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R&G FINANCIAL CORP
Form S-3
May 15, 2001

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AS FILED WITH THE SECURITIES AND EXCHANGE COMMISSION ON MAY 15, 2001

REGISTRATION NO. 333-

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM S-3
REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933

R&G FINANCIAL CORPORATION
(Exact name of Registrant as specified in its charter)

PUERTO RICO
(State or other jurisdiction
of incorporation or organization)

66-0532217
(I.R.S. Employer
Identification No.)

280 JESUS T. PINERO AVENUE
SAN JUAN, PUERTO RICO 00918
(787) 758-2424
(Address, including zip code, and telephone number, including
area code, of registrant's principal executive offices)

VICTOR J. GALAN
CHAIRMAN OF THE BOARD AND CHIEF EXECUTIVE OFFICER
R&G FINANCIAL CORPORATION
280 JESUS T. PINERO AVENUE
SAN JUAN, PUERTO RICO 00918
(787) 758-2424
(Name, address, including zip code, and telephone number, including
area code, of agent for service)

WITH COPIES TO:

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APPROXIMATE DATE OF COMMENCEMENT OF PROPOSED SALE TO THE PUBLIC: As soon as practicable after this registration statement becomes effective. If the only securities being registered on this Form are being offered pursuant to dividend

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or interest reinvestment plans, please check the following box. []

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, other than securities offered only in connection with dividend or interest reinvestment plans, check the following box. []

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. []

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. []

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. []

CALCULATION OF REGISTRATION FEE

TITLE OF EACH CLASS OF SECURITIES TO BE REGISTERED	PROPOSED MAXIMUM AGGREGATE OFFERING PRICE (1)
Class B common stock, par value \$0.01 per share.....	\$76,153,000

(1) Pursuant to Rule 457(c) under the Securities Act of 1933, as amended, the proposed maximum aggregate offering price is estimated solely for purposes of calculating the registration fee and is based on the average of the high and low prices of the Class B common stock reported on the Nasdaq National Market on May 10, 2001.

THE REGISTRANT HEREBY AMENDS THIS REGISTRATION STATEMENT ON SUCH DATE OR DATES AS MAY BE NECESSARY TO DELAY ITS EFFECTIVE DATE UNTIL THE REGISTRANT SHALL FILE A FURTHER AMENDMENT WHICH SPECIFICALLY STATES THAT THIS REGISTRATION STATEMENT SHALL THEREAFTER BECOME EFFECTIVE IN ACCORDANCE WITH SECTION 8(A) OF THE SECURITIES ACT OF 1933 OR UNTIL THE REGISTRATION STATEMENT SHALL BECOME EFFECTIVE ON SUCH DATE AS THE COMMISSION, ACTING PURSUANT TO SAID SECTION 8(A), MAY DETERMINE.

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The information in this Prospectus is not complete and may be changed. We may not sell these securities until the Securities and Exchange Commission declares our registration statement effective. This Prospectus is not an offer to sell these securities and is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

PRELIMINARY PROSPECTUS Subject to completion May 15, 2001

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4,000,000 SHARES

(RPG FIN. CORP. LOGO)

CLASS B COMMON STOCK

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. We are offering 2,000,000 shares of Class B common stock and two of our stockholders (the "Selling Stockholders") are offering 2,000,000 shares of Class B common stock. We will not receive any proceeds from the sale of shares by the Selling Stockholders.

Our Class B common stock is quoted on the Nasdaq National Market under the symbol "RGFC." The last reported sale price of our Class B common stock on May , 2001 was \$ per share.

INVESTING IN OUR CLASS B COMMON STOCK INVOLVES RISKS. SEE "RISK FACTORS" BEGINNING ON PAGE 8 OF THIS PROSPECTUS.

NEITHER THE SECURITIES AND EXCHANGE COMMISSION NOR ANY STATE OR COMMONWEALTH OF PUERTO RICO SECURITIES COMMISSION HAS APPROVED OR DISAPPROVED THESE SECURITIES OR PASSED UPON THE ACCURACY OR ADEQUACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

THESE SECURITIES ARE NOT SAVINGS ACCOUNTS, DEPOSITS OR OBLIGATIONS OF ANY BANK AND ARE NOT INSURED BY THE FEDERAL DEPOSIT INSURANCE CORPORATION OR ANY OTHER GOVERNMENTAL AGENCY, AND ARE SUBJECT TO INVESTMENT RISKS, INCLUDING LOSS OF THE PRINCIPAL INVESTED.

