

R&G FINANCIAL CORP
Form 10-Q
November 14, 2003

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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

◆ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2003

OR

◇ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM _____ TO ____.

Commission file number: 000-21137

R&G FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

Puerto Rico

66-0532217

(State of incorporation
or organization)

(I.R.S. Employer
Identification No.)

280 Jesús T. Piñero Avenue
Hato Rey, San Juan, Puerto Rico

00918

(Address of principal executive offices)

(Zip Code)

(787) 758-2424

(Registrant's telephone number, including area code)

Indicate by checkmark whether Registrant (a) 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 report (s) and (b) has been subject to such filing requirements for at least 90 days.

YES NO

Indicate by checkmark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Securities Exchange Act of 1934).

x Yes NO

Number of shares of Class B Common Stock outstanding as of November 11, 2003: 19,670,888 (Does not include 14,373,056 Class A Shares of Common Stock which are exchangeable into Class B Shares of Common Stock at the option of the holder.)

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CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION**

| | <u>September 30, 2003</u> | <u>December 31, 2002</u> |
|--|---------------------------|--------------------------|
| | (Unaudited) | |
| | (Dollars in thousands) | |
| ASSETS | | |
| Cash and due from banks | \$ 81,774 | \$ 128,085 |
| Money market investments: | | |
| Securities purchased under agreements to resell | 53,698 | |
| Time deposits with other banks | 41,306 | 65,401 |
| Short-term investments | | 4,157 |
| Mortgage loans held for sale, at lower of cost or market | 240,535 | 258,738 |
| Mortgage-backed and investment securities held for trading, at fair value | 33,821 | 48,651 |
| Trading securities pledged on repurchase agreements, at fair value | 7,128 | 26,106 |
| Mortgage-backed and investment securities available for sale, at fair value | 2,135,193 | 1,819,257 |
| Available for sale securities pledged on repurchase agreements, at fair value | 1,040,408 | 737,656 |
| Mortgage-backed and investment securities held to maturity, at amortized cost (estimated market value: 2003 - \$15,927; 2002 - \$30,885) | 15,436 | 30,661 |
| Held to maturity securities pledged on repurchase agreements, at amortized cost (estimated market value: 2003 - \$57,810; 2002 - \$45,926) | 55,884 | 44,930 |
| Loans receivable, net | 3,754,039 | 2,759,689 |
| Accounts receivable, including advances to investors, net | 40,911 | 32,100 |
| Accrued interest receivable | 42,425 | 40,401 |
| Servicing asset | 124,149 | 142,334 |
| Premises and equipment | 40,358 | 38,665 |
| Other assets | 127,936 | 100,415 |
| | <u>\$ 7,835,001</u> | <u>\$ 6,277,246</u> |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Liabilities: | | |
| Deposits | \$ 3,431,976 | \$ 2,802,324 |
| Federal funds purchased | 35,000 | |
| Securities sold under agreements to repurchase | 2,112,382 | 1,489,758 |
| Notes payable | 194,632 | 194,607 |
| Advances from FHLB | 1,098,725 | 940,725 |
| Other borrowings | 57,739 | 45,066 |
| Accounts payable and accrued liabilities | 165,844 | 134,427 |
| Other liabilities | 13,571 | 8,121 |
| | <u>7,109,869</u> | <u>5,615,028</u> |
| Stockholders equity: | | |
| Preferred stock, \$.01 par value, 20,000,000 shares authorized: | | |
| Non-cumulative perpetual Monthly Income Preferred Stock, \$25 liquidation value: | | |
| 7.40% Series A, 2,000,000 shares authorized, issued and outstanding | 50,000 | 50,000 |
| 7.75% Series B, 1,000,000 shares authorized, issued and outstanding | 25,000 | 25,000 |
| 7.60% Series C, 2,760,000 shares authorized, issued and outstanding | 69,000 | 69,000 |
| 7.25% Series D, 2,760,000 shares authorized, issued and outstanding | 69,000 | 69,000 |

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| | | |
|---|--------------------|--------------------|
| Common stock: | | |
| Class A - \$.01 par value, 40,000,000 shares authorized, 14,373,056 issued and outstanding (2002 - 14,553,056) | 144 | 145 |
| Class B - \$.01 par value, 60,000,000 shares authorized, 19,670,888 issued and outstanding (2002-19,440,206) | 197 | 194 |
| Additional paid-in capital | 115,177 | 114,951 |
| Retained earnings | 366,720 | 294,592 |
| Capital reserves | 17,419 | 17,419 |
| Accumulated other comprehensive income | 12,475 | 21,917 |
| | <u>725,132</u> | <u>662,218</u> |
| | <u>\$7,835,001</u> | <u>\$6,277,246</u> |

The accompanying notes are an integral part of these statements.

Table of Contents**R&G FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF INCOME**

| | Three month period ended September 30, | | Nine month period ended September 30, | |
|--|--|---------------|---|----------------|
| | 2003 | 2002 | 2003 | 2002 |
| | (Unaudited) | | (Unaudited) | |
| | (Dollars in thousands except for per share data) | | | |
| Interest income: | | | | |
| Loans | \$ 59,528 | \$ 50,086 | \$ 166,490 | \$ 127,569 |
| Money market and other investments | 8,003 | 9,480 | 24,593 | 28,113 |
| Mortgage-backed securities | 27,816 | 29,346 | 85,078 | 83,564 |
| Total interest income | 95,347 | 88,912 | 276,161 | 239,246 |
| Interest expense: | | | | |
| Deposits | 23,362 | 23,826 | 68,023 | 65,416 |
| Securities sold under agreements to repurchase | 12,144 | 12,708 | 37,729 | 37,764 |
| Notes payable | 1,519 | 1,795 | 5,528 | 5,152 |
| Other | 10,579 | 9,273 | 30,348 | 21,550 |
| Total interest expense | 47,604 | 47,602 | 141,628 | 129,882 |
| Net interest income | 47,743 | 41,310 | 134,533 | 109,364 |
| Provision for loan losses | (4,292) | (3,970) | (12,956) | (13,520) |
| Net interest income after provision for loan losses | 43,451 | 37,340 | 121,577 | 95,844 |
| Other income: | | | | |
| Net gain on origination and sale of loans | 30,167 | 24,380 | 107,970 | 57,841 |
| Loan administration and servicing fees | 12,587 | 11,193 | 38,989 | 30,817 |
| Service charges, fees and other | 7,943 | 4,539 | 20,890 | 12,471 |
| Total revenues | 50,697 | 40,112 | 167,849 | 101,129 |
| Operating expenses: | | | | |
| Employee compensation and benefits | 15,377 | 12,535 | 45,030 | 32,087 |
| Office occupancy and equipment | 6,489 | 5,138 | 18,265 | 14,106 |
| Other administrative and general | 26,638 | 27,712 | 99,887 | 61,681 |
| Total operating expenses | 48,504 | 45,385 | 163,182 | 107,874 |
| Income before income taxes | 45,644 | 32,067 | 126,244 | 89,099 |
| Income tax expense: | | | | |
| Current | 9,179 | 5,880 | 21,985 | 18,575 |
| Deferred | 2,173 | 1,139 | 9,376 | 1,324 |

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| | 11,352 | 7,019 | 31,361 | 19,899 |
|--|------------|------------|------------|------------|
| Net income | \$ 34,292 | \$ 25,048 | \$ 94,883 | \$ 69,200 |
| Earnings per common share - Basic | \$ 0.89 | \$ 0.64 | \$ 2.44 | \$ 1.83 |
| - Diluted | \$ 0.89 | \$ 0.63 | \$ 2.43 | \$ 1.81 |
| Weighted average number of shares outstanding - Basic | 34,043,641 | 33,053,988 | 34,036,563 | 31,892,007 |
| - Diluted | 34,193,941 | 33,301,846 | 34,185,327 | 32,209,740 |

The accompanying notes are an integral part of these statements.

Table of Contents**R&G FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

| | Three month period ended September 30, | | Nine month period ended September 30, | |
|---|--|-------------|---|-------------|
| | 2003 | 2002 | 2003 | 2002 |
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) |
| | (Dollars in thousands) | | | |
| Net income | \$ 34,292 | \$ 25,048 | \$ 94,883 | \$ 69,200 |
| Other comprehensive income, before tax: | | | | |
| Unrealized gains (losses): | | | | |
| Cash flow hedges | 2,482 | (6,749) | 843 | (7,954) |
| Investment securities: | | | | |
| Arising during period | (5,816) | 12,651 | (15,477) | 35,265 |
| Less: Reclassification adjustments for gains included in net income | (11) | (228) | (831) | (449) |
| | (5,827) | 12,423 | (16,308) | 34,816 |
| | (3,345) | 5,674 | (15,465) | 26,862 |
| Income tax (expense) benefit related to items of other comprehensive income | 1,295 | (2,226) | 6,023 | (10,476) |
| Other comprehensive (loss) income, net of tax | (2,050) | 3,448 | (9,442) | 16,386 |
| Comprehensive income, net of tax | \$ 32,242 | \$ 28,496 | \$ 85,441 | \$ 85,586 |

The accompanying notes are an integral part of these statements.

