, are deemed material to an investor's understanding of the extent to which R&G Financial and its subsidiary companies are regulated. The description of these laws and regulations, as well as descriptions of laws and regulations contained elsewhere herein, does not purport to be complete and is qualified in its entirety by reference to applicable laws and regulations.

#### R&G FINANCIAL

General. R&G Financial is a registered financial holding company pursuant to the Bank Holding Company Act of 1956, as amended (the "BHCA"). R&G Financial, as a financial holding company, is subject to regulation and supervision by the Federal Reserve Board and the OCFI. R&G Financial is required to file annually a report of its operations with, and is subject to examination by, the Federal Reserve Board and the OCFI.

BHCA Activities and Other Limitations. The BHCA prohibits a bank holding company from acquiring direct or indirect ownership or control of more than 5% of the voting shares of any bank, or increasing such ownership or control of any bank, without prior approval of the Federal Reserve Board. No approval under the BHCA is required, however, for a bank holding company already owning or controlling 50% of the voting shares of a bank to acquire additional shares of such bank.

The BHCA also prohibits a bank holding company, with certain exceptions, from acquiring more than 5% of the voting shares of any company that



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is not a bank and from engaging in any business other than banking or managing or controlling banks. Under the BHCA, the Federal Reserve Board is authorized to approve the ownership of shares by a bank holding company in any company, the activities of which the Federal Reserve Board has determined to be so closely related to banking or to managing or controlling banks as to be a proper incident thereto. In making such determinations, the Federal Reserve Board is required to weigh the expected benefit to the public, such as greater convenience, increased competition or gains in efficiency, against the possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest or unsound banking practices.

The Federal Reserve Board has by regulation determined that certain activities are closely related to banking within the meaning of the BHCA. These activities include operating a mortgage company, such a R&G Mortgage, finance company, credit card company, factoring company, trust company or

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savings association; performing certain data processing operations; providing limited securities brokerage services; acting as an investment or financial advisor; acting as an insurance agent for certain types of credit-related insurance; leasing personal property on a full-payout, non-operating basis; providing tax planning and preparation services; operating a collection agency; and providing certain courier services. The Federal Reserve Board also has determined that certain other activities, including real estate brokerage and syndication, land development, property management and underwriting of life insurance not related to credit transactions, are not closely related to banking and a proper incident thereto.

Limitations on Transactions with Affiliates. Transactions between financial institutions and any affiliate are governed by Sections 23A and 23B of the Federal Reserve Act. An affiliate of a financial institution is any company or entity which controls, is controlled by or is under common control with the financial institution. In a holding company context, the parent holding company of a financial institution (such as R&G Financial) and any companies which are controlled by such parent holding company are affiliates of the financial institution. Generally, Sections 23A and 23B (i) limit the extent to which the financial institution or its subsidiaries may engage in "covered transactions" with any one affiliate to an amount equal to 10% of such institution's capital stock and surplus, and contain an aggregate limit on all such transactions with all affiliates to an amount equal to 20% of such capital stock and surplus and (ii) require that all such transactions be on terms substantially the same, or at least as favorable, to the institution or subsidiary as those provided to a non-affiliate. The term "covered transaction" includes the making of loans, purchase of assets, issuance of a guarantee and other similar transactions. In addition to the restrictions imposed by Sections 23A and 23B, no financial institution may (i) loan or otherwise extend credit to an affiliate, except for any affiliate which engages only in activities which are permissible for bank holding companies, or (ii) purchase or invest in any stocks, bonds, debentures, notes or similar obligations of any affiliate, except for affiliates which are subsidiaries of the financial institution.

The Gramm-Leach-Bliley Act, described under "- Recent Legislation" below, amended several provisions of Sections 23A and 23B of the Federal Reserve Act. The amendments provide that financial subsidiaries of banks are treated as affiliates for purposes of Sections 23A and 23B of the Federal Reserve Act, but that (i) the 10% capital limit on transactions between the bank and such financial subsidiary as an affiliate is not applicable, and (ii) the investment by the bank in the financial subsidiary does not include retained earnings in the financial subsidiary. Certain anti-evasion provisions have been included

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that relate to the relationship between any financial subsidiary of a bank and sister companies of the bank: (1) any purchase of, or investment in, the securities of a financial subsidiary by any affiliate of the bank is considered a purchase or investment by the bank; or (2) if the Federal Reserve Board determines that such treatment is necessary, any loan made by an affiliate of the bank to the financial subsidiary is to be considered a loan made by the bank.

