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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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IN RE R&G FINANCIAL CORPORATION
SECURITIES LITIGATION
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ECF CASE

MASTER FILE NO.
05 Civ. 4186 (JES)

This Document relates to:
All Actions

JURY TRIAL DEMANDED

CONSOLIDATED AMENDED CLASS ACTION COMPLAINT

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Attorneys for Lead Plaintiffs and Co-Lead Counsel for the Class

Court-appointed Lead Plaintiffs, City of Philadelphia Board of Pensions and Retirement (“Philadelphia Pensions”) and General Retirement System of the City of Detroit (“Detroit Retirement”) (together “Lead Plaintiffs”), bring this federal securities class action on behalf of themselves and all other persons and entities, other than Defendants and their affiliates as specified in ¶¶13-19 below, who purchased or acquired publicly traded securities of R&G Financial Corporation (“R&G” or the “Company”) between January 21, 2003 and February 13, 2007 inclusive (the “Class Period”), and who, based on conduct asserted herein, were injured thereby.

I. NATURE OF THE ACTION

1. This is a case of egregious accounting fraud. R&G is a financial holding company that, throughout the Class Period, claimed to be the second largest residential mortgage loan originator and servicer in Puerto Rico. During the Class Period, R&G and its senior officers publicly reported financial results that created the impression that the Company was achieving record earnings and income growth. Indeed, each time R&G reported its financial results during the Class Period, R&G’s CEO, Victor J. Galan, touted the Company’s “record earnings” and “excellent results,” and highlighted the fact that the Company’s earnings and income vastly exceeded (usually by as much as 30%) the amounts reported for the same quarter of the previous year.

2. The Company largely attributed this “record” growth to gain on sale income from purported “sales” of non-conforming mortgages to other Puerto Rican financial institutions, including First BanCorp and Doral Financial Corporation (“Doral”). Indeed, such income frequently accounted for as much as 100% of R&G’s publicly reported earnings during the Class Period. Fueled by the income derived from these “sales,” R&G’s stock price experienced a meteoric rise, reaching a high of more than \$40 per share in December 2004 – an increase of

more than 150% from the price at which the stock was trading at the start of the Class Period, and Defendant Galan became the wealthiest person in Puerto Rico.

3. As the Company has now admitted, its purportedly strong financial results for 2002, 2003 and 2004 were materially false, and all of the gain on sale income it recognized during these years was fictitious. Contrary to Defendants' representations during the Class Period, R&G did not truly "sell" the mortgages to these banks; rather, the "sales" were actually loans which the Company was obligated to repay. Defendants' accounting improprieties transformed R&G from a company that was actually incurring significant losses during the Class Period to one that reported "record" profits for every quarter of the Class Period.

4. In December 2006, R&G disclosed that an internal investigation into its gain on sale accounting had determined that Defendants Galan and Joseph Sandoval, R&G's CFO, had been informed by the Company's counsel back in December 2003 that the transactions R&G engaged in with Doral, First BanCorp and other Puerto Rican banks were not "true sales," and that there would be a catastrophic impact on the Company's financial statements when these transactions were re-characterized as secured borrowings. Notwithstanding the fact that they were told in December 2003 that the transactions were not "true sales," Galan and Sandoval continued to treat the transactions as sales so that they could continue to recognize hundreds of millions of dollars in fictitious gain on sale income and continue to fraudulently report "record earnings." Specifically, the Company's Form 8-K stated that:

[T]he investigation found that in December 2003, an outside lawyer for the Company who is now its general counsel, was asked by the Company's former chief financial officer [Defendant Sandoval] to provide a legal opinion with respect to the treatment of certain mortgage loan sale transactions as "true sales". The investigation found that outside counsel, after legal research and analysis, informed the Company's former chief financial officer that he could not provide the requested opinion, did not believe that the transactions qualified as true sales, and believed that there would be a significant adverse impact on the Company's

financial statements should the transactions be recharacterized as secured borrowings. The investigation found that outside counsel subsequently had a brief conversation with Mr. Galan in which he informed Mr. Galan that he had been asked to provide such an opinion but could not, and that he was concerned that the Company had a problem.