Table of Contents**R&G FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS**

| | Nine month period ended September 30, | |
|--|---------------------------------------|-----------|
| | 2003 | 2002 |
| | (Unaudited) | |
| | (Dollars in thousands) | |
| Cash flows from operating activities: | | |
| Net income | \$ 94,883 | \$ 69,200 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 7,055 | 5,132 |
| Amortization of premium on investments and mortgage-backed securities, net | 10,557 | 3,042 |
| Scheduled amortization of servicing asset | 17,134 | 13,669 |
| Impairment charges on servicing asset | 32,113 | 13,687 |
| Provision for loan losses | 12,956 | 13,520 |
| Gain on sales of mortgage-backed and investment securities available for sale | (831) | (449) |
| Unrealized loss (gain) on trading securities and derivative instruments, net | 853 | (151) |
| Increase in mortgage loans held for sale | (13,096) | (54,181) |
| Net decrease in securities held for trading | 33,043 | 20,739 |
| Increase in receivables | (10,835) | (13,896) |
| Increase in other assets | (27,835) | (6,687) |
| Increase in notes payable and other borrowings | 12,698 | 2,356 |
| Increase in accounts payable and accrued liabilities | 38,534 | 22,619 |
| Increase in other liabilities | 5,450 | 1,343 |
| Total adjustments | 117,796 | 20,743 |
| Net cash provided by operating activities | 212,679 | 89,943 |
| Cash flows from investing activities: | | |
| Purchases of investment securities | (2,043,565) | (889,752) |
| Proceeds from sales of securities available for sale | 121,068 | 431,949 |
| Principal repayments on mortgage-backed securities and redemption of securities available for sale | 1,335,265 | 581,476 |
| Net assets acquired, net of cash received | | (63,679) |
| Proceeds from sales of loans | 129,195 | |
| Net originations of loans | (1,136,501) | (820,786) |
| Purchases of FHLB stock, net | (22,820) | (19,171) |
| Acquisition of premises and equipment | (7,873) | (6,796) |
| Acquisition of servicing rights | (31,062) | (37,285) |
| Net cash used in investing activities | (1,656,293) | (824,044) |
| Cash flows from financing activities: | | |
| Increase in deposits net | 629,652 | 284,987 |
| Increase in federal funds purchased | 35,000 | |
| Increase in securities sold under agreements to repurchase - net | 622,624 | 92,234 |
| Advances from FHLB, net | 158,000 | 288,500 |
| Net proceeds from issuance of preferred stock | | 66,591 |
| Proceeds from issuance of common stock | 227 | 46,096 |
| Cash dividends: | | |
| Common stock | (10,841) | (7,876) |
| Preferred stock | (11,913) | (10,984) |

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| | | |
|--|------------|------------|
| Net cash provided by financing activities | 1,422,749 | 759,548 |
| Net (decrease) increase in cash and cash equivalents | (20,865) | 25,447 |
| Cash and cash equivalents at beginning of period | 197,643 | 157,724 |
| Cash and cash equivalents at end of period | \$ 176,778 | \$ 183,171 |
| Cash and cash equivalents include: | | |
| Cash and due from banks | \$ 81,774 | \$ 100,577 |
| Securities purchased under agreements to resell | 53,698 | |
| Time deposits with other banks | 41,306 | 82,594 |
| | \$ 176,778 | \$ 183,171 |

The accompanying notes are an integral part of these statements.

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**R&G FINANCIAL CORPORATION
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

NOTE 1 - REPORTING ENTITY AND BASIS OF PRESENTATION

Reporting entity

The accompanying unaudited consolidated financial statements include the accounts of R&G Financial Corporation (the Company), a diversified financial services company, and its wholly-owned subsidiaries, R-G Premier Bank of Puerto Rico (Premier Bank), a Puerto Rico commercial bank, R-G Crown Bank (formerly Crown Bank, F.S.B.) (Crown Bank), a Florida-based federal savings bank, R&G Mortgage Corp. (R&G Mortgage), Puerto Rico's second largest mortgage banker, R-G Investments Corporation, a Puerto Rico licensed securities broker-dealer, and Home & Property Insurance Corp., a Puerto Rico insurance agency. The Company, currently in its 31st year of operations, operates as a financial holding company, pursuant to the provisions of the Gramm-Leach-Bliley Act of 1999, and is engaged in banking, mortgage banking, and securities and insurance brokerage through its subsidiaries.

Premier Bank and Crown Bank provide a full range of banking services, including residential, commercial and personal loans and a variety of deposit products. Premier Bank operates through thirty-one branches located mainly in the northeastern part of the Commonwealth of Puerto Rico. Crown Bank operates in the Orlando and Tampa/St. Petersburg metropolitan areas through fifteen full service branches and six commercial lending offices. Premier Bank also provides private banking and trust and other financial services to its customers. Premier Bank and Crown Bank are subject to the regulations of certain federal and Puerto Rico agencies, and undergo periodic examinations by those regulatory agencies.

Crown Bank is also engaged in the origination of FHA-insured, VA-guaranteed and privately insured first and second mortgage loans on residential real estate (1 to 4 families) in the States of New York, New Jersey, Connecticut, North Carolina and Florida, through its wholly-owned subsidiary, Continental Capital Corporation (Continental Capital).

R&G Mortgage is engaged primarily in the business of originating FHA-insured, VA-guaranteed, and privately insured first and second mortgage loans on residential real estate (1 to 4 families), directly and through its wholly-owned subsidiary, Mortgage Store of Puerto Rico, Inc. R&G Mortgage pools FHA and VA loans into GNMA mortgage-backed securities and collateralized mortgage obligation certificates for sale to investors. After selling the loans, it retains the servicing on the loans. R&G Mortgage is also a FNMA and FHLMC seller-servicer of conventional loans.

Basis of presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with the instructions for Form 10-Q. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles. However, in the opinion of management, the accompanying unaudited consolidated financial statements include all adjustments (principally consisting of normal recurring accruals) necessary for a fair presentation of the Company's financial condition as of September 30, 2003 and the results of operations and changes in its cash flows for the three and nine months ended September 30, 2003 and 2002.

The results of operations for the three and nine month periods ended September 30, 2003 are not necessarily indicative of the results to be expected for the year ending December 31, 2003. The unaudited consolidated financial statements and notes thereto should be read in conjunction with the audited financial statements and notes thereto for the year ended December 31, 2002.

Basis of consolidation

All significant intercompany balances and transactions have been eliminated in the accompanying unaudited financial statements.

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New accounting pronouncements

In November 2002, the FASB issued Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees of Indebtedness of Others* (an interpretation of FASB Statements No. 5, 57, 107 and rescission of FASB Interpretation No. 34) (*FIN No. 45*). *FIN No. 45* clarifies the requirements of FASB Statement No. 5, *Accounting for Contingencies* relating to a guarantor's accounting for, and disclosure of, the issuance of certain types of guarantees. *FIN No. 45* requires a guarantor of certain guarantees to recognize at its inception a liability for the fair value of the obligation undertaken when issuing the guarantee, and also expands the related disclosures. The provisions of initial recognition are effective for guarantees issued or modified after December 31, 2002. The adoption of *FIN No. 45* on January 1, 2003 did not have a significant impact on the Company's consolidated financial statements.

On April 30, 2003 the FASB issued SFAS No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities*, which amends and clarifies financial accounting and reporting for derivative instruments, including certain derivatives instruments embedded in other contracts, and for hedging activities under FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*. This Statement is effective for contracts entered into or modified after June 30, 2003. The adoption of this Statement on July 1, 2003 had no significant effect on the consolidated financial condition or results of operations of the Company.

In May 2003, the FASB issued SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity*. FAS 150 represents phase 1 of the FASB's broader project on (1) distinguishing between liability and equity instruments and (2) accounting for instruments that have characteristics of both types of instruments (the *liabilities and equity project*). SFAS No. 150 covers a limited number of instruments that are to be classified as liabilities and specifies that such instruments embody obligations of the issuer and that, therefore, the issuer must classify them as liabilities. It is expected that phase 2 of the project will address (1) separating compound financial instruments (including convertible debt and conditionally redeemable stock) that have characteristics of liabilities and equity into their liability and equity components, (2) the definition of an ownership relationship, and (3) the definition of liabilities in FASB Concepts Statement No. 6 (*CON 6*), *Elements of Financial Statements*.

Under the provisions of this Statement, SFAS No. 150 was effective July 1, 2003 for the Company. Among the instruments specified by SFAS No. 150, mandatorily redeemable financial instruments must be classified as liabilities. The Company has \$35 million of guaranteed preferred beneficial interest in company junior subordinated deferrable interest debentures (*trust preferred securities*) that had already been classified as other borrowings in its consolidated statements of financial condition as of June 30, 2003 and accordingly, the adoption of this Statement did not have any effect on the Company's consolidated financial statements.

In January 2003, the FASB issued *FIN 46*, *Consolidation of Variable Interest Entities*, an Interpretation of ARB No. 51 (*FIN 46*). Under *FIN 46* entities that would be assessed for consolidation are typically referred to as *Special-Purposed Entities* (*SPEs*), although non-SPE-type entities may also be subject to the guidance. *FIN 46* requires a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or entitled to receive a majority of the entities residual returns, or both. *FIN 46* was effective immediately for variable interest entities created after January 31, 2003. For variable interest entities created prior to February 1, 2003, the provisions of *FIN 46* became effective July 1, 2003. On October 9, 2003 the FASB opted to defer to October 1, 2003 the effective date for variable interest entities created prior to February 1, 2003. The provisions of *FIN 46* continue to apply to variable interest entities created after January 31, 2003.

Under the provisions of *FIN 46*, effective July 1, 2003, the Company deconsolidated a limited number of vehicles, consisting of the wholly-owned Delaware statutory business trusts (*R&G Capital Trust I and II*) discussed in Note 1 on pages 64 of R&G Financial's 2002 Annual Report, which had issued trust preferred securities. As discussed above, the Company had classified its \$35 million trust preferred securities as borrowings in its consolidated statements of financial condition prior to such deconsolidation. The primary effect of deconsolidating these trusts was to change the balance sheet classification of the liabilities from guaranteed preferred beneficial interest in company junior subordinated deferrable interest debentures to long-term debt.

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The deconsolidation requirements were also applied to another wholly-owned Delaware statutory business trust (R&G Capital Trust IV) created by the Company in August 2003, which issued \$15 million in trust preferred securities in a private placement, and will be applied to another wholly-owned Delaware statutory business trust (R&G Capital Trust III) which in October 2003 issued \$100 million of trust preferred securities in a public offering. Based on interim guidance issued by the Federal Reserve Board, the deconsolidation of these vehicles pursuant to FIN 46 would not impact the Tier 1 capital treatment of the liabilities to the extent permitted under current regulations until notice is given to the contrary.