In addition, Sections 22(h) and (g) of the Federal Reserve Act places restrictions on loans to executive officers, directors and principal stockholders. Under Section 22(h), loans to a director, an executive officer and to a greater than 10% stockholder of a financial institution, and certain affiliated interests of either, may not exceed, together with all other outstanding loans to such person and affiliated interests, the financial institution's loans to one borrower limit (generally equal to 15% of the institution's unimpaired capital and surplus). Section 22(h) also requires that loans to directors, executive officers and principal stockholders be made on terms substantially the same as offered in comparable transactions to other persons unless the loans are made pursuant to a benefit or compensation program that (i) is widely available to employees of the institution and (ii) does not give preference to any director, executive officer or principal stockholder, or certain affiliated interests of either, over other employees of the savings institutions. Section 22(h) also requires prior board approval for certain loans. In addition, the aggregate amount of extensions of credit by a financial institution to all insiders cannot exceed the institution's unimpaired capital and surplus. Furthermore, Section 22(g) places additional restrictions on loans to executive officers.

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R&G Mortgage and the Bank are parties to various agreements which address how each would conduct itself in specifically delineated affiliated transactions (the "Affiliated Transaction Agreements"). The Affiliated Transaction Agreements include a Master Purchase, Servicing and Collections Agreement (the "Master Purchase Agreement"), a Master Custodian Agreement, a Master Production Agreement, a Securitization Agreement and a Data Processing Computer Service Agreement. The terms of these agreements were negotiated at arm's length on the basis that they are substantially the same, or at least as favorable to the Bank, as those prevailing for comparable transactions with, or involving, other nonaffiliated companies.

Pursuant to the Master Production Agreement, the Bank, on a monthly basis, determines its loan production targets and goals (the "Loan Production Goals") and R&G Mortgage assists the 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 the 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 the Bank. In exchange for these services, the 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. See "-Lending Activities of the Bank - Originations, Purchases and Sales of Loans."

Until January 1, 2001, the Master Purchase Agreement provided for the sale by the Bank to R&G Mortgage of the servicing rights to all first and second mortgage loans secured by residential properties which become part of the Bank's loan portfolio once the related loans were sold. Effective January 1, 2001, the Bank retains servicing rights on loans sold or securitized into mortgage backed securities. R&G Mortgage also services all other loans held in the Bank's loan portfolio (including single-family residential loans retained by the Bank and

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certain commercial real estate loans), although R&G Mortgage does not actually acquire such servicing rights. The Master Purchase Agreement further provides that R&G Mortgage exclusively will service such loans and that the Bank will process payments of such loans, all according to a fee schedule. See " - Mortgage Banking Activities - Loan Originations, Purchases and Sales of Loans."

Under the Securitization Agreement, R&G Mortgage renders securitization services with respect to the pooling of some of the Bank's mortgage loans into mortgage-backed securities. With respect to securitization services rendered, the Bank pays a securitization fee of 25 basis points. The Master Custodian Agreement provides that the Bank shall be the custodial agent for R&G Mortgage of certain documentation related to the issuance by R&G Mortgage of GNMA, FNMA or FHLMC mortgage-backed certificates. In consideration of these services, the Bank receives a fee for each mortgage note included in a mortgage-backed certificate per year for which it acts as custodian, as set forth in the agreement. See " - Mortgage Banking Activities - Loan Originations, Purchases and Sales of Loans."

Capital Requirements. The Federal Reserve Board has adopted capital adequacy guidelines pursuant to which it assesses the adequacy of capital in examining and supervising a bank holding company and in analyzing applications to it under the BHCA. The Federal Reserve Board capital adequacy guidelines generally require bank holding companies to maintain total capital equal to 8% of total risk-adjusted assets, with at least one-half of that amount consisting of Tier I or core capital and up to one-half of that amount consisting of Tier II or supplementary capital. Tier I capital for bank holding companies generally consists of the sum of common stockholders' equity and perpetual preferred stock (subject in the case of the latter to limitations on the kind and amount of such stocks which may be included as Tier I capital), less goodwill and, with certain exceptions, intangibles. Tier II capital generally consists of hybrid capital instruments; perpetual preferred stock which is not eligible to be included as Tier I capital; term subordinated debt and intermediate-term preferred stock; and, subject to limitations, general allowances for loan losses. Assets are adjusted under the risk-based guidelines to take into account different risk characteristics, with the categories ranging from 0% (requiring no additional

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capital) for assets such as cash to 100% for the bulk of assets which are typically held by a bank holding company, including multi-family residential and commercial real estate loans, commercial business loans and consumer loans. Single-family residential first mortgage loans which are not past-due (90 days or more) or non-performing and which have been made in accordance with prudent underwriting standards are assigned a 50% level in the risk-weighting system, as are certain privately-issued mortgage-backed securities representing indirect ownership of such loans. Off-balance sheet items also are adjusted to take into account certain risk characteristics.