	PER SHARE	TOTAL
Public offering price	\$	\$
Underwriting discounts and commissions	\$	\$
Proceeds, before expenses, to R&G Financial	\$	\$
Proceeds, before expenses, to the Selling Stockholders	\$	\$

We and one of the Selling Stockholders have also each granted the underwriters a 30-day option to purchase up to 150,000 shares of Class B common stock, or an aggregate of an additional 300,000 shares, to cover over-allotments at the public offering price per share less the underwriting discounts and commissions.

The underwriters are offering the shares of our Class B common stock as described in "Underwriting." Delivery of the shares will be made on or about , 2001.

UBS WARBURG

KEEFE, BRUYETTE & WOODS, INC.

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PROSPECTIVE INVESTORS MAY RELY ONLY ON THE INFORMATION INCORPORATED BY REFERENCE OR CONTAINED IN THIS PROSPECTUS. NEITHER R&G FINANCIAL NOR ANY UNDERWRITER HAS AUTHORIZED ANYONE TO PROVIDE PROSPECTIVE INVESTORS WITH INFORMATION DIFFERENT FROM THAT INCORPORATED BY REFERENCE OR CONTAINED IN THIS PROSPECTUS. THIS PROSPECTUS IS NOT AN OFFER TO SELL, NOR IS IT SEEKING AN OFFER TO BUY, THE CLASS B COMMON STOCK IN ANY JURISDICTION WHERE THE OFFER OR SALE IS NOT PERMITTED. THE INFORMATION IN THIS PROSPECTUS IS COMPLETE AND ACCURATE ONLY AS OF THE DATE SET FORTH ON THE FRONT COVER, REGARDLESS OF THE TIME OF DELIVERY OF THIS PROSPECTUS OR ANY SALE OF THESE SECURITIES.

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SUMMARY

This summary provides an overview of selected information contained elsewhere in this prospectus and does not contain all the information you should consider. You should also read the more detailed information set out in this prospectus or incorporated by reference into this prospectus and the "Risk Factors" section beginning on page 8. Unless otherwise stated, all information in this prospectus assumes that (i) the proposal currently being submitted to R&G Financial's stockholders at a Special Meeting to be held on May , 2001, to increase the authorized shares of Class B common stock will be approved, as discussed under "Capitalization," and (ii) the underwriters will not exercise their overallotment option to purchase any of the 300,000 shares of Class B common stock subject to that option.

R&G FINANCIAL

GENERAL

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 Mortgage Store of Puerto Rico, Inc., formerly Champion Mortgage Corporation, a Puerto Rico mortgage company, and through R-G Premier Bank, we operate Continental Capital Corp., a Huntington Station, New York mortgage

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banking company. With our acquisition of Continental in late 1999, we plan to expand its operations in the United States, concentrating initially in New York and then into other markets to the extent that it is presented with appropriate expansion opportunities. We also recently acquired Home and Property Insurance Corporation, a Puerto Rico insurance agency, and intend to open R&G Investments Corporation, a licensed broker dealer, during the second quarter of this year.

We are currently in our 29th year of operations and operate our business through our subsidiaries. We are 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. We also originate commercial real estate loans, residential construction loans, commercial business loans and consumer loans for its portfolio. Finally, we provide a variety of trust and investment services to our customers.

R&G Financial 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 March 31, 2001, R&G Financial had consolidated total assets of approximately \$3.7 billion, consolidated total deposits of approximately \$1.7 billion and consolidated stockholders' equity of approximately \$389.5 million. R&G Financial operates 60 branch offices (32 mortgage offices in Puerto Rico, 4 mortgage offices in the United States, and 24 bank branches mainly located in the northeastern section of Puerto Rico) at that date.

We have generally sought to achieve long-term financial strength and profitability by increasing the amount and stability of our net interest income and non-interest income. We have sought to implement this strategy by (1) emphasizing the growth of our mortgage banking activities, including the origination and sale of mortgage loans, and growing our loan servicing operation; (2) expanding our retail banking franchise in order to achieve increased market presence and to increase core deposits; (3) enhancing our net interest income by increasing our 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 our retail products and services, including an increase in consumer loan originations; (6) meeting the banking needs of our customers through, among other things, the offering of trust and investment services and insurance products; (7) expanding our operations in the United States; and (8) controlled growth and the pursuit of a variety of acquisition opportunities when appropriate.