On October 31, 2003, the FASB issued an Exposure Draft of a Proposed Interpretation, Consolidation of Variable Interest Entities a modification of FIN 46 to modify and clarify certain of the provisions of FIN 46. Due to the complexity of FIN 46 and evolving interpretations, the Company continues to assess the accounting and disclosure impact of FIN 46 on all of its relationships with variable interest entities. However, based on presently available information, the implementation of FIN 46 is not expected to have a material impact on the Company s consolidated balance sheet, earnings or capital resources.

NOTE 2 - EARNINGS PER SHARE

Basic earnings per common share are computed by dividing net income (less preferred stock dividends) by the weighted average number of shares of common stock outstanding. The weighted average number of outstanding stock options granted in connection with the Company s Stock Option Plan (150,300 and 247,858 during the three months ended September 30, 2003 and 2002, respectively, and 148,764 and 317,733 during the nine month periods ended September 30, 2003 and 2002, respectively), are included in the weighted average number of shares for purposes of the diluted earnings per share computation. No other adjustments are made to the computation of basic earnings per share to arrive at diluted earnings per share.

Dividends per share on common stock declared and paid by the Company were as follows:

| Three month period ended September 30, | | Nine month period ended September 30, | |
|--|------------|---|------------|
| 2003 | 2002 | 2003 | 2002 |
| \$0.1140 | \$0.086375 | \$0.3180 | \$0.243875 |

NOTE 3 - INVESTMENT AND MORTGAGE-BACKED SECURITIES

The carrying value and estimated fair value of investment and mortgage-backed securities by category are shown below. The fair value of investment securities is based on quoted market prices and dealer quotes, except for the investment in Federal Home Loan Bank (FHLB) stock which is valued at its redemption value.

| | September 30, 2003 | December 31, 2002 |
|---|------------------------|----------------------|
| | (Unaudited) | |
| | (Dollars in thousands) | |
| Mortgage-backed securities held for trading: | | |
| GNMA certificates | \$ | \$ 9,741 |
| FHLMC certificates | 37,034 | 65,016 |
| | 37,034 | 74,757 |
| Investment securities held for trading: | | |
| Mortgage securities portfolio mutual fund | 2,589 | |
| US government securities mutual fund | 538 | |
| HLB Bonds | 480 | |
| Other | 308 | |
| | 3,915 | |

| | | |
|--|-----------------|-----------------|
| | <u>\$40,949</u> | <u>\$74,757</u> |
|--|-----------------|-----------------|

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| | September 30, 2003 | | December 31, 2002 | |
|--|--------------------|------------------|-------------------|------------------|
| | Amortized cost | Fair value | Amortized cost | Fair value |
| (Unaudited) | | | | |
| (Dollars in thousands) | | | | |
| Mortgage-backed securities available for sale: | | | | |
| Collateralized mortgage obligations (CMO): | | | | |
| Due within one year | \$ | \$ | \$ 113 | \$ 113 |
| Due from one to five years | 7,440 | 7,589 | 17,178 | 17,288 |
| Due from five to ten years | 11,278 | 11,394 | 31,571 | 32,219 |
| Due over ten years | 932,119 | 933,357 | 404,981 | 409,830 |
| | <u>950,837</u> | <u>952,340</u> | <u>453,843</u> | <u>459,450</u> |
| CMO residuals (interest only), and interest only strips (IO s) | 74,470 | 76,398 | 30,964 | 32,759 |
| FNMA certificates: | | | | |
| Due from one to five years | 71 | 73 | | |
| Due from five to ten years | 75,704 | 74,787 | 370 | 390 |
| Due over ten years | 420,570 | 434,720 | 258,805 | 269,367 |
| | <u>496,345</u> | <u>509,580</u> | <u>259,175</u> | <u>269,757</u> |
| FHLMC certificates: | | | | |
| Due within one year | 2 | 2 | 2 | 2 |
| Due from one to five years | 5 | 5 | 20 | 21 |
| Due from five to ten years | 21,581 | 21,306 | 889 | 935 |
| Due over ten years | 486,279 | 494,836 | 738,041 | 756,228 |
| | <u>507,867</u> | <u>516,149</u> | <u>738,952</u> | <u>757,186</u> |
| GNMA certificates: | | | | |
| Due from one to five years | 50 | 52 | | |
| Due from five to ten years | 13,339 | 13,727 | 16,515 | 16,759 |
| Due over ten years | 361,573 | 366,119 | 440,767 | 446,339 |
| | <u>374,962</u> | <u>379,898</u> | <u>457,282</u> | <u>463,098</u> |
| | <u>2,404,481</u> | <u>2,434,365</u> | <u>1,940,216</u> | <u>1,982,250</u> |
| Investment securities available for sale: | | | | |
| Mortgage securities portfolio mutual fund | | | 3,266 | 2,964 |
| U.S. Government and Agencies securities: | | | | |
| Due within one year | 54,104 | 54,724 | | |
| Due from one to five years | 370,789 | 372,458 | 263,632 | 267,896 |
| Due from five to ten years | 120,630 | 122,790 | 137,756 | 143,695 |
| | <u>545,523</u> | <u>549,972</u> | <u>401,388</u> | <u>411,591</u> |
| Corporate debt obligations: | | | | |
| Due within one year | 17,481 | 17,786 | 3,205 | 3,367 |
| Due from one to five years | 48,589 | 51,707 | 52,779 | 55,283 |

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| | | | | |
|---|--------------------|--------------------|--------------------|--------------------|
| Due from five to ten years | 2,463 | 2,444 | 2,979 | 2,385 |
| Due over ten years | | | 9,805 | 9,808 |
| | <u>68,533</u> | <u>71,937</u> | <u>68,768</u> | <u>70,843</u> |
| US Municipal debt obligations- Due over ten years | 12,212 | 12,170 | 4,884 | 4,879 |
| FHLB Stock | 107,157 | 107,157 | 84,337 | 84,337 |
| Other | | | 49 | 49 |
| | <u>733,425</u> | <u>741,236</u> | <u>562,692</u> | <u>574,663</u> |
| | <u>\$3,137,906</u> | <u>\$3,175,601</u> | <u>\$2,502,908</u> | <u>\$2,556,913</u> |

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| | September 30, 2003 | | December 31, 2002 | |
|---|--------------------|-----------------|-------------------|-----------------|
| | Amortized cost | Fair value | Amortized cost | Fair value |
| (Unaudited) | | | | |
| (Dollars in thousands) | | | | |
| Mortgage-backed securities held to maturity: | | | | |
| GNMA certificates: | | | | |
| Due from one to five years | \$ 805 | \$ 818 | \$ | \$ |
| Due from five to ten years | 3,451 | 3,534 | 5,457 | 5,513 |
| Due over ten years | 27,479 | 28,230 | 33,521 | 34,091 |
| | <u>31,735</u> | <u>32,582</u> | <u>38,978</u> | <u>39,604</u> |
| FNMA certificates- Due over ten years | 5,067 | 5,293 | 6,328 | 6,698 |
| | <u>87</u> | <u>85</u> | <u>102</u> | <u>102</u> |
| | <u>36,889</u> | <u>37,960</u> | <u>45,408</u> | <u>46,404</u> |
| Investment securities held to maturity: | | | | |
| United States Government and Agencies obligations: | | | | |
| Due within one year | 2,529 | 2,529 | 997 | 997 |
| Due from one to five years | | | 1,500 | 1,500 |
| | <u>2,529</u> | <u>2,529</u> | <u>2,497</u> | <u>2,497</u> |
| Puerto Rico Government and Agencies obligations: | | | | |
| Due within one year | 248 | 253 | | |
| Due from one to five years | 26,156 | 27,694 | 26,586 | 26,804 |
| Due from five to ten years | 5,398 | 5,201 | 1,000 | 1,005 |
| | <u>31,802</u> | <u>33,148</u> | <u>27,586</u> | <u>27,809</u> |
| Other - Due from one to five years | 100 | 100 | 100 | 100 |
| | <u>34,431</u> | <u>35,777</u> | <u>30,183</u> | <u>30,406</u> |
| | <u>\$71,320</u> | <u>\$73,737</u> | <u>\$75,591</u> | <u>\$76,810</u> |

In addition to the investment and mortgage-backed securities pledged on repurchase agreements and reported as pledged assets in the statement of financial condition, at September 30, 2003 the Company had investment and mortgage-backed securities pledged as collateral on repurchase agreements where the counterparties do not have the right to sell or repledge the assets as follows:

| | Carrying Amount |
|---|-----------------|
| | (Unaudited) |
| | (Dollars in |
| | thousands) |
| Mortgage-backed and investment securities available for sale, at fair value | \$ 1,114,887 |
| Mortgage-backed securities held to maturity, at amortized cost | 314 |

Table of Contents**NOTE 4 - LOANS AND ALLOWANCE FOR LOAN LOSSES**

Loans consist of the following:

| | September 30, 2003 | December 31, 2002 |
|---|------------------------|----------------------|
| | (Unaudited) | |
| | (Dollars in thousands) | |
| Real estate loans: | | |
| Residential - first mortgage | \$ 2,237,384 | \$ 1,473,051 |
| Residential - second mortgage | 34,890 | 40,429 |
| Land | 68,110 | 27,521 |
| Construction | 449,392 | 355,367 |
| Commercial | 806,292 | 633,233 |
| | 3,596,068 | 2,529,601 |
| Undisbursed portion of loans in process | (177,282) | (90,432) |
| Net deferred loan costs (fees) | 956 | (45) |
| | 3,419,742 | 2,439,124 |
| Other loans: | | |
| Commercial | 166,604 | 152,743 |
| Consumer: | | |
| Secured by deposits | 23,279 | 28,070 |
| Secured by real estate | 56,651 | 68,156 |
| Other | 123,990 | 104,715 |
| Unearned interest | (498) | (444) |
| | 370,026 | 353,240 |
| Total loans | 3,789,768 | 2,792,364 |
| Allowance for loan losses | (35,729) | (32,675) |
| | \$ 3,754,039 | \$ 2,759,689 |