In addition to the risk-based capital requirements, the Federal Reserve Board requires bank holding companies to maintain a minimum leverage capital ratio of Tier I capital to total assets of 3.0%. Total assets for this purpose does not include goodwill and any other intangible assets and investments that the Federal Reserve Board determines should be deducted from Tier I capital. The Federal Reserve Board has announced that the 3.0% Tier I leverage capital ratio requirement is the minimum for the top-rated bank holding companies without any supervisory, financial or operational weaknesses or deficiencies or those which are not experiencing or anticipating significant growth. Other bank holding companies are expected to maintain Tier I leverage capital ratios of at least 4.0% to 5.0% or more, depending on their overall condition.

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R&G Financial is in compliance with the above-described Federal Reserve Board regulatory capital requirements.

Financial Support of Affiliated Institutions. Under Federal Reserve Board policy, R&G Financial will be expected to act as a source of financial strength to the Bank and to commit resources to support the Bank in circumstances when it might not do so absent such policy. The legality and precise scope of this policy is unclear, however, in light of recent judicial precedent. In addition, any capital loans by a bank holding company to a subsidiary bank is subordinate in right of payment to deposits and to certain other indebtedness of such subsidiary bank. In the event of a bank holding company's bankruptcy, any commitment by the bank holding company to a federal bank regulatory agency to maintain the capital of a subsidiary bank will be assumed by the bankruptcy trustee and entitled to a priority of payment.

Recent Legislation. The Gramm-Leach-Bliley Act, signed into law on November 12, 1999, revises and expands the existing provisions of the BHCA by including a new section that permits a bank holding company to elect to become a financial holding company, which may engage in a full range of financial activities. The qualification requirements and the process for a bank holding company that elects to be treated as a financial holding company requires that all the subsidiary banks controlled by the bank holding company at the time of election to become a financial holding company must be and remain at all times well capitalized and well managed. R&G Financial applied for and became a financial holding company in 2000.

Financial holding companies may engage, directly or indirectly, in any activity that is determined to be (i) financial in nature, (ii) incidental to such financial activity, or (iii) complementary to a financial activity and which does not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally. The Gramm-Leach-Bliley Act specifically provides that the following activities have been determined to be "financial in nature": (a) lending, trust and other banking activities; (b) insurance activities; (c) financial or economic advice or services; (d) pooled investments; (e) securities underwriting and dealing; (f) existing bank holding company domestic activities; (g) existing bank holding company foreign activities and (h) merchant banking activities.

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

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"pose a substantial risk to the safety and soundness of depository institutions or the financial system generally."

### THE BANK

General. The Bank is incorporated under the Puerto Rico Banking Act of 1933, as amended (the "Puerto Rico Banking Law") and is subject to extensive regulation and examination by the OCFI, the FDIC and certain requirements established by the Federal Reserve Board. The federal and Puerto Rico laws and regulations which are applicable to banks regulate, among other things, the scope of their business, their investments, their reserves against deposits, the timing of the availability of deposited funds and the nature and amount of and collateral for certain loans. There are periodic examinations by the OCFI and the FDIC to test the Bank's compliance with various regulatory requirements.

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This regulation and supervision establishes a comprehensive framework of activities in which an institution can engage and is intended primarily for the protection of the insurance fund and depositors. The regulatory structure also gives the regulatory authorities extensive discretion in connection with their supervisory and enforcement activities and examination policies, including policies with respect to the classification of assets and the establishment of adequate loan loss reserves for regulatory purposes. Any change in such regulation, whether by the OCFI, the FDIC or the U.S. Congress or Puerto Rico legislature could have a material adverse impact on R&G Financial, R&G Mortgage, the Bank and their operations.

FDIC Insurance Premiums. The Bank currently pays deposit insurance premiums to the FDIC based on a risk-based assessment system established by the FDIC for all Savings Association Insurance Fund ("SAIF") and Bank Insurance Fund ("BIF") member institutions. Under applicable regulations, institutions are assigned to one of three capital groups which is based solely on the level on an institution's capital: "well capitalized," "adequately capitalized" and "undercapitalized". These three groups are then divided into three subgroups which reflect varying levels of supervisory concern, from those which are considered to be healthy to those which are considered to be of substantial supervisory concern. The matrix so created results in nine assessment risk classifications, with rates ranging from .0% for well capitalized, healthy institutions to .27% for undercapitalized institutions with substantial supervisory concerns. The Bank was classified as a "well-capitalized" institution as of December 31, 2001.