5. Significantly, when confronted with these facts during the investigation, Galan denied that he had any such conversation with R&G's attorney. However, the internal investigation determined that Galan was lying. As set forth in the R&G's December 18, 2006 press release, Galan's "denial that this conversation took place was contradicted by outside counsel's recollection and detailed billing records." Accordingly, the Board immediately removed Galan as the Company's CEO.

6. When the truth about the Company's fraud was disclosed beginning in March 2005, the price of R&G's stock crashed, falling from \$40 per share to approximately \$15 per share. Indeed, on April 26, 2005, the day after R&G announced it had to restate its previously-filed financial statements for 2003 and 2004 because of serious accounting issues regarding its gain on sale income from certain loan transactions, the Company's stock fell 35% (from \$23.18 to \$15.04) in a single day, on heavy volume. In fact, the fraud at R&G was so massive that to date, almost two years after R&G announced it would have to restate its financial statements, R&G has been unable to complete the restatement or otherwise file any of its financial statements with the Securities and Exchange Commission ("SEC"). On February 13, 2007, R&G announced that it was not going to be able to file its restated financial statements by the April 2007 deadline imposed by the New York Stock Exchange ("NYSE"). As a result of this announcement, the NYSE announced that it would de-list R&G's stock by no later than February 22, 2007 and R&G stock fell to an all-time low of \$5.68.¹

¹ The Court's November 9, 2005 Order provided for the Amended Complaint to be filed no later than thirty days after R&G issued its restated financial statements. While the Company has not yet issued the restatement, in light of

II. JURISDICTION AND VENUE

7. The claims asserted herein arise under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. §§ 78j(b), 78t(a) and 78t-1, and the rules and regulations promulgated thereunder, including SEC Rule 10b-5, 17 C.F.R. § 240.10b-5.

8. This Court has jurisdiction over the subject matter of this action pursuant to Section 27 of the Exchange Act, 15 U.S.C. §§ 78aa, 28 U.S.C. §§1331 and 1337 and 28 U.S.C. §§1331 and 1337.

9. Venue is proper in this district pursuant to Section 27 of the Exchange Act, 15 U.S.C. §§ 78aa and 28 U.S.C. §1391(b) and (c). Many of the acts and transactions alleged herein, including the dissemination of materially false and misleading statements and information, occurred in substantial part in this District.

10. In connection with the acts alleged in herein, Defendants, directly or indirectly, used the means and instrumentalities of interstate commerce, including, but not limited to, the United States mails, interstate telephone communications and the facilities of national securities exchanges, including the NYSE.

III. THE PARTIES

A. Lead Plaintiffs

11. Lead Plaintiff Philadelphia Pensions purchased R&G publicly traded securities as set forth in its certification, which was previously filed in this litigation and is incorporated herein by reference, and has suffered damages.

12. Lead Plaintiff Detroit Retirement purchased R&G publicly traded securities as set forth in its certification, which was previously filed in this litigation and is incorporated herein

the Company's recent disclosures and the other facts alleged herein, Lead Plaintiffs believe that the best interests of the Class are served by filing the Complaint at this time.

by reference, and has suffered damages.

B. The Defendants

13. Defendant R&G is a Puerto Rico-chartered, financial holding company that, through its wholly-owned subsidiaries, is engaged in banking, mortgage banking, broker-dealer and insurance activities, with operations in Puerto Rico and the continental United States. The Company is engaged in providing a full range of banking services in Puerto Rico and in the Orlando and Tampa/St. Petersburg Florida markets. R&G operates R-G Premier Bank of Puerto Rico ("Premier Bank"), a Puerto Rico commercial bank, and R-G Crown Bank ("Crown Bank"), a Florida-domiciled federal savings bank. The Company also operates R&G Mortgage Corporation ("R&G Mortgage") in Puerto Rico, The Mortgage Store of Puerto Rico, Inc. (the "Mortgage Store"), a subsidiary of R&G Mortgage, and Continental Capital Corp., a mortgage-banking subsidiary of Crown Bank, which does business in the continental United States. The Company also has an insurance agency business and offers broker-dealer services in Puerto Rico through Home & Property Insurance Corp. and R-G Investments Corporation, respectively. As of December 31, 2004, R&G reported consolidated assets of \$10.2 billion and consolidated stockholders' equity of \$855.6 million.