The changes in the allowance for loan losses follow:

| | Nine months ended September 30, | |
|------------------------------|------------------------------------|-----------|
| | 2003 | 2002 |
| | (Unaudited) | |
| | (Dollars in thousands) | |
| Balance, beginning of period | \$ 32,675 | \$ 17,428 |
| Provision for loan losses | 12,956 | 13,520 |
| Acquired reserves | | 7,463 |
| Loans charged-off | (11,284) | (9,763) |
| Recoveries | 1,382 | 798 |
| Balance, end of period | \$ 35,729 | \$ 29,446 |



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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.

| | September 30, 2003 | December 31, 2002 |
|--|------------------------|----------------------|
| | (Unaudited) | |
| | (Dollars in thousands) | |
| Non-accruing loans: | | |
| Residential real estate (1) | \$ 60,928 | \$43,281 |
| Residential construction | 1,471 | 1,512 |
| Commercial real estate | 21,796 | 29,375 |
| Commercial business | 1,871 | 2,197 |
| Consumer unsecured | 871 | 802 |
| | <u> </u> | <u> </u> |
| Total | 86,937 | 77,167 |
| | <u> </u> | <u> </u> |
| Accruing loans greater than 90 days delinquent: | | |
| Residential real estate (1) | 45 | 104 |
| Residential construction | 168 | |
| Commercial real estate | | |
| Commercial business | 301 | 261 |
| Consumer | 352 | 667 |
| | <u> </u> | <u> </u> |
| Total accruing loans greater than 90 days delinquent | 866 | 1,032 |
| | <u> </u> | <u> </u> |
| Total non-performing loans | 87,803 | 78,199 |
| | <u> </u> | <u> </u> |
| Real estate owned (2) | 18,577 | 15,544 |
| Other repossessed assets | 191 | 292 |
| | <u> </u> | <u> </u> |
| | 18,768 | 15,836 |
| | <u> </u> | <u> </u> |
| Total non-performing assets | \$106,571 | \$94,035 |
| | <u> </u> | <u> </u> |
| Total non-performing loans as a percentage of total loans | 2.21% | 2.71% |
| | <u> </u> | <u> </u> |
| Total non-performing assets as a percentage of total assets | 1.36% | 1.50% |
| | <u> </u> | <u> </u> |
| Allowance for loan losses as a percentage of total non-performing loans | 40.69% | 41.79% |
| | <u> </u> | <u> </u> |
| Allowance for loan losses as a percentage of total loans outstanding | 0.90% | 1.13% |
| | <u> </u> | <u> </u> |
| Net charge-offs to average loans outstanding | 0.38% | 0.41% |
| | <u> </u> | <u> </u> |

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- (1) R&G Financial's historical charge-offs with respect to residential real estate loans have been low. As a result, R&G Financial's aggregate charge-offs as a percentage of total average loans outstanding amounted to 0.38% during the nine months ended September 30, 2003 and 0.41% during the year ended December 31, 2002.
- (2) Consist primarily of residential real estate foreclosed by the Company.

Table of Contents**NOTE 5 - SERVICING ASSET**

The changes in the servicing asset of the Company follows:

| | Three months period ended September 30, | | Nine months period ended September 30, | |
|--|---|------------|--|------------|
| | 2003 | 2002 | 2003 | 2002 |
| | (Unaudited) | | (Unaudited) | |
| | (Dollars in thousands) | | | |
| Balance at beginning of period | \$ 127,146 | \$ 146,199 | \$ 142,334 | \$ 105,146 |
| Rights originated | 7,227 | 6,132 | 21,310 | 19,041 |
| Crown Bank acquired | | | | 32,478 |
| Rights purchased | 242 | 12,117 | 9,752 | 22,682 |
| Scheduled amortization | (5,889) | (6,161) | (17,134) | (13,669) |
| Impairment charges: | | | | |
| Unscheduled amortization | (6,142) | (3,774) | (18,966) | (7,187) |
| Reversal (provision) of valuation reserves | 1,565 | (6,959) | (13,147) | (6,500) |
| Other adjustments | | | | (4,437) |
| Balance at end of period | \$ 124,149 | \$ 147,554 | \$ 124,149 | \$ 147,554 |

NOTE 6 - DEPOSITS

Deposits are summarized as follows:

| | September 30, 2003 | December 31, 2002 |
|---|------------------------|----------------------|
| | (Unaudited) | |
| | (Dollars in thousands) | |
| Passbook savings | \$ 348,503 | \$ 329,489 |
| NOW accounts | 120,469 | 100,031 |
| Super NOW accounts | 427,175 | 335,015 |
| Regular checking accounts (non-interest bearing) | 120,355 | 107,586 |
| Commercial checking accounts (non-interest bearing) | 284,164 | 282,769 |
| | 952,163 | 825,401 |
| Certificates of deposit: | | |
| Under \$100,000 | 646,993 | 652,065 |
| \$100,000 and over | 1,478,964 | 991,504 |
| | 2,125,957 | 1,643,569 |
| Accrued interest payable | 5,353 | 3,865 |
| | \$3,431,976 | \$2,802,324 |

Table of Contents**NOTE 7 - COMMITMENTS AND CONTINGENCIES*****Commitments to buy and sell GNMA certificates***

As of September 30, 2003, the Company had open commitments to issue GNMA certificates of approximately \$113.9 million.

Commitments to sell mortgage loans

As of September 30, 2003 the Company had commitments to sell mortgage loans to third party investors amounting to approximately \$269.4 million.

Lease commitments

The Company is obligated under several noncancelable leases for office space and equipment rentals, all of which are accounted for as operating leases. The leases expire at various dates with options for renewals.

Other

At September 30, 2003, the Company is liable under limited recourse provisions resulting from the sale of loans to several investors, principally FHLMC. The principal balance of these loans, which are serviced by the Company, amounts to approximately \$1.0 billion at September 30, 2003. At September 30, 2003, the Company has an allowance for recourse provisions of \$3.9 million. Historical losses on recourse obligations have not been significant.

In April 2002, R&G Acquisition Holdings Corporation (a wholly-owned subsidiary of R&G Financial) (RAC), a Florida corporation and the holding company of Crown Bank, formed R&G Capital Trust I. R&G Capital Trust I issued \$25.0 million of trust preferred securities in a private placement. In addition, in August 2003, RAC also formed R&G Capital Trust IV which issued \$15 million of trust preferred securities in a private placement. Subsequent to September 30, 2003, the Company formed R&G Capital Trust III, which in October 2003 issued \$100 million of trust preferred securities in a public offering (see Note 1). The Company has guaranteed certain obligations of RAC to R&G Capital Trust I and IV, and has guaranteed certain obligations of R&G Capital Trust III.

During the second quarter of 2003, the US Internal Revenue Service (IRS) began an income tax examination of the income tax returns for the year 2001 for the predecessor thrift holding company of Crown Bank prior to its acquisition by the Company in June 2002. Management believes that this examination should not result in any significant adverse effect on the Company's financial condition or results of operations.

NOTE 8 - SUPPLEMENTAL INCOME STATEMENT INFORMATION

Employee costs and other administrative and general expenses are shown in the Consolidated Statements of Income net of direct loan origination costs. Direct loan origination costs are capitalized as part of the carrying cost of mortgage loans and are offset against mortgage loan sales and fees when the loans are sold, or amortized as a yield adjustment to interest income on loans held for investment. Total employee costs and other expenses before capitalization follows:

| | Three month period ended September 30, | | Nine month period ended September 30, | |
|---|---|----------|--|----------|
| | 2003 | 2002 | 2003 | 2002 |
| | (Unaudited) | | (Unaudited) | |
| | (Dollars in thousands) | | | |
| Employee costs | \$24,575 | \$19,524 | \$70,879 | \$51,940 |
| Other administrative and general expenses | \$28,912 | \$29,083 | \$105,132 | \$65,530 |

Table of Contents**NOTE 9 - INDUSTRY SEGMENTS**

The following summarized information presents the results of the Company's operations for its traditional banking and mortgage banking activities:

| (Dollars in thousands) | | | | | | | | |
|--|----------|---------------------|-----------|--------------------|----------|---------------------|-----------|--------------------|
| Three month period ended September 30, | | | | | | | | |
| 2003 | | | | 2002 | | | | |
| (Unaudited) | | | | | | | | |
| | Banking | Mortgage Banking | Other (1) | Segments Totals | Banking | Mortgage Banking | Other (1) | Segments Totals |
| Revenues | \$56,578 | \$34,747 | \$4,484 | \$95,809 | \$39,991 | \$35,733 | \$2,310 | \$78,034 |
| Non-interest expenses | 24,174 | 23,961 | 1,410 | 49,545 | 18,924 | 26,333 | 984 | 46,241 |
| Income before income taxes | \$32,404 | \$10,786 | \$3,074 | \$46,264 | \$21,067 | \$9,400 | \$1,326 | \$31,793 |

| Nine month period ended September 30, | | | | | | | | |
|---------------------------------------|-----------|---------------------|-----------|--------------------|-----------|---------------------|-----------|--------------------|
| 2003 | | | | 2002 | | | | |
| (Unaudited) | | | | | | | | |
| | Banking | Mortgage Banking | Other (1) | Segments Totals | Banking | Mortgage Banking | Other (1) | Segments Totals |
| Revenues | \$144,367 | \$136,106 | \$11,682 | \$292,155 | \$103,809 | \$89,067 | \$6,131 | \$199,007 |
| Non-interest expenses | 67,879 | 94,153 | 3,764 | 165,796 | 49,378 | 58,996 | 2,466 | 110,840 |
| Income before income taxes | \$76,488 | \$41,953 | \$7,918 | \$126,359 | \$54,431 | \$30,071 | \$3,665 | \$88,167 |

(1) Comprised of broker-dealer and insurance agency operations.