The FDIC may terminate the deposit insurance of any insured depository institution, including the Bank, if it determines after a hearing that the institution has engaged or is engaging in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, order or any condition imposed by an agreement with the FDIC. It also may suspend deposit insurance temporarily during the hearing process for the permanent termination of insurance, if the institution has no tangible capital. If insurance of accounts is terminated, the accounts at the institution at the time of the termination, less subsequent withdrawals, shall continue to be insured for a period of six months to two years, as determined by the FDIC. Management is aware of no existing circumstances which would result in termination of the Bank's deposit insurance.

Capital Requirements. The FDIC has promulgated regulations and adopted a statement of policy regarding the capital adequacy of state-chartered banks which, like the Bank, will not be members of the Federal Reserve System. These requirements are substantially similar to those adopted by the Federal Reserve Board regarding bank holding companies, as described above.

The FDIC's capital regulations establish a minimum 3.0% Tier I leverage capital requirement for the most highly-rated state-chartered, non-member banks, with an additional cushion of at least 100 to 200 basis points for all other state-chartered, non-member banks, which effectively increases the minimum Tier I leverage ratio for such other banks to 4.0% to 5.0% or more. Under the FDIC's regulation, the highest-rated banks are those that the FDIC determines are not anticipating or experiencing

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significant growth and have well diversified risk, including no undue interest rate risk exposure, excellent asset quality, high liquidity, good earnings and, in general, which are considered a strong banking organization and are rated composite 1 under the Uniform Financial Institutions Rating System. Leverage or core capital is defined as the sum of common stockholders' equity (including

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retained earnings), noncumulative perpetual preferred stock and related surplus, and minority interests in consolidated subsidiaries, minus all intangible assets other than certain qualifying supervisory goodwill and certain purchased mortgage servicing rights.

The FDIC also requires that banks meet a risk-based capital standard. The risk-based capital standard for banks requires the maintenance of total capital (which is defined as Tier I capital and supplementary (Tier 2) capital) to risk weighted assets of 8%. In determining the amount of risk-weighted assets, all assets, plus certain off balance sheet assets, are multiplied by a risk-weight of 0% to 100%, based on the risks the FDIC believes are inherent in the type of asset or item. The components of Tier I capital are equivalent to those discussed above under the 3% leverage capital standard. The components of supplementary capital include certain perpetual preferred stock, certain mandatory convertible securities, certain subordinated debt and intermediate preferred stock and general allowances for loan and lease losses. Allowance for loan and lease losses includable in supplementary capital is limited to a maximum of 1.25% of risk-weighted assets. Overall, the amount of capital counted toward supplementary capital cannot exceed 100% of core capital. At December 31, 2001, the Bank met each of its capital requirements.

The FDIC and the other federal banking agencies have published a joint policy statement that describes the process the banking agencies will use to measure and assess the exposure of a bank's net economic value to changes in interest rates. The FDIC and other federal banking agencies have also adopted a joint policy statement on interest rate risk policy. Because market conditions, bank structure, and bank activities vary, the agencies concluded that each bank needs to develop its own interest rate risk management program tailored to its needs and circumstances. The policy statement describes prudent principles and practices that are fundamental to sound interest rate risk management, including appropriate board and senior management oversight and a comprehensive risk management process that effectively identifies, measures, monitors and controls risks.

Activities and Investments. The activities and equity investments of FDIC-insured, state-chartered banks (which under the Federal Deposit Insurance Act includes banking institutions incorporated under the laws of Puerto Rico) are generally limited to those that are permissible for national banks. Under regulations dealing with equity investments, an insured state bank generally may not directly or indirectly acquire or retain any equity investment of a type, or in an amount, that is not permissible for a national bank. An insured state bank is not prohibited from, among other things, (i) acquiring or retaining a majority interest in a subsidiary, (ii) investing as a limited partner in a partnership the sole purpose of which is direct or indirect investment in the acquisition, rehabilitation or new construction of a qualified housing project, provided that such limited partnership investments may not exceed 2% of the bank's total assets, (iii) acquiring up to 10% of the voting stock of a company that solely provides or reinsures directors', trustees' and officers' liability insurance coverage or bankers' blanket bond group insurance coverage for insured depository institutions, and (iv) acquiring or retaining the voting shares of a depository institution if certain requirements are met. In addition, an insured state-chartered bank may not, directly, or indirectly through a subsidiary, engage as "principal" in any activity that is not permissible for a national bank unless the FDIC has determined that such activities would pose no risk to the insurance fund of which it is a member and the bank is in compliance with applicable regulatory capital requirements. Any insured state-chartered bank directly or indirectly engaged in any activity that is not permitted for a national bank must cease the impermissible activity.