14. Defendant Victor J. Galan ("Galan") founded R&G in 1972 and, beginning in March 1996, served as the Company's President and Chief Executive Officer during the Class Period. On December 18, 2006, the Company announced that Defendant Galan was stepping down as President and CEO effective as of December 31, 2006. However, Galan is continuing as R&G's Chairman of the Board until June 30, 2007 and will remain a director of the Company. As of December 31, 2004, Galan owned all of the Company's Class A shares, which have not been registered with the SEC under the Exchange Act but are exchangeable into an equal number of Class B shares, which are registered under the Exchange Act and are publicly-traded on the

NYSE. Galan is entitled to two votes per Class A share and the holders of the publicly-traded Class B shares are entitled to one vote per share on all matters presented at the Company's annual meeting. As a result of such voting rights, Galan holds 59.28% of the voting power of the aggregate issued and outstanding shares of the Company's common stock as of March 25, 2005. Defendant Galan assisted in preparing and/or signed all of the Company's false and misleading press releases, financial statements and SEC filings issued during the Class Period, and repeated the contents therein to the market.

15. Defendant Joseph R. Sandoval ("Sandoval") was Executive Vice President and Chief Financial Officer of R&G during the Class Period. Sandoval served as the Chief Financial Officer of R&G since 1997 and as a Senior Vice President since 1998. Effective August 24, 2005, R&G's Board of Directors removed Defendant Sandoval from his positions with the Company and placed him on an indefinite leave of absence. On January 4, 2006, Sandoval tendered his resignation on terms other than those requested by R&G's Board of Directors. R&G did not accept Sandoval's resignation and terminated his employment with the Company on January 5, 2006. Sandoval assisted in preparing and/or signed all of the Company's false and misleading press releases, financial statements and SEC filings issued during the Class Period, and repeated the contents therein to the market.

16. Defendant Ramon Prats ("Prats") is a citizen of Puerto Rico. Prats was a director and the Vice Chairman of the Board of Directors of the Company from April 1996, and President of the Company, R&G Mortgage and Premier Bank from January 2001. Prats was a director and Executive Vice President of R&G Mortgage (beginning in April 1985 and February 1980, respectively) and the Mortgage Store (beginning in October 1997). Prats was also Vice Chairman of the Board of Directors of R&G Premier Bank (beginning in February 1990) and a

director of R-G Investments and Crown Bank. As of March 25, 2005, Prats held 1,203,681 shares of R&G's Class B common stock. Prats resigned from his positions as an officer and a director of the Company and its subsidiaries effective January 5, 2006. During the Class Period, as alleged below, Prats participated in the issuance of the false and/or misleading statements alleged herein, including preparing and/or signing the false and misleading year-end financial statements for 2002, 2003 and 2004.

17. The individuals named as Defendants in ¶¶14-16 are referred to herein as the "Officer Defendants."

18. Defendants Benigno R. Fernandez ("Fernandez"), Gilberto Rivera-Arreaga ("Rivera-Arreaga") and Ileana M. Colon-Carlo ("Colon-Carlo") (together, the "Audit Committee" or "Audit Committee Defendants") served on the Audit Committee of R&G's Board of Directors during the Class Period. Messrs. Rivera-Arreaga and Fernandez have served on R&G's Audit Committee since the Company went public in 1996. Ms. Colon-Carlo has been a director of R&G since July 1998 and has served on the Company's Audit Committee since 2003. Rivera-Arreaga, Fernandez, and Colon-Carlo are all certified public accountants with substantial experience in accounting. Mr. Fernandez was the Chairman of R&G's Audit Committee during the Class Period and is the Senior Partner of a certified public accounting firm in Puerto Rico. Ms. Colon-Carlo is an accounting professor at a university in Puerto Rico and is a past President of the Puerto Rico Certified Public Accountants State Society and past member of the Commonwealth of Puerto Rico Board of Accountancy. Mr. Rivera-Arreaga is the Executive Vice President of the National College of Business & Technology, a post-secondary institution in Puerto Rico. Defendants Fernandez and Rivera-Arreaga signed R&G's Annual Reports on Form 10-K for fiscal years 2002, 2003 and 2004 and Defendant Colon-Carlo signed R&G's Form 10-

K for fiscal years 2003 and 2004.