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The following is a reconciliation of reportable segment revenues and income before income taxes to the Company's consolidated amounts (unaudited):

| | Three month period ended September 30, | | Nine month period ended September 30, | |
|--|---|-----------------|--|------------------|
| | 2003 | 2002 | 2003 | 2002 |
| (Dollars in thousands) | | | | |
| Revenues: | | | | |
| Total revenues for reportable segments | \$95,809 | \$78,034 | \$292,155 | \$199,007 |
| Elimination of intersegment revenues | (2,029) | (1,248) | (4,012) | (3,949) |
| Corporate revenues | 368 | 666 | 1,283 | 1,915 |
| Total consolidated revenues | \$94,148 | \$77,452 | \$289,426 | \$196,973 |
| Income before income taxes: | | | | |
| Total income before income taxes for reportable segments | \$46,264 | \$31,793 | \$126,359 | \$88,167 |
| Elimination of intersegment profits | (767) | (171) | (644) | (388) |
| Unallocated corporate income | 147 | 445 | 529 | 1,320 |
| Income before income taxes, consolidated | \$45,644 | \$32,067 | \$126,244 | \$89,099 |

Total assets of the Company among its industry segments and a reconciliation of reportable segment assets to the Company's consolidated total assets as of September 30, 2003 and December 31, 2002 follows:

| | September 30, 2003 | December 31, 2002 |
|---|-----------------------|----------------------|
| (Unaudited) | | |
| (Dollars in thousands) | | |
| Assets: | | |
| Banking | \$6,995,792 | \$5,453,321 |
| Mortgage Banking | 885,387 | 908,660 |
| Other | 137,988 | 111,005 |
| Total assets for reportable segments | 8,019,167 | 6,472,986 |
| Parent company assets | 50,892 | 62,971 |
| Elimination of intersegment balances | (235,058) | (258,711) |
| Consolidated total assets | \$7,835,001 | \$6,277,246 |

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Item 2: Management's Discussion and Analysis

Cautionary Statement Regarding Forward-Looking Statements

A number of the presentations and disclosures in this Form 10-Q, including, without limitation, statements regarding the level of allowance for loan losses, the rate of delinquencies and amounts of charge-offs, and the rates of loan growth, and any statements preceded by, followed by or which include the words may, could, should, will, would, hope, might, believe, expect, anticipate, estimate, intend, expressions constitute forward-looking statements. These forward-looking statements, implicitly and explicitly, include the assumptions underlying the statements and other information with respect to our beliefs, plans, objectives, goals, expectations, anticipations, estimates, intentions, financial condition, results of operations, future performance and business, including our expectations and estimates with respect to our revenues, expenses, earnings, return on equity, return on assets, efficiency ratio, asset quality and other financial data and capital and performance ratios.

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

the strength of the United States economy in general and the strength of the regional and local economies within our markets;

adverse changes in the local real estate market, as most of the Company's loans are concentrated in Puerto Rico and Florida and a substantial portion of these loans have real estate as collateral;

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

inflation, interest rate, market and monetary fluctuations;

adverse changes in asset quality and the resulting credit risk-related losses and expenses;

our timely development of new products and services in a changing environment, including the features, pricing and quality of our products and services compared to the products and services of our competitors;

the willingness of users to substitute competitors' products and services for our products and services;

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

technological changes;

changes in consumer spending and savings habits; and

regulatory or judicial proceedings.

If one or more of the factors affecting our forward-looking information and statements proves incorrect, then our actual results, performance or achievements could differ materially from those expressed in, or implied by, forward-looking information and statements contained in this Form 10-Q. Therefore, we caution you not to place undue reliance on our forward-looking information and statements.

We do not intend to update our forward-looking information and statements, whether written or oral, to reflect change. All forward-looking statements attributable to us are expressly qualified by these cautionary statements.

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General

R&G Financial Corporation (the Company) is a Puerto Rico chartered diversified financial holding company that, through its wholly-owned subsidiaries, is engaged in banking, mortgage banking, securities and insurance brokerage activities. The Company, currently in its 31st year of operations, operates 31 bank branches mainly located in the northeastern section of Puerto Rico, 15 bank branches in the Orlando and Tampa/St. Petersburg Florida markets, 6 mortgage and 6 commercial lending offices in the continental United States, and 44 mortgage offices in Puerto Rico, including 24 facilities located within Premier Bank's branches.

The Company is engaged in providing a full range of banking services through R-G Premier Bank of Puerto Rico (Premier Bank), its Puerto Rico commercial bank, and R-G Crown Bank (formerly Crown Bank, F.S.B.) (Crown Bank), its Florida-based federal savings bank acquired in June 2002. Banking activities include commercial banking services, corporate and construction lending, consumer lending and credit cards, offering a variety of deposit products and, to a lesser extent, trust and investment services through private banking.

The Company is also engaged in mortgage banking activities. Mortgage banking activities are conducted through R&G Mortgage Corp., Puerto Rico's second largest mortgage banker, The Mortgage Store of Puerto Rico, Inc., also a Puerto Rico mortgage company, and Continental Capital Corporation, a New York mortgage banking subsidiary of Crown Bank with offices in New York, North Carolina and Florida. Mortgage banking activities include the origination, purchase, sale and servicing of mortgage loans on single-family residences, the issuance and sale of various types of mortgage-backed securities, the holding of mortgage loans, mortgage-backed securities and other investment securities for sale or investment, and the purchase and sale of servicing rights associated with such mortgage loans and, to a lesser extent, the origination of construction loans and mortgage loans secured by income producing real estate and land (the mortgage banking business).

The Company is also engaged in insurance brokerage through Home & Property Insurance Corp., a Puerto Rico insurance agency, and securities brokerage through R-G Investments Corporation, a Puerto Rico licensed broker-dealer.

The Company is the second largest mortgage loans originator and servicer of mortgage loans on single family residences in Puerto Rico. R&G Financial's mortgage servicing portfolio amounted to approximately \$10.9 billion as of September 30, 2003, compared to \$11.3 billion as of the same date a year ago, a decrease of 2.9%. R&G Financial's servicing portfolio during such period was affected by a high level of prepayments due to lower interest rates. Nonetheless, R&G Financial's strategy is to increase the size of its mortgage servicing portfolio by relying principally on internal loan originations.

As part of its strategy to maximize net interest income, R&G Financial maintains a substantial portfolio of mortgage-backed and investment securities. At September 30, 2003, the Company held securities available for sale with a fair market value of \$3.2 billion, which included \$2.4 billion of mortgage-backed securities, of which \$363.0 million consisted of Puerto Rico GNMA securities, the interest on which is tax-exempt to the Company. These securities are generally held by the Company for longer periods prior to sale in order to maximize the tax-exempt interest received thereon. R&G Financial's lower effective tax rate compared to the maximum statutory rate reflect the exemption under Puerto Rico law of the net interest income derived from such securities. In addition, the Company invests in certain U.S. agency securities that are exempt from Puerto Rico taxation and are not subject to federal income taxation. Finally, through an international banking subsidiary, the Company may invest in various U.S. securities, the income on which is exempt from Puerto Rico income taxation and is also not subject to federal income taxation.

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A substantial portion of R&G Financial's total mortgage loan originations has been comprised of refinance loans. R&G Financial's future results could be adversely affected by a significant increase in mortgage interest rates that reduces refinancing activity. However, the Company believes that refinancing activity is less sensitive to interest rate changes in Puerto Rico than in the mainland United States because a significant amount of refinance loans are made for debt consolidation purposes.

R&G Financial customarily sells or securitizes into mortgage-backed securities substantially all the loans it originates, except for certain non-conforming conventional mortgage loans and certain consumer, construction, land, and commercial loans which are held for investment and classified as loans receivable.

Financial Condition

At September 30, 2003, total assets amounted to \$7.8 billion, as compared to \$6.3 billion at December 31, 2002. The \$1.56 billion or 24.8% increase in total assets since the beginning of the year was primarily the result of a \$618.9 million or 24.2% increase in mortgage-backed and investment securities available for sale, and a \$994.4 million or 36.0% increase in loans receivable, net, due to record loan production during the nine month period ended September 30, 2003 of \$3.4 billion, a 64.1% increase when compared to the corresponding period in 2002.

At September 30, 2003, R&G Financial had \$3.5 billion of borrowings (consisting of securities sold under agreements to repurchase, notes payable, FHLB advances and other borrowings), compared to \$2.7 billion at December 31, 2002. R&G Financial utilized repurchase agreements and deposits to fund its growth during the period; total deposits grew 22.5% from \$2.8 billion at December 31, 2002 to \$3.4 billion at September 30, 2003, whereas repurchase agreements increased by \$622.6 million or 41.8%.

At September 30, 2003, R&G Financial's allowance for loan losses totaled \$35.7 million, which represented a \$3.1 million or 9.3% increase from the level maintained at December 31, 2002. At September 30, 2003, R&G Financial's allowance represented approximately 0.90% of the total loan portfolio and 40.69% of total non-performing loans. However, excluding R&G Financial's residential loan portfolio, which has minimal charge-off experience, the allowance for loan losses to total loans and to total non-performing loans would have been 2.11% and 133.17%, respectively, at September 30, 2003, compared to 2.39% and 98.12% at December 31, 2002.

Non-performing loans amounted to \$87.8 million at September 30, 2003, an increase of \$9.6 million when compared to \$78.2 million at December 31, 2002. The increase is primarily related to a \$17.6 million increase in delinquent residential real estate loans over 90 days past due. At September 30, 2003, \$61.0 million or 69.4% of non-performing loans consisted of residential mortgage loans in which R&G Financial has historically experienced a low level of loan charge-offs. As a result, R&G Financial's aggregate charge-offs as a percentage of total average loans outstanding amounted to 0.38% during the nine months ended September 30, 2003 and 0.41% during the year ended December 31, 2002. Although loan delinquencies have historically been higher in Puerto Rico than in the United States, actual foreclosures and the resulting loan charge-offs have historically been lower than in the United States.

Real estate owned properties of the Company also increased 19.5% from \$15.5 million at December 31, 2002 to \$18.6 million at September 30, 2003. The increase is mostly related to residential real estate loans foreclosed by the Company during the period.

Stockholders' equity increased from \$662.2 million at December 31, 2002 to \$725.1 million at September 30, 2003. The \$62.9 million or 9.5% increase was due primarily to the net income recognized during the period, net of dividends paid.