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Puerto Rico Banking Law. As a commercial bank organized under the laws of the Commonwealth, the Bank is subject to supervision, examination and regulation by the OCFI pursuant to the Puerto Rico Banking Law.

The Puerto Rico Banking Law requires that at least ten percent (10%) of the yearly net income of the Bank be credited annually to a reserve fund. This apportionment shall be done every year until the reserve fund shall be equal to the sum of the Bank's paid-in common and preferred stock capital. As of December 31, 2001, the Bank had credited \$11.6 million to such reserve fund.

The Puerto Rico Banking Law also provides that when the expenditures of a bank are greater than the receipts, the excess of the former over the latter shall be charged against the undistributed profits of the bank, and the balance, if any, shall be charged against the reserve fund, as a reduction thereof. If there is no reserve fund sufficient to cover such balance in whole or in part, the outstanding amount shall be charged against the capital account and no dividend shall be declared until said capital has been restored to its original amount and the reserve fund to 20% of the original capital. In addition, every bank is required by the Puerto Rico Banking Law to maintain a legal reserve which shall not be less than 20% of its demand liabilities, except government deposits (federal, state and municipal) which are secured by actual collateral. The reserve is required to be made up of any of the following instruments or any combination of them: (i) legal tender of the United States; (ii) checks on banks or trust companies located in any part of Puerto Rico, to be presented for collection during the day following that on which they are received; (iii) money deposited in other banks provided said deposits are authorized by the Commissioner, subject to immediate collection; and (iv) federal funds sold and securities purchased under agreements to resell, provided such funds are repaid on or prior to the close of the next business day.

Under the Puerto Rico Banking Law, the Bank is permitted to make loans to any one person, firm, partnership or corporation, up to an aggregate amount of fifteen percent (15%) of the paid-in capital and reserve fund of the Bank, plus 15% of 50% of undistributed earnings for "well capitalized" institutions. As of December 31, 2001, the legal lending limit for the Bank under these provisions was approximately \$29.9 million. If such loans are secured by collateral worth at least twenty-five percent (25%) more than the amount of the loan, the aggregate maximum amount may reach one-third of the paid-in capital of the Bank, plus its reserve fund. The legal lending limit for the Bank for loans secured by collateral with at least 25% more than the amount of the loan was approximately \$65.9 million. The Bank's maximum extension of credit to any one borrower was \$35.9 million at December 31, 2001, which is fully secured with collateral with a "loan to value" ratio of less than 80%. There are no restrictions on the amount of loans to subsidiaries of banks or loans that are wholly secured by bonds, securities and other evidences of indebtedness of the United States or the Commonwealth, or by current debt bonds, not in default, of municipalities or instrumentalities of the Commonwealth. Loans to non-banking affiliates of the Bank, are subject however to the lending limitations set forth in Sections 23A and 23B of the Federal Reserve Act. The Puerto Rico Banking Law also authorizes the Bank to conduct certain financial and related activities directly or through subsidiaries. The Puerto Rico Banking Law also prohibits Puerto Rico banks from making loans secured by their own stock, and from purchasing their own stock, unless such purchase is necessary to prevent losses because of a debt previously contracted in good faith. The stock so purchased by the bank must be sold in a private or public sale within one year from the date of purchase. The Bank may repurchase its own stock for the purpose of reducing its capital, subject to the approval of the OCFI.

The rate of interest that the Bank may charge on mortgage and other types of loans to individuals in Puerto Rico is subject to Puerto Rico's usury laws. Such laws are administered by the Financing Board, which consists of the Commissioner of Financial Institutions, the President of the Government

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Development Bank, the Chairman of the Planning Board and the Puerto Rico Secretaries of Commerce, Treasury and Consumer Affairs and three representatives from the private sector. The Financing Board promulgates regulations which specify maximum rates on various types of loans to individuals. The Financing Board eliminated the regulations that set forth the maximum interest rates that could be

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charged on consumer loans, mortgage loans and commercial loans. The origination charges on residential mortgage loans may not exceed 6% of the loan amount.

Regulatory Enforcement Authority. Applicable banking laws include substantial enforcement powers available to federal and Puerto Rico banking regulators. This enforcement authority includes, among other things, the ability to assess civil money penalties, to issue cease-and-desist or removal orders and to initiate injunctive actions against banking organizations and institution-affiliated parties, as defined. In general, these enforcement actions may be initiated for violations of laws and regulations and unsafe or unsound practices. Other actions or inactions may provide the basis for enforcement action, including misleading or untimely reports filed with regulatory authorities.