19. Defendant PricewaterhouseCoopers ("PwC") is one of the largest professional services firms in the world and is the largest of the "Big Four" audit firms. PwC served as R&G's purportedly independent auditor at all relevant times during the Class Period. In this role, PwC provided auditing and accounting services to the Company, which included the issuance of clean and unqualified audit opinion letters on R&G's financial statements for the fiscal years 2002, 2003 and 2004. PwC's unqualified audit opinion letters were included in the Company's Annual Reports on Form 10-K for the fiscal years 2002, 2003 and 2004. PwC also served as the "independent" auditor to both First BanCorp and Doral throughout the Class Period.

IV. CLASS ALLEGATIONS

20. Lead Plaintiffs bring this action on behalf of themselves and as a class action pursuant to Rules 23(a) and 23(b)(3) of the Federal Rules of Civil Procedure on behalf of a class consisting of all persons and entities who purchased or otherwise acquired publicly traded securities of R&G during the Class Period, and who, based on conduct asserted herein, were injured thereby (the "Class"). Excluded from the Class are: (a) the Defendants named herein; (b) members of the families of the Individual Defendants; (c) the subsidiaries and affiliates of the Defendants; (d) any person or entity who is a partner, officer, director, or controlling person of R&G (including any of its subsidiaries or affiliates) or of any defendant; (e) any entity in which any Defendant has a controlling interest; (f) the Defendants' directors' and officers' liability insurance carriers, and any affiliates or subsidiaries thereof; and (g) the legal representatives, heirs, successors and assigns of any such excluded party.

21. The members of the Class are so numerous that joinder of all members is impracticable. The disposition of their claims in a class action will provide substantial benefits

to the parties and the Court. According to R&G's Form 10-K for the fiscal year end December 31, 2004 (i.e., the Company's last Form 10-K filed with the SEC), R&G had over 29 million shares of Class B Common Stock outstanding. While Lead Plaintiffs do not know the exact number of purchasers of R&G's publicly-traded securities, Lead Plaintiffs believe that Class members number in the thousands.

22. Lead Plaintiffs' claims are typical of the claims of the members of the Class. Lead Plaintiffs and the other members of the Class acquired R&G's publicly-traded securities in the secondary market, and sustained damages as a result of Defendants' wrongful conduct complained of herein.

23. Lead Plaintiffs will fairly and adequately protect the interests of the members of the Class and have retained counsel competent and experienced in class and securities litigation. Lead Plaintiffs have no interests that are adverse or antagonistic to the Class.

24. A class action is superior to other available methods for the fair and efficient adjudication of this controversy. Because the damages suffered by individual members of the Class may be relatively small, the expense and burden of individual litigation make it impracticable for Class members individually to seek redress for the wrongful conduct alleged herein.

25. Common questions of law and fact exist as to all members of the Class, and predominate over any questions affecting solely individual members of the Class. Among the questions of law and fact common to the Class are:

- (a) Whether the federal securities laws were violated by Defendants' conduct as alleged herein;

- (b) Whether the SEC filings, press releases, reports, and other public statements disseminated to the investing public during the Class Period contained material misstatements or omitted to state material information;
- (c) Whether and to what extent the Company's financial statements failed to comply with Generally Accepted Accounting Principles ("GAAP") during the Class Period;
- (d) Whether and to what extent PwC's audits of R&G violated Generally Accepted Auditing Standards ("GAAS");
- (e) Whether and to what extent the market prices of the Company's securities were artificially inflated during the Class Period due to the non-disclosures and/or misrepresentations complained of herein;
- (f) Whether R&G, the Individual Defendants, and PwC acted with scienter;
- (g) With respect to Lead Plaintiffs' claims pursuant to Section 20(a) of the Exchange Act, whether the Defendants named in those counts are controlling persons of the Company;
- (h) Whether reliance may be presumed pursuant to the fraud-on-the-market rule; and
- (i) Whether the members of the Class have sustained damages as a result of the misconduct complained of herein and, if so, the proper measure thereof.