Table of Contents***Results of Operations***

During the three and nine months ended September 30, 2003, R&G Financial reported net income of \$34.3 million and \$94.9 million, or \$0.89 and \$2.43 of earnings per diluted share, respectively, compared to net income of \$25.0 million and \$69.2 million or \$0.63 and \$1.81 of earnings per diluted share for the comparative periods in 2002. Such results reflect an increase in earnings per diluted share of 41.3% and 34.3% for the three and nine months periods ending September 30, 2003 over the comparable periods in 2002.

Net interest income increased by \$25.2 million or 23.0% during the nine month period ended September 30, 2003 to \$134.5 million, due to a \$1.6 billion increase in the average balance of interest-earning assets, partially offset by a 21 basis point decrease in the net interest margin from 2.96% to 2.75%. Contributing to the increase in average earning assets were the assets of Crown Bank, the Company's Florida-based banking subsidiary acquired in June 2002. The decrease in the Company's net interest margin during the period is due primarily to the repricing at lower rates of interest of a portion of the Company's earning assets as a result of an increase in prepayments in the Company's loans and investment securities portfolio caused by lower interest rates.

The provision for loan losses amounted to \$13.0 million during the nine months ended September 30, 2003, a 4.2% decrease over the prior comparable period, reflecting the fact that approximately 69.4% of total non-performing loans as of September 30, 2003 consist of residential mortgage loans, in which the Company's historical charge-off experience has been very low.

R&G Financial also experienced an increase in non-interest income during the nine months ended September 30, 2003 over the comparable period. Net gain on sale of loans increased by \$50.1 million or 86.7% over the prior comparable period, as a result of record loan production and sales. Total loan production during the nine months ended September 30, 2003 amounted to \$3.4 billion compared to \$2.1 billion during the prior comparable period. Loan administration and servicing fees also increased by \$8.2 million or 26.5% over the comparable periods, due to an increase in the average outstanding loan servicing portfolio as a result of the \$2.6 billion portfolio acquired in connection with the acquisition of Crown Bank in June 2002. Other fee income also increased by \$8.4 million or 67.5%. Such increase reflects the added contributions made by the Company's insurance agency and broker-dealer subsidiaries, as well as the fee income generated through the operations of Crown Bank.

Net interest income increased by \$6.4 million or 15.6% to \$47.7 million during the quarter ended September 30, 2003 over the prior comparable period, due to a 1.4 billion increase in the average balance of interest-earning assets, partially offset by a 24 basis points decrease in the net interest margin from 2.96% to 2.72%. Net gain on sale of loans increased 23.7% to \$30.2 million during the three month ended September 30, 2003, together with a \$1.4 million or 12.5% increase in loan administration and servicing fees and a \$3.4 million or 75.0% increase in other fee income.

Total expenses increased by \$55.3 million or 51.3% during the nine months ended September 30, 2003 over the comparable 2002 period, partially due to a \$12.9 million or 40.3% increase in employee compensation and benefits associated with general growth in Company operations, including expenses associated with the operations of Crown Bank. The increase in total expenses was also due to a \$38.2 million or 61.9% increase in other administrative and general expenses, which includes an \$18.4 million increase in expenses associated with impairment charges (including unscheduled amortization) of the Company's servicing asset, as well as increased expenses related to the operations of Crown Bank.

Increased unscheduled amortization amounts are a result of higher prepayment speeds in the Company's servicing portfolio. The increases in prepayments reflect decreases in interest rates for new mortgage loans, which reached historically low levels during the second quarter of 2003. During the third quarter of 2003, however, interest rates for mortgage loans increased from the last quarter, and prepayment speeds have declined from the last quarter as a result. The value of the Company's servicing portfolio is expected to increase if rates remain at the current or higher levels due to lower prepayment speeds. Unscheduled amortization amounts are expected to continue, however, although at a lower pace, until prepayment speeds further decline.

Total expenses increased by \$3.1 million or 6.9% during the three month period ended September 30, 2003 over the prior comparable period, due to a \$2.8 million or 22.7% increase in employee compensation and benefits, and a \$1.4 million or 26.3% increase in occupancy expenses, partially offset

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by a \$1.1 million or 3.9% decrease in other general and administrative expenses, which includes a \$6.2 million decrease in expenses associated with impairment charges of the Company's servicing asset.

Interest Rate Risk Management

The following table summarizes the anticipated maturities or repricing of R&G Financial's interest-earning assets and interest-bearing liabilities as of September 30, 2003, based on the information and assumptions set forth in the notes below. For purposes of this presentation, the interest earning components of loans held for sale and mortgage-backed securities held in connection with the Company's mortgage banking business as well as all securities held for trading, are assumed to mature within one year. In addition, investments held by the Company which have call features are presented according to their contractual maturity date.

| (Dollars in Thousands) | Within Three Months | Four to Twelve Months | More Than One Year to Three Years | More Than Three Years to Five Years | Over Five Years | Total |
|--|---------------------------|-----------------------------|---|---|---------------------|---------------------|
| Interest-earning assets(1): | | | | | | |
| Loans receivable | \$ 1,075,306 | \$ 441,078 | \$ 690,636 | \$ 423,844 | \$ 1,158,446 | \$ 3,789,310 |
| Mortgage loans held for sale | 55,518 | 27,184 | 62,437 | 50,413 | 44,983 | 240,535 |
| Mortgage-backed securities(2)(3) | 152,097 | 433,091 | 510,370 | 294,201 | 1,108,940 | 2,498,699 |
| Investment Securities(3) | 190,226 | 189,589 | 191,709 | 195,381 | 22,456 | 789,361 |
| Other interest-earning assets(4) | 95,004 | | | | | 95,004 |
| Total | \$ 1,568,151 | \$ 1,090,942 | \$ 1,455,152 | \$ 963,839 | \$ 2,334,825 | \$ 7,412,909 |
| Interest bearing liabilities: | | | | | | |
| Deposits (5) | | | | | | |
| NOW and Super NOW accounts | \$ 27,381 | \$ 76,669 | \$ 84,282 | \$ 68,268 | \$ 291,044 | \$ 547,644 |
| Passbook savings accounts | 8,712 | 25,266 | 62,905 | 50,324 | 201,296 | 348,503 |
| Regular and commercial checking | 20,226 | 56,632 | 62,256 | 50,427 | 214,977 | 404,518 |
| Certificates of deposit | 246,064 | 742,110 | 633,675 | 502,215 | 1,893 | 2,125,957 |
| FHLB advances | 281,125 | | 494,600 | 183,000 | 140,000 | 1,098,725 |
| Securities sold under agreements to repurchase (6) | 932,849 | 449,462 | 501,871 | 125,000 | 138,000 | 2,147,182 |
| Other borrowings(7) | 64,904 | 137,468 | | | | 202,372 |
| Total | 1,581,261 | 1,487,607 | 1,839,589 | 979,234 | 987,210 | 6,874,901 |
| Effect of hedging instruments | 170,000 | | (65,000) | (25,000) | (80,000) | |
| Excess (deficiency) of interest-earning assets over interest-bearing liabilities | \$ 156,890 | (\$ 396,665) | (\$ 449,437) | (\$ 40,395) | \$ 1,267,615 | \$ 538,008 |
| Cumulative excess (deficiency) of interest-earning assets over interest-bearing liabilities | \$ 156,890 | (\$ 239,775) | (\$ 689,212) | (\$ 729,607) | \$ 538,008 | |
| Cumulative excess (deficiency) of interest-earning assets over interest-bearing liabilities as a percent of total | 2.00% | -3.06% | -8.80% | -9.31% | 6.87% | |

assets



(footnotes on following page)

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- (1) Adjustable-rate loans are included in the period in which interest rates are next scheduled to adjust rather than in the period in which they are due, and fixed-rate loans are included in the periods in which they are scheduled to be repaid, based on scheduled amortization, in each case as adjusted to take into account estimated prepayments.
- (2) Reflects estimated prepayments in the current interest rate environment.
- (3) Includes securities held for trading, available for sale and held to maturity.
- (4) Includes securities purchased under agreement to resell, time deposits with other banks and federal funds sold.
- (5) Does not include non-interest-bearing deposit accounts.
- (6) Includes federal funds purchased, if any.
- (7) Comprised of warehousing lines, notes payable and other borrowings.

As of September 30, 2003, the Company had a one year negative gap of approximately \$239.8 million, which constituted 3.1% of total assets at such date, compared to a positive gap of approximately \$498.1 million or 7.9% of total assets at December 31, 2002. R&G Financial had a positive gap within one year until June 30, 2003, due primarily to an increasing amount of adjustable rate loans resulting from greater emphasis in commercial and construction lending as well as to the extension during 2001 and 2002 of the maturity dates of certain borrowings of the Company into longer-term maturities at very attractive rates, taking advantage of consecutive reductions in interest rates during such years. Even though the emphasis in commercial lending continues, R&G Financial's one year negative gap as of September 30, 2003 is due to an increase in the amount of prepayments on its investments securities portfolio with call options, as a result of a relatively low interest rate environment. In addition, in light of the recent steepening of the yield curve, the Company opted to fund a larger proportion of its growth during the quarter through shorter term funding sources in an attempt to maximize its net interest income. Nonetheless, management continues the active management of its gap position in an attempt to maintain a positive gap. The Company estimates that as of September 30, 2003, close to 44.7% of all borrowings of the Company had maturity dates longer than one year.

While the above table presents the Company's loans receivable portfolio held for investment purposes according to its maturity date, from time to time the Company may negotiate special transactions with FHLMC and/or FNMA or other third party investors for the sale of such loans. There can be no assurance, however, that the Company will be successful in consummating any such transactions.

The following table presents for the periods indicated R&G Financial's total dollar amount of interest from average interest-earning assets and the resultant yields, as well as the interest expense on average interest-bearing liabilities expressed both in dollars and rates, and the net interest margin. The table does not reflect any effect of income taxes. All average balances are based on the average of month-end balances for non-banking subsidiaries and average daily balances for banking subsidiaries in each case during the periods presented.