### MORTGAGE BANKING SUBSIDIARIES

The mortgage banking business conducted by R&G Mortgage, The Mortgage Store and Continental are subject to the rules and regulations of FHA, VA, FNMA, FHLMC and GNMA with respect to originating, processing, selling and servicing mortgage loans and the issuance and sale of mortgage-backed securities. Those rules and regulations, among other things, prohibit discrimination and establish underwriting guidelines which include provisions for inspections and appraisals, require credit reports on prospective borrowers and fix maximum loan amounts and, with respect to VA loans, fix maximum interest rates. Moreover, lenders are required annually to submit to FNMA, FHA, FHLMC, GNMA and VA audited financial statements, and each regulatory entity has its own financial requirements. The affairs of these subsidiaries are also subject to supervision and examination by FNMA, FHA, FHLMC, GNMA, HUD and VA at all times to assure compliance with the applicable regulations, policies and procedures. Mortgage origination activities are subject to, among others, the Equal Credit Opportunity Act, Federal Truth-in-Lending Act and the Real Estate Settlement Procedures Act and the regulations promulgated thereunder.

Mortgage loan production activities are subject to the Federal Truth-in-Lending Act and Regulation Z promulgated thereunder. The Truth-in-Lending Act contains disclosure requirements designed to provide consumers with uniform, understandable information with respect to the terms and conditions of loans and credit transactions in order to give them the ability to compare credit terms. The Truth-in-Lending Act provides consumers a three day right to cancel certain credit transactions, including any refinance mortgage or junior mortgage loan on a consumer's primary residence.

The mortgage subsidiaries are required to comply with the Equal Credit Opportunity Act of 1974, as amended ("ECOA"), and Regulation B promulgated thereunder, which prohibit creditors from discriminating against applicants on the basis of race, color, sex, age or marital status, and restrict creditors from obtaining certain types of information from loan applicants. It also requires certain disclosures by lenders regarding consumer rights and requires lenders to advise applicants of the reasons for any credit denial. In instances where the applicant is denied credit or the rate or charge for loan increases as a result of information obtained from a consumer credit agency, another statute,



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The Fair Credit Reporting Act of 1970, as amended, requires the lenders to supply the applicant with the name and address of the reporting agency.

The Federal Real Estate Settlement Procedures Act ("RESPA") imposes, among other things, limits on the amount of funds a borrower can be required to deposit with the mortgage subsidiaries in any escrow account for the payment of taxes, insurance premiums or other charges.

R&G Mortgage and The Mortgage Store are also subject to regulation by the OCFI, with respect to, among other things, licensing requirements and the record-keeping, examination and reporting requirements of the Puerto Rico Mortgage Banking Institutions Law (the "Mortgage Banking Law"). R&G Mortgage and The Mortgage Store are licensed by the OCFI as a mortgage banking institution in

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Puerto Rico. Such authorization to act as a mortgage banking institution must be renewed as of January 1 of each year. In the past, neither R&G Mortgage nor The Mortgage Store has not had any difficulty in renewing its authorization to act as a mortgage banking institution, and management is unaware of any existing practices, conditions or violations which would result in either company being unable to receive such authorization in the future.

The Mortgage Banking Law requires the prior approval of the OCFI for the acquisition of control of any mortgage banking institution licensed under the Mortgage Banking Law. For purposes of the Mortgage Banking Law, the term "control" means the power to direct or influence decisively, directly or indirectly, the management or policies of a mortgage banking institution. The Mortgage Banking Law provides that a transaction that results in the holding of less than 10% of the outstanding voting securities of a mortgage banking institution shall not be considered a change of control. Pursuant to the Mortgage Banking Law, upon receipt of notice of a proposed transaction that may result in change of control, the OCFI is obligated to make such inquires as it deems necessary to review the transaction. Under the Mortgage Banking Law, the determination of the OCFI whether or not to authorize a proposed change of control is final and non-appealable.

As is the case with the Bank, the rate of interest that R&G Mortgage and The Mortgage Store may charge on mortgage loans to individuals is subject to Puerto Rico's usury laws. Such laws are administered by the Financing Board which promulgates regulations that specify maximum rates on various types of loans to individuals. Regulation 26-A promulgated by the Financing Board fixes the maximum rate (which is adjusted on a weekly basis) which may be charged on residential first mortgage loans.

In 1996, the Financing Board eliminated the regulations that set forth the maximum interest rates that could be charged on non-federal government guaranteed loans.

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ITEM 2:

### PROPERTIES

The Company's principal executive office is located at 280 Jesus T. Pioero Avenue, Hato Ray, San Juan, Puerto Rico 00918. At December 31, 2001, we

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operated through our subsidiaries a total of 65 offices, mostly through leased facilities. All of our subsidiaries except Continental Capital Corp., conduct business in Puerto Rico. R-G Premier Bank of Puerto Rico operates from 25 offices, R&G Mortgage operates from 29 offices, The Mortgage Store of Puerto Rico, Inc. operates from 7 offices, Home & Property Insurance Corporation operates from 1 office, R-G Investments Corporation operates from 3 offices and Continental Capital Corp. operates from 4 offices located in the States of New York and North Carolina.