Our senior management is comprised of five persons with over an average of 26.8 years of experience in the financial services industry. We recently promoted Ramon Prats, our Vice Chairman, to the office of President. Mr. Prats formerly was Executive Vice President of R&G Mortgage, a position he held since 1980. Victor J. Galan, one of the Selling Stockholders, is our Chairman and Chief Executive Officer, positions he has

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held since our incorporation in 1996. Mr. Galan is also the founder and Chairman of R&G Mortgage, a position he has held since 1972.

Our principal executive offices are located at 280 Jesus T. Pinero Avenue, San Juan, Puerto Rico, 00918 and our telephone number is (787) 758-2424.

R&G MORTGAGE

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Origination. R&G Mortgage is engaged primarily 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, a 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 non-conforming 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 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 three months ended March 31, 2001 and the years ended December 31, 2000, 1999 and 1998, R&G Mortgage originated a total of \$375.2 million, \$1.1 billion, \$1.1 billion and \$914.1 million of residential mortgage loans, respectively. These aggregate originations include loans originated by R&G Mortgage directly for R-G Premier Bank of \$166.9 million, \$451.4 million, \$437.1 million and \$450.6 million during the three months ended March 31, 2001 and the years ended December 31, 2000, 1999 and 1998, respectively, or 44%, 43%, 41% and 49%, 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 ("spot") loans and consumer loans secured by real estate.

Servicing. R&G Financial's servicing portfolio has grown significantly over the past several years. At March 31, 2001, R&G Financial's servicing portfolio totaled \$6.8 billion and consisted of a total of 111,925 loans. These amounts include R&G Mortgage's servicing portfolio totaling \$6.3 billion and Continental's servicing portfolio totaling \$471.0 million at March 31, 2001. At March 31, 2001, R&G Financial's servicing portfolio included \$986.2 million of loans serviced for R-G Premier Bank or 14.5% 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. 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 FHA/VA loans into mortgage-backed securities which are guaranteed by the Government National Mortgage Association, or 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, or FNMA, and the Federal Home Loan Mortgage Corporation, or FHLMC, or to private investors, or may be pooled into FNMA or FHLMC mortgage-backed securities which are generally sold to investors. During the three months ended March 31, 2001 and the years ended December 31, 2000, 1999 and 1998, R&G Financial sold \$160.6 million, \$637.8 million \$721.0 million and \$493.0 million of loans, respectively, as part of its mortgage banking activities, which includes loans 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. To a lesser extent but with increasing emphasis over the past few years, R-G

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Premier Bank also originates construction loans and loans secured by commercial real

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estate, as well as consumer 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. The Bank also offers trust services through its Trust Department.

Residential Loans. At March 31, 2001, R&G Financial's loans receivable, net, totaled \$1.7 billion, which represented 45.3% of R&G Financial's \$3.7 billion of total assets. At such date, all but \$1.1 million of R&G Financial's loans receivable, net, were held by R-G Premier Bank. R-G Premier Bank's loan portfolio has historically been concentrated with loans secured by first mortgage liens on existing single-family residences. At March 31, 2001, \$1.0 billion or 54.4% of R&G Financial's total loans held for investment consisted of such loans, of which all but \$1.3 million consisted of conventional loans.

Construction Loans. R-G Premier Bank has been active in originating loans to construct single-family residences. At March 31, 2001, retail construction ("spot") loans amounted to \$45.7 million or 2.5% of R&G Financial's total loans held for investment, while commercial construction and land acquisition loans amounted to in the aggregate \$230.3 million or 12.5% 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 the Bank the opportunity to increase the interest rate sensitivity of its loan portfolio.

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 March 31, 2001, \$276.5 million or 15.0% 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 1,036 loans with an average principal balance of \$267,000. 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 March 31, 2001, consumer loans, which are primarily secured by real estate, amounted to \$173.1 million or 9.4% of total loans held for investment and commercial business loans amounted to \$76.4 million or 4.2% of total loans held for investment.