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| (Dollars in thousands) | For the three month period ended September 30, 2003 | | | 2002 | | |
|---|--|-----------------|-----------------|--------------------|-----------------|-----------------|
| | Average Balance | Interest | Yield / Rate | Average Balance | Interest | Yield / Rate |
| Interest-Earning Assets: | | | | | | |
| Cash and cash equivalents(1) | \$ 145,879 | \$ 510 | 1.40% | \$ 164,721 | \$ 306 | 0.74% |
| Investment securities held for trading | 4,998 | 24 | 1.92% | | | |
| Investment securities available for sale | 587,195 | 5,836 | 3.98% | 586,240 | 8,029 | 5.48% |
| Investment securities held to maturity | 31,549 | 374 | 4.74% | 27,414 | 369 | 5.38% |
| Mortgage-backed securities held for trading | 49,189 | 800 | 6.51% | 77,719 | 1,106 | 5.69% |
| Mortgage-backed securities available for sale | 2,248,109 | 26,478 | 4.71% | 1,795,230 | 27,547 | 6.14% |
| Mortgage-backed securities held to maturity | 38,527 | 540 | 5.61% | 48,520 | 693 | 5.71% |
| Loans receivable, net (2) | 3,808,755 | 59,528 | 6.25% | 2,784,689 | 50,086 | 7.19% |
| FHLB Stock | 103,460 | 1,257 | 4.86% | 93,066 | 776 | 3.34% |
| Total interest-earning assets | 7,017,661 | \$95,347 | 5.43% | 5,577,599 | \$88,912 | 6.38% |
| Non-interest-earning assets | 527,905 | | | 203,668 | | |
| Total assets | \$7,545,566 | | | \$5,781,267 | | |
| Interest-Bearing Liabilities: | | | | | | |
| Deposits | \$3,414,109 | \$23,362 | 2.74% | \$2,698,319 | \$23,826 | 3.53% |
| Securities sold under agreements to repurchase (3) | 1,931,273 | 12,144 | 2.52% | 1,376,646 | 12,708 | 3.69% |
| Notes payable | 224,238 | 1,519 | 2.71% | 232,472 | 1,795 | 3.09% |
| Other borrowings(4) | 1,034,100 | 10,579 | 4.09% | 827,888 | 9,273 | 4.48% |
| Total interest-bearing liabilities | 6,603,720 | \$47,604 | 2.88% | 5,135,325 | \$47,602 | 3.71% |
| Non-interest-bearing liabilities | 228,914 | | | 40,993 | | |
| Total liabilities | 6,832,634 | | | 5,176,318 | | |
| Stockholders' equity | 712,932 | | | 604,949 | | |
| Total liabilities and stockholders' equity | \$7,545,566 | | | \$5,781,267 | | |
| Net interest income; interest rate spread (5) | | \$47,743 | 2.55% | | \$41,310 | 2.67% |
| Net interest margin | | | 2.72% | | | 2.96% |
| Average interest-earning assets to average interest-bearing liabilities | | | 106.27% | | | 108.61% |

(footnotes on page 27)

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| (Dollars in thousands) | For the nine month period ended September 30, 2003 | | | 2002 | | |
|---|---|------------------|-----------------|--------------------|------------------|-----------------|
| | Average Balance | Interest | Yield / Rate | Average Balance | Interest | Yield / Rate |
| Interest-Earning Assets: | | | | | | |
| Cash and cash equivalents(1) | \$ 123,614 | \$ 1,093 | 1.18% | \$ 91,933 | \$ 902 | 1.31% |
| Investment securities held for trading | 2,117 | 24 | 1.51% | | | |
| Investment securities available for sale | 581,096 | 18,746 | 4.30% | 563,497 | 23,950 | 5.67% |
| Investment securities held to maturity | 30,798 | 1,142 | 4.94% | 25,093 | 1,020 | 5.42% |
| Mortgage-backed securities held for trading | 53,833 | 2,731 | 6.76% | 84,241 | 3,480 | 5.51% |
| Mortgage-backed securities available for sale | 2,135,204 | 80,559 | 5.03% | 1,677,697 | 77,901 | 6.19% |
| Mortgage-backed securities held to maturity | 41,731 | 1,788 | 5.71% | 49,982 | 2,183 | 5.82% |
| Loans receivable, net (2) | 3,444,204 | 166,490 | 6.45% | 2,354,631 | 127,569 | 7.22% |
| FHLB Stock | 98,917 | 3,588 | 4.84% | 79,151 | 2,241 | 3.77% |
| Total interest-earning assets | 6,511,514 | \$276,161 | 5.65% | 4,926,225 | \$239,246 | 6.48% |
| Non-interest-earning assets | 553,114 | | | 338,364 | | |
| Total assets | \$7,064,628 | | | \$5,264,589 | | |
| Interest-Bearing Liabilities: | | | | | | |
| Deposits | \$3,129,486 | \$ 68,023 | 2.90% | \$2,340,924 | \$ 65,416 | 3.73% |
| Securities sold under agreements to repurchase (3) | 1,801,577 | 37,729 | 2.79% | 1,399,763 | 37,764 | 3.60% |
| Notes payable | 228,706 | 5,528 | 3.22% | 252,815 | 5,152 | 2.72% |
| Other borrowings(4) | 1,008,906 | 30,348 | 4.01% | 643,326 | 21,550 | 4.47% |
| Total interest-bearing liabilities | 6,168,675 | \$141,628 | 3.06% | 4,636,828 | \$129,882 | 3.73% |
| Non-interest-bearing liabilities | 203,559 | | | 112,911 | | |
| Total liabilities | 6,372,234 | | | 4,749,739 | | |
| Stockholders equity | 692,394 | | | 514,850 | | |
| Total liabilities and stockholders equity | \$7,064,628 | | | \$5,264,589 | | |
| Net interest income; interest rate spread (5) | | \$ 134,533 | 2.59% | | \$ 109,364 | 2.75% |
| Net interest margin | | | 2.75% | | | 2.96% |
| Average interest-earning assets to average interest-bearing liabilities | | | 105.56% | | | 106.24% |

(footnotes on following page)

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- (1) Comprised of cash and due from banks, securities purchased under agreements to resell, time deposits with other banks and other short term investments.
- (2) Includes mortgage loans held for sale and non-accrual loans.
- (3) Includes federal funds purchased, if any.
- (4) Comprised of long-term debt, advances from the FHLB and other borrowings.
- (5) Interest rate spread represents the difference between R&G Financial's weighted average yield on interest-earning assets and the weighted average rate on interest-bearing liabilities. Net interest margin represents net interest income as a percent of average interest-earning assets.

Mortgage Loan Servicing

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

| | At or for the nine month period ended September 30, | |
|---|--|----------------------|
| | 2003 | 2002 |
| (Dollars in thousands) | | |
| Composition of Servicing Portfolio at period end: | | |
| GNMA | \$ 2,385,047 | \$ 2,721,221 |
| FNMA/FHLMC | 5,147,685 | 5,926,375 |
| Other mortgage loans (4) | 3,391,531 | 2,602,507 |
| Total servicing portfolio (4) | <u>\$ 10,924,263</u> | <u>\$ 11,250,103</u> |
| Activity in the Servicing Portfolio: | | |
| Beginning servicing portfolio | \$ 10,991,945 | \$ 7,224,571 |
| Add: Loan originations and purchases | 2,216,772 | 1,529,819 |
| Servicing of portfolio loans acquired (3) | 1,007,374 | 4,168,844 |
| Less: Sale of servicing rights (1) | (209,560) | (176,644) |
| Run-offs (2) | (3,082,268) | (1,496,487) |
| Ending servicing portfolio (4) | <u>\$ 10,924,263</u> | <u>\$ 11,250,103</u> |
| Number of loans serviced | 150,159 | 162,823 |
| Average loan size | \$ 73 | \$ 69 |
| Average servicing fee rate | 0.49% | 0.51% |

- (1) Corresponds to loans sold, servicing released, by Continental Capital.

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- (2) Run-off refers to regular amortization of loans, prepayments and foreclosures.
- (3) Includes \$2.6 billion in June 2002 acquired in connection with the acquisition of Crown Bank.
- (4) At the dates shown, included \$1.8 billion and \$981.1 million, respectively, serviced for Premier Bank, which constituted 16.3% and 8.7% of the total servicing portfolio, and \$120.6 million and \$120.8 million, respectively, serviced for Crown Bank, which constituted 1.1% and 1.1%, respectively, of the total servicing portfolio at such dates.

Substantially all of the mortgage loans in R&G Financial's servicing portfolio are secured by single (one-to-four) family residences secured by real estate located in Puerto Rico. At September 30, 2003, approximately 29.6% of the Company's mortgage servicing portfolio was related to mortgages secured by real property located outside Puerto Rico.

The Company reduces the sensitivity of its servicing income to increases in prepayment rates through a strong retail origination network that has increased or maintained the size of R&G Financial's servicing portfolio even during periods of high prepayments. In addition, a substantial portion of the Company's servicing portfolio consists of tax-exempt FHA/VA mortgage loans which carry lower interest rates than those on conventional loans, which tends to reduce risks related to R&G Financial's servicing portfolio. During the nine month periods ended September 30, 2003 and 2002, the Company recognized \$19.0 million and \$7.2 million, respectively, of unscheduled amortization on mortgage servicing rights.

Liquidity and Capital Resources

Liquidity - Liquidity refers to the Company's ability to generate sufficient cash to meet the funding needs of current loan demand, savings deposit withdrawals, principal and interest payments with respect to outstanding borrowings and to pay operating expenses. It is management's policy to maintain greater liquidity than required in order to be in a position to fund loan purchases and originations, to meet withdrawals from deposit accounts, to make principal and interest payments with respect to outstanding borrowings and to make investments that take advantage of interest rate spreads. The Company monitors its liquidity in accordance with guidelines established by the Company and applicable regulatory requirements. The Company's need for liquidity is affected by loan demand, net changes in deposit levels and the scheduled maturities of its borrowings. The Company can minimize the cash required during the times of heavy loan demand by modifying its credit policies or reducing its marketing efforts. Liquidity demand caused by net reductions in deposits are usually caused by factors over which the Company has limited control. The Company derives its liquidity from both its assets and liabilities. Liquidity is derived from assets by receipt of interest and principal payments and prepayments, by the ability to sell assets at market prices and by utilizing unpledged assets as collateral for borrowings. Liquidity is derived from liabilities by maintaining a variety of funding sources, including deposits, advances from the FHLB of New York and Atlanta (the FHLB) and other short and long-term borrowings.