### ITEM 3: LEGAL PROCEEDINGS.

The Company is not involved in any pending legal proceedings other than nonmaterial legal proceedings occurring in the ordinary course of business.

### ITEM 4: SUBMISSION OF MATTERS TO A VOTE OF SECURITY-HOLDERS.

Not applicable.

## PART II

### ITEM 5: MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS.

The information required herein is incorporated by reference from pages 82 and 83 of the Registrant's 2001 Annual Report.

### ITEM 6: SELECTED FINANCIAL DATA.

The information required herein is incorporated by reference from pages 31 to 32 of the Registrant's 2001 Annual Report.

### ITEM 7: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

The information required herein is incorporated by reference from pages 33 to 46 of the Registrant's 2001 Annual Report.

#### ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

The information required herein is incorporated by reference from pages 40 to 44 of the Registrant's 2001 Annual Report.

### ITEM 8: FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

The information required herein is incorporated by reference from pages 47 to 80 of the Registrant's 2001 Annual Report.

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### ITEM 9: CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

Not applicable.

## PART III

### ITEM 10: DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT.

The information required herein is incorporated by reference from pages 2 to 5 and 6 of the Registrant's Proxy Statement dated March 31, 2002 ("Proxy Statement").

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### ITEM 11: EXECUTIVE COMPENSATION.

The information required herein is incorporated by reference from pages 9 to 10 and 11 to 12 of the Registrant's Proxy Statement.

### ITEM 12: SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT.

The information required herein is incorporated by reference from pages 7 to 8 of the Registrant's Proxy Statement.

### ITEM 13: CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS.

The information required herein is incorporated by reference from pages 12 to 13 of the Registrant's Proxy Statement.

## PART IV

### ITEM 14: EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K.

(a) Documents Filed as Part of this Report

(1) The following financial statements are incorporated by reference from Item 8 hereof (see Exhibit 13):

Independent Auditors' Report.

Consolidated Statements of Financial Condition as of December 31, 2001 and 2000.

Consolidated Statements of Income for the Years Ended December 31, 2001, 2000 and 1999.

Consolidated Statements of Cash Flows for the Years Ended December 31, 2001, 2000 and 1999.

Consolidated Statements of Changes in Stockholders' Equity for the Years Ended December 31, 2001, 2000 and 1999.

Notes to Consolidated Financial Statements.

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(2) All schedules for which provision is made in the applicable accounting regulation of the SEC are omitted because of the absence of conditions under which they are required or because the required information is included in the consolidated financial statements and related notes thereto.

(3) The following exhibits are filed as part of this Form 10-K, and this list includes the Exhibit Index.

No.	Description
2.1	Amended and Restated Agreement and Plan of Merger by and between R&G Financial Corporation, the Bank and R-G Interim Premiere Bank, dated as of September 27, 1996(1)
2.2	Agreement and Plan of Reorganization among R&G Financial Corporation, R&G Holdings Corporation, The Crown Group, Inc. and Crown Bank, a Federal Savings Bank dated as of December 19, 2001(2)

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3.1.0	Certificate of Incorporation of R&G Financial Corporation (3)
3.1.1	Certificate of Amendment to Certificate of Incorporation of R&G Financial Corporation (2)
3.1.2	Amended and Restated Certificate of Incorporation of R&G Financial Corporation (4)
3.1.3	Amendment to Amended and Restated Certificate of Incorporation of R&G Financial Corporation (5)
3.1.4	Certificate of Resolutions designating the terms of the Series A Preferred Stock (6)
3.1.5	Certificate of Resolutions designating the terms of the Series B Preferred Stock (7)
3.1.6	Certificate of Resolutions designating the terms of the Series C Preferred Stock (12)
3.1.7	Certificate of Resolutions designating the terms of the Series D Preferred Stock (13)
3.2	Bylaws of R&G Financial Corporation (3)
4.0	Specimen of Stock Certificate of R&G Financial Corporation (3)
4.1	Form of Series A Preferred Stock Certificate of R&G Financial Corporation (9)
4.2	Form of Series B Preferred Stock Certificate of R&G Financial Corporation (10)
4.3	Form of Series C Preferred Stock Certificate of R&G Financial Corporation (11)
4.4	Form of Series D Preferred Stock Certificate of R&G Financial Corporation (14)
10.2	Master Custodian Agreement between R&G Mortgage and the Bank dated February 16, 1990, as amended on June 27, 1996(3)
10.3	Master Production Agreement between R&G Mortgage and the Bank dated February 16, 1990, as amended on August 30, 1991 and March 31, 1995(3)
10.4	Data Processing Computer Service Agreement between R&G Mortgage and R-G Premier Bank dated December 1, 1994(3)
10.5	Securitization Agreement by and between R&G Mortgage and the Bank, dated as of July 1, 1995(3)
10.6	R&G Financial Corporation Stock Option Plan(3)(*)
13.0	2001 Annual Report to Stockholders
21.0	Subsidiaries of the Registrant - Reference is made to "Item 1 Business" for the required information