REGULATION

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 the Office of the Commissioner of Financial Institutions of Puerto Rico, or OFCI. 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, OFCI 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 OFCI and the Federal

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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 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 tier will depend on various capital measures and other qualitative factors and will subject it to specific requirements. As of March 31, 2001, R-G Premier Bank met the capital measures for being "well capitalized" under the FDIC's regulations.

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THE OFFERING

Class B common stock Offered by:

R&G Financial..... 2,000,000

Selling Stockholders(1).... 2,000,000

Common Stock Outstanding

After This Offering(2)... 16,440,556 shares of Class A common stock
14,237,675 shares of Class B common stock

Nasdaq National Market

Symbol..... RGFC

Use of Proceeds..... We are raising funds in this offering primarily for general corporate purposes and to support further expansion both in Puerto Rico and in the United States. We expect to use a portion of the net proceeds to increase R-G Premier Bank's regulatory capital, which will facilitate its ability to increase deposits and borrowings to fund additional investments.

While we periodically engage in discussions with companies and investment banking firms concerning potential acquisition opportunities, we have no present agreements or understandings with any party and there can be no assurance that we will be successful in completing any acquisitions in the future.

We will not receive any of the proceeds from the sale of the Class B common stock by the Selling Stockholders.

Dividends..... We currently pay a cash dividend of \$0.06375 per share of Class A or Class B common stock per quarter, or \$0.2550 per share per year. The dividend payment we declared for the quarter ended March 31, 2001, which is payable on June 1, 2001, represents the 18th consecutive increase in quarterly dividend payments by us which reflects every quarter since our initial public offering in 1996. We pay the same dividend per share to the holders of shares of Class A common stock and Class

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B common stock. The dividend rate and the continued payment of dividends will depend on a number of factors. No assurance can be given that we will continue to pay dividends or that they will not be reduced in the future.

- (1) We have two classes of outstanding common stock: Class A common stock, which is unregistered and solely owned by Victor J. Galan, our Chairman of the Board and Chief Executive Officer, who is one of the Selling Stockholders; and Class B common stock, which is registered and trades on the Nasdaq National Market. (The shares of Class A common stock and Class B common stock are sometimes collectively referred to as the "Common Stock"). The shares of Class A common stock are convertible into shares of Class B common stock on a one-for-one basis. Only shares of Class B common stock are being offered by this prospectus.
- (2) Excludes 729,600 shares of Common Stock which are reserved for issuance upon the exercise of outstanding options pursuant to our stock option plan at exercise prices ranging between \$4.03 and \$16.125.

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Voting Rights..... The rights of holders of our common stock are identical, except that the Class A common stock is entitled to two votes per share and the Class B common stock is entitled to one vote per share. Following the offering, Victor Galan, our Chairman of the Board and one of the Selling Stockholders, will own 53.6% of the outstanding Common Stock and will be entitled to exercise 69.8% of the outstanding voting rights (53.1% and 69.3%, respectively, if the underwriters' over-allotment option is exercised in full).

Risk Factors..... Investing in our Class B common stock involves certain risks, which are described under "Risk Factors."

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SUMMARY CONSOLIDATED FINANCIAL AND OTHER DATA

You should read the summary consolidated financial information presented below, together with our consolidated financial statements and notes which are incorporated by reference into this prospectus and with our historical financial information included under "Selected Consolidated Financial and Other Data" beginning on page 14 of this prospectus. Per share information takes into account prior stock splits and dividends.

The return on average assets ratio is computed by dividing net income by average total assets for the period. The return on average common equity ratio is computed by dividing net income less preferred stock dividends by average stockholders' equity for the period. Both ratios have been computed using month-end averages.