The Company's liquidity management is both a daily and long-term function of funds management. Liquid assets are generally invested in short-term investments such as securities purchased under agreements to resell, federal funds sold and certificates of deposit in other financial institutions. If the Company requires funds beyond its ability to generate them internally, various forms of both short and long-term borrowings provide an additional source of funds. At September 30, 2003, the Company had \$143.9 million in borrowing capacity under unused warehousing and other lines of credit and \$1.0 billion in borrowings capacity under unused lines of credit with the FHLB.

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At September 30, 2003, the Company had outstanding commitments to originate and/or purchase mortgage and non-mortgage loans of \$596.5 million (including unused lines of credit). Certificates of deposit which are scheduled to mature within one year totaled \$978.7 million at September 30, 2003, and borrowings that are scheduled to mature within the same period amounted to \$1.9 billion. The Company anticipates that it will have sufficient funds available to meet its current loan commitments.

Capital Resources - 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 will increase the minimum Tier 1 leverage ratio for such other banks from 4.0% to 5.0% or more. Under the FDIC's regulations, the highest-rated banks are those that the FDIC determines are not anticipating or experiencing significant growth and have well diversified risk, including no undue interest rate risk exposure, excellent asset quality, high liquidity, good earnings and, in general, 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 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 1 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 September 30, 2003, Premier Bank met each of its capital requirements, with Tier 1 leverage capital, Tier 1 risk-based capital and total risk-based capital ratios of 6.52%, 11.49% and 12.43%, respectively. At September 30, 2003 Crown Bank also met each of its capital requirements, with Tier 1 leverage capital, Tier 1 risk-based capital and total risk-based capital ratios of 6.57%, 9.99% and 10.66%, respectively. Thus, at September 30, 2003 both Premier Bank and Crown Bank were well capitalized institutions under the capital adequacy regulatory guidelines.

In addition, the Federal Reserve Board has promulgated capital adequacy guidelines for bank holding companies which are substantially similar to those adopted by FDIC regarding state-chartered banks, as described above. R&G Financial is currently in compliance with such regulatory capital requirements.

Inflation and Changing Prices

The unaudited consolidated financial statements and related data presented herein have been prepared in accordance with generally accepted accounting principles, which require the measurement of financial position and operating results in terms of historical dollars (except with respect to securities which are carried at market value), without considering changes in the relative purchasing power of money over time due to inflation. Unlike most industrial companies, substantially all of the assets and liabilities of the Company are monetary in nature. As a result, interest rates have a more significant impact on the Company's performance than the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or in the same magnitude as the prices of goods and services.

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Item 3: Quantitative and Qualitative Disclosures about Market Risk

Quantitative and qualitative disclosures about market risks at December 31, 2002 are presented in Item 7A of the Company's Annual report on Form 10-K. Information at September 30, 2003 is presented on page 23 of this Report. Management believes there have been no material changes in the Company's market risk since December 31, 2002.

Item 4: Controls and Procedures

As of the end of the period covered by this report, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer along with the Company's Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to the Securities Exchange Act of 1934 (Exchange Act) Rule 13a-15(b). Based upon that evaluation, the Company's Chief Executive Officer along with the Company's Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective in timely alerting them to material information relating to the Company (including its consolidated subsidiaries) required to be included in the Company's periodic Securities and Exchange Commission (SEC) filings. There has not been any change in the Company's internal control over financial reporting that occurred during the Company's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Disclosure controls and procedures are Company controls and other procedures that are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Table of Contents**PART II - OTHER INFORMATION****Item 1:** Legal Proceedings

The Registrant is involved in routine legal proceedings occurring in the ordinary course of business which, in the aggregate, are believed by management to be immaterial to the financial condition and results of operations of the Registrant.

Item 2: Changes in Securities

Not applicable

Item 3: Defaults Upon Senior Securities

Not applicable

Item 4: Submission of Matters to a Vote of Security Holders

Not applicable

Item 5: Other Information

Not applicable.

Item 6: Exhibits and Reports on Form 8-K.

(a) Item 601 Exhibits.

| No. | Description |
|-------|---|
| 2.1 | Amended and Restated Agreement and Plan of Merger by and between R&G Financial Corporation, R-G Premier Bank of Puerto Rico and R-G Interim Premier Bank, dated as of September 27, 1996 (1) |
| 2.2.0 | Agreement and Plan of Reorganization among R&G Financial Corporation, R&G Acquisition Holdings Corporation, The Crown Group, Inc. and Crown Bank, a Federal Savings Bank dated as of December 19, 2001 (2) |
| 2.2.1 | Amendment No. 2 to Agreement and Plan of Reorganization among R&G Financial Corporation, R&G Acquisition Holdings Corporation, The Crown Group, Inc. and Crown Bank, a Federal Savings Bank dated as of February 27, 2002 (3) |
| 3.1.0 | Certificate of Incorporation of R&G Financial Corporation (4) |
| 3.1.1 | Certificate of Amendment to Certificate of Incorporation of R&G Financial Corporation (4) |
| 3.1.2 | Amended and Restated Certificate of Incorporation of R&G Financial Corporation (5) |
| 3.1.3 | Certificate of Amendment to Amended and Restated Certificate of Incorporation of R&G Financial Corporation (6) |
| 3.1.4 | Second Certificate of Amendment to Amended and Restated Certificate of Incorporation of R&G Financial Corporation (15) |
| 3.1.5 | Certificate of Resolution designating the terms of the Series A Preferred Stock (7) |
| 3.1.6 | Certificate of Resolution designating the terms of the Series B Preferred Stock (8) |
| 3.1.7 | Certificate of Designation for Series C Preferred Stock (12) |
| 3.1.8 | Certificate of Designation for Series D Preferred Stock (13) |
| 3.2 | Bylaws of R&G Financial Corporation (4) |
| 4.0 | Form of Stock Certificate of R&G Financial Corporation (4) |

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- 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)

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| No. | Description |
|------|---|
| 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) |
| 10.1 | Master Purchase, Servicing and Collection Agreement between R&G Mortgage Corporation and R-G Premier Bank of Puerto Rico dated February 16, 1990, as amended on April 1, 1991, December 1, 1991, February 1, 1994 and July 1, 1994 (4) |
| 10.2 | Master Custodian Agreement between R&G Mortgage Corporation and R-G Premier Bank of Puerto Rico dated February 16, 1990, as amended on June 27, 1996 (4) |
| 10.3 | Master Production Agreement between R&G Mortgage and R-G Premier Bank of Puerto Rico dated February 16, 1990, as amended on August 30, 1991 and March 31, 1995 (4) |
| 10.4 | Data Processing Computer Service Agreement between R&G Mortgage and R-G Premier Bank of Puerto Rico dated December 1, 1994 (4) |
| 10.5 | Securitization Agreement by and between R&G Mortgage and R-G Premier Bank of Puerto Rico, dated as of July 1, 1995 (4) |
| 10.6 | R&G Financial Corporation Stock Option Plan (4)(*) |
| 10.7 | Guarantee Agreement between R&G Financial Corporation, R&G Acquisition Holdings Corporation and Wilmington Trust as Guarantee Trustee with respect to the Capital Securities issued by R&G Capital Trust I, dated as of April 10, 2002 (16) |
| 10.8 | Guarantee Agreement between R&G Financial Corporation and U.S. Bank National Association as Guarantee Trustee with respect to the Capital Securities issued by R&G Capital Trust IV, LLT, dated as of August 8, 2003 |
| 31.1 | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act |
| 31.2 | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act |
| 32 | Certification pursuant to Section 906 of the Sarbanes-Oxley Act |
| (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 on Form 8-K filed with the SEC on December 20, 2001. |
| (3) | Incorporated by reference from the Registrant s Current Report on Form 8-K filed with the SEC on February 28, 2002. |
| (4) | Incorporated by reference from the Registration Statement on Form S-1 (Registration No. 333-06245) filed by the Registrant with the SEC on September 18, 1996, as amended. |
| (5) | Incorporated by reference from the Registrant s Current Report on Form 8-K filed with the SEC on November 19, 1999. |
| (6) | Incorporated by reference from the Registrant s Current Report on Form 8-K filed with the SEC on June 12, 2001. |
| (7) | Incorporated by reference from the Registrant s Current Report on Form 8-K filed with the SEC on August 31, 1998. |
| (8) | Incorporated by reference from the Registrant s Form 10-K filed with the SEC on April 13, 2000. |
| (9) | Incorporated by reference from the Registrant s Registration Statement on Form S-3 (Registration No. 333-60923) 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. |

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- (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 Registrant's Form 10-K filed with the SEC on April 2, 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.
- (15) Incorporated by reference from the Registrant's Current Report on Form 8-K filed with the SEC on June 18, 2002.

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(16) Incorporated by reference from the Registrant's Form 10-Q filed with the SEC on November 14, 2002.

(*) Management contract or compensatory plan or arrangement.

(b) Reports on Form 8-K.

The Registrant filed the following Reports on Form 8-K during the quarter ended September 30, 2003:

(1) Form 8-K filed on July 17, 2003 with an attached press release announcing the Registrant's earnings for the quarter ended June 30, 2003.

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SIGNATURES

Pursuant to the requirements 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

Date: November 14, 2003

By: /S/ VICTOR J. GALAN

Víctor J. Galán, Chairman
and Chief Executive Officer
(Principal Executive Officer)

By: /S/ JOSEPH R. SANDOVAL

Joseph R. Sandoval
Executive Vice President
and Chief Financial Officer
(Principal Financial and
Accounting Officer)