26. The names and addresses of those persons and entities that purchased publicly-traded securities of R&G, and/or of the record owners of the Company's securities, are available from the Company's transfer agent(s). Notice may be provided to such purchasers and/or record

owners via first class mail using techniques and a form of notice similar to those customarily used in class actions.

V. SUBSTANTIVE ALLEGATIONS

A. The Company and its Business

27. R&G is a financial holding company that was incorporated in Puerto Rico in 1972 and went public in 1996, first trading on the NASDAQ exchange and then on the NYSE beginning on July 12, 2002.

28. During the Class Period, R&G purported to be the second largest residential mortgage loan originator and servicer in Puerto Rico, behind only Doral. Together, R&G and Doral controlled approximately 70-80% of the residential mortgage origination market in Puerto Rico. Traditionally, R&G's mortgage banking segment was its core business segment and resulted in the majority of the Company's reported net earnings. Indeed, in 1999, R&G's mortgage banking segment accounted for 95% of the Company's gross revenues and 98% of the Company's total assets.

29. Prior to the Class Period, and throughout 2002, R&G's stock price consistently traded in a range of \$11 to \$15 per share. However, beginning in late 2002, R&G and the Officer Defendants devised a scheme to inflate R&G's publicly reported revenue and income, and, concomitantly, its stock price.

30. Specifically, beginning in late 2002, R&G began to "sell" large amounts of its "non-conforming" mortgages to other financial institutions, while still retaining certain rights to the interest payments and servicing rights of the underlying mortgages. During the years ended December 31, 2004, 2003 and 2002, R&G sold \$1.2 billion, \$1.6 billion and \$1.2 billion of loans, respectively, more than half of which consisted of sales of "non-conforming loans." Many of these purported sales were to two other banks located in Puerto Rico -- namely, Doral and First

BanCorp.

31. The purported gains recognized from these “sales” transformed R&G from a Company that would have suffered losses for virtually every quarter during the Class Period into a Company that reported so-called “record” profits for twelve consecutive quarters. As a result of these “record” earnings, R&G’s stock price skyrocketed from \$15 per share in January 2003 to over \$40 in April 2004, an increase of 150%. However, as the Company has recently admitted, the Company’s “record” financial results were the product of fraud, and these “sales” were shams devised by the Officer Defendants to artificially inflate R&G’s earnings and stock price. In reality, these “sales” were merely loans, collateralized by R&G’s mortgages, that R&G was obligated to repay.

B. R&G “Sells” Its Pools of Mortgage Loans and Records Gains on the “Sales” of the Loans Generating Hundreds of Millions of Dollars of Phantom Income

32. During the Class Period, R&G and the Officer Defendants engaged in a fraudulent scheme designed to artificially inflate the income and assets of R&G by engaging in fictitious sales of mortgages.

33. The majority of mortgages “sold” by R&G to First BanCorp and Doral were non-conforming mortgages. During the years ended December 31, 2004, 2003, and 2002, non-conforming conventional loans represented 63%, 52%, and 54%, respectively, of R&G’s total volume of mortgage loans originated. According to R&G, most of its non-conforming mortgages were designated as such because they failed to conform to United States guidelines with respect to documentation, employment history, income verification, and qualifying ratios. Typical borrower characteristics for these loans included the self-employed, those with incentive-based compensation, recently divorced borrowers, or those with complex sources of income. Such non-conforming mortgages were issued at higher interest rates than conforming

mortgages because of the higher risk associated with them. Because these loans were non-conforming, R&G could not sell them to government sponsored entities, such as Fannie Mae or Freddie Mac, the two agencies that are the largest purchasers of conforming mortgages in the United States. Instead, R&G purportedly sold these non-conforming mortgages to other Puerto Rican banks, with the vast majority going to either First BanCorp or Doral.