THREE MONTHS ENDED
MARCH 31,

YEAR ENDED DECEMBER

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	2001	2000	2000	1999	1998
	-----	-----	-----	-----	-----
	(DOLLARS IN THOUSANDS, EXCEPT PER SHARE DATA)				
BALANCE SHEET DATA:					
Total assets.....	\$3,671,472	\$3,121,835	\$3,539,444	\$2,911,993	\$2,044,782
Stockholders' equity.....	389,463	275,229	308,836	269,535	221,162
Common stockholders' equity per share.....	8.56	6.99	8.16	6.79	5.99
INCOME STATEMENT DATA:					
Income before cumulative effect from change in accounting principle, net of taxes(1).....	\$ 13,006	\$ 9,487	43,633	41,335	34,034
Diluted earnings per common share before cumulative effect of change in accounting principle.....	0.39	0.28	1.30	1.28	1.12
OPERATING DATA:					
Loan production.....	528,096	438,959	1,729,373	1,977,322	1,426,069
Loan servicing portfolio.....	6,791,561	6,320,007	6,634,059	6,177,511	4,827,798
PERFORMANCE RATIOS:					
Return on average assets.....	1.48%	1.26%	1.34%	1.72%	1.95%
Return on average common equity.....	19.31	16.37	18.00	20.23	21.32
Net interest margin.....	2.18	2.43	2.16	2.60	2.72
ASSET QUALITY RATIOS:					
Non-performing assets to total assets at end of period.....	3.19%	2.14%	2.96%	2.26%	2.41%
Non-performing loans to total loans at end of period.....	5.83(2)	3.39	5.38(2)	3.66	4.08
Allowance for loan losses to total loans at end of period(3).....	0.66	0.54	0.66	0.55	0.74
Allowance for loan losses to total non-performing loans at end of period(3).....	11.25	15.77	12.21	15.11	17.92
Net charge-offs to average loans outstanding.....	0.35	0.19	0.17	0.25	0.55

(1) In June 1998, the FASB issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." This Statement, as amended, requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. Upon the adoption of this Statement, R&G Financial recognized a gain of approximately \$1.9 million as other comprehensive income in stockholders' equity related to derivative instruments that were designated as cash flow hedges, and a loss of approximately \$529,000 in the income statement related to derivative instruments that did not qualify for hedge accounting.

(2) The increase in the ratio was partially caused by significant loan securitizations during the last two quarters of 2000 and the first quarter of 2001, which reduced the amount of loans held in portfolio which are

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securitizations, as of March 31, 2001 and December 31, 2000, the ratio of non-performing loans to total loans would have been 4.60% and 4.37%, respectively.

- (3) See "Recent Developments" for a discussion of our historical charge-off experience. Because of the nature of the collateral, our historical charge-offs with respect to residential real estate loans have been low. Excluding our residential loan portfolio, the allowance for loan losses to total loans and to total non-performing loans at March 31, 2001 and December 31, 2000 would have been 1.49% and 61.2%, respectively, and 1.57% and 73.7%, respectively.

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RISK FACTORS

You should carefully read the following risk factors before you decide to buy any Class B common stock. You should also consider the other information in this prospectus and the documents that are incorporated by reference.

FLUCTUATIONS IN INTEREST RATES MAY IMPACT R&G FINANCIAL'S BUSINESS

Interest rate fluctuations are the primary market risks affecting R&G Financial. Changes in interest rates affect the following areas of its business:

- the number of mortgage loans originated and purchased;
- the interest income earned on loans and securities;
- gain on sale of loans;
- the value of securities holdings; and
- the value of its servicing asset.

Increases in Interest Rates Reduce Demand for New Mortgage Loan Originations and Refinancings. Higher interest rates increase the cost of mortgage loans to consumers and reduce demand for mortgage loans, which negatively impacts R&G Financial's profits. Reduced demand for mortgage loans results in reduced loan originations by R&G Financial, lower mortgage origination income and lower gain on sales of loans. Demand for refinancings is particularly sensitive to increases in interest rates.

Increases in Interest Rates Reduce Net Interest Income. Increases in short-term interest rates reduce net interest income, which is an important part of R&G Financial's earnings. Net interest income is the difference between the interest received by R&G Financial on its assets and the interest paid on its borrowings. Most of R&G Financial's assets, like its mortgage loans and mortgage-backed securities are long-term assets. In contrast, most of R&G Financial's borrowings are short-term. When interest rates rise, R&G Financial must pay more in interest while interest earned on its assets does not rise as quickly, which causes profits to decrease.

Increases in Interest Rates May Reduce or Eliminate Gain on Sale of Mortgage Loans. If long-term interest rates increase between the time R&G Financial commits to or establishes an interest rate on a mortgage loan and the time it sells the loan, R&G Financial may realize a reduced gain or a loss on such sale.

Increases in Interest Rates May Reduce the Value of Mortgage Loans and Securities' Holdings. Increases in interest rates may reduce the value of R&G

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

Decreases in Intere