- (1) Incorporated by reference from the Registration Statement on Form S-4 (Registration No. 333-13199) filed by the Registrant with the Securities and Exchange Commission ("SEC") on October 1, 1996.
- (2) Incorporated by reference from the Registrant's Current Report of Form 8-K filed with the SEC on December 20, 2001.
- (3) Incorporated by reference from the Registration Statement on Form S-1 (Registration No. 333-06245) filed by the Registrant with the SEC on June 18, 1996, as amended.
- (4) Incorporated by reference from the Registrant's Current Report on Form 8-K filed with the SEC on November 19, 1999.
- (5) Incorporated by reference from the Registrant's Current Report on Form 8-K filed with the SEC on June 12, 2001.

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- (6) Incorporated by reference from the Registrant's Current Report on Form 8-K filed with the SEC on August 31, 1998
- (7) Incorporated by reference from the Registrants' Form 10-K filed with the SEC on April 13, 2000.
- (8) Incorporated by reference from Pre-Effective Amendment No. 1 to the Registrant's Registration Statement on Form S-3 (File No. 333-55834),

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- filed with the SEC on March 7, 2001.
- (9) Incorporated by reference from the Registrant's Registration Statement on Form S-3 (Registration No. 333-60923), as amended, filed with the SEC on August 7, 1998.
  - (10) Incorporated by reference from the Registrant's Registration Statement on Form S-3 (Registration No. 333-90463), filed with the SEC on November 5, 1999.
  - (11) Incorporated by reference from the Registrant's Registration Statement on Form S-3 (File No. 333-55834), filed with the SEC on February 16, 2001.
  - (12) Incorporated by reference from the Registrants' Form 10-K filed with the SEC on April 14, 2001.
  - (13) Incorporated by reference from the Registrant's Current Report on Form 8-K filed with the SEC on March 7, 2002.
  - (14) Incorporated by reference from the Registrant's Registration Statement on Form S-3 (File No. 333-81214), filed with the SEC on January 22, 2002.

(\* ) Management contract or compensatory plan or arrangement.

(3) (b) Reports on Form 8-K.

The Registrant filed a Form 8-K on December 19, 2001 with respect to its execution of an Agreement and Plan of Reorganization with The Crown Group, Inc. and its wholly owned subsidiary, Crown Bank, a Federal Savings Bank.

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SIGNATURES

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

R&G FINANCIAL CORPORATION

March 28, 2002

By: /s/ Victor J. Galan

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Victor J. Galan  
Chairman of the Board and Chief  
Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

/s/ Victor J. Galan

March 28, 2002

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Victor J. Galan  
Chairman of the Board and  
Chief Executive Officer  
(principal executive officer)

/s/ Ramon Prats

March 28, 2002

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Ramon Prats  
President and Director

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/s/ Joseph R. Sandoval March 28, 2002

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Joseph R. Sandoval  
Senior Vice President and Chief Financial  
Officer (principal financial and  
accounting officer)

/s/ Ana M. Armendariz March 28, 2002

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Ana M. Armendariz  
Director and Treasurer

/s/ Enrique Umpierre-Suarez March 28, 2002

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Enrique Umpierre-Suarez  
Director and Secretary

/s/ Victor L. Galan Fundora March 28, 2002

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Victor J. Galan Fundora  
Director

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/s/ Pedro Ramirez March 28, 2002

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Pedro Ramirez  
Director

/s/ Laureno Carus Abarca March 28, 2002

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Laureno Carus Abarca  
Director

/s/ Eduardo McCormack March 28, 2002

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Eduardo McCormack  
Director

/s/ Gilberto Rivera-Arrega March 28, 2002

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Gilberto Rivera-Arreaga  
Director

/s/ Benigno R. Fernandez March 28, 2002

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Benigno R. Fernandez  
Director

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/s/ Ileana M. Colon-Carlo

March 28, 2002

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Ileana M. Colon-Carlo  
Director

/s/ Roberto Gorbea

March 28, 2002

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Roberto Gorbea  
Director