34. When purporting to sell these non-conforming mortgages, R&G typically retained the right to receive a portion of the interest payments for itself. In these transactions, R&G would separate, or “strip,” the interest from the principal portion of the loans (the “IO Strip”), and then convey to the buyer the right to receive a portion of those interest payments. R&G would retain the right to receive part of the interest, and would also retain the valuable servicing rights. The interest rates R&G paid the “purchasing banks” were variable, and R&G’s profits from these transactions were based on the difference between the variable rates it paid the purchaser and the fixed interest rates it received from the borrowers.

35. When selling mortgages, the seller can account for the interest and servicing fees it is entitled to receive in two fashions. The first method, which is the more conservative method, is to simply recognize the income and the servicing fees as they are received each month over the life of the loan. The other method, which is referred to as “gain on sale accounting,” allows the seller to record upfront and immediately at the time of the sale all of the interest (or, in the case of the IO strips “sold” by R&G, the expected interest retained after paying the “purchaser” interest at variable rates) and servicing fees the seller expects to receive over the life of the loan (i.e., the “gain”). The gain on sale method is attractive to companies because it allows them to recognize a large amount of income immediately, rather than having to wait as interest payments and servicing fees trickle in over the life of the loan. Calculating the “gain”

under the gain on sale method requires the lender to truly sell the mortgage to a willing purchaser, and also (assuming there is a true sale) requires the seller to calculate the gain the seller expects to earn over the life of the loan – a calculation which takes into account prepayment rates, changes in interest rates, default rates and the discount rate.

36. During the Class Period, R&G consistently reported “record” earnings – earnings that it directly attributed to profits generated through gains on the sale of mortgages. Each and every quarter, R&G reported results that Defendant Galan claimed were “exceptional” and “extraordinary” – a stunning twelve consecutive quarters of record profits. Fueled by these strong earnings, R&G stock increased more than 150% during the Class Period, rising from a price of \$15 in early 2003 – when the Company first began to employ gain on sale accounting – to more than \$40 in early 2005.

37. In turn, R&G’s CEO and founder, Defendant Galan, became the wealthiest person in Puerto Rico. In March 2004, Forbes Magazine published an article about Galan entitled “Paradise Found.” The article prominently featured a picture of Galan on his 68-foot sportfishing boat – named “My Way” – and reported that his stake in the Company was worth \$700 million – making him the first person from Puerto Rico to make “The Forbes 400” list of the wealthiest Americans. The article further credited Galan with “single-handedly” turning R&G into the third most profitable company in Puerto Rico through the use of gain on sale accounting, noting that “Galan sells off most of the mortgages he writes while retaining the right to service the loans” and that “he has a habit of booking paper gains on the servicing portfolio: as soon as a loan is closed, he books as income the value of the right to service it.”

C. R&G Falsely Represents that It Sold the Mortgages It Originated

38. In reality, the income the Company attributed to gains on sales of mortgages was fictitious. As the Company has now acknowledged, R&G was not selling these pools of non-

conforming mortgages to other banks, but was instead taking out massive loans from these banks, using the mortgages it held as collateral. Unbeknownst to investors, in order to recognize hundreds of millions of dollars in fictitious gains on these “sales” of the mortgages, R&G provided the “purchasers” of these loans with full recourse rights. This meant that, in the event of a default on the mortgages, it would be R&G, and not the “purchaser,” who would be responsible for and suffer the loss.

39. Because R&G granted the purchasers of the mortgages with full recourse, R&G’s “sales” failed to meet the applicable accounting standards for a sale. Pursuant to GAAP, several criteria must be met to conclude that a sale has occurred and control over an asset has been surrendered to a purchaser. When control has not been surrendered, as was the case with R&G’s “sales,” the transfer must be accounted for by both parties as a secured borrowing and not as a sale.

40. The Financial Accounting Standards Board’s (“FASB”) Statement of Financial Accounting Standards (“SFAS”) No. 140 is the primary relevant GAAP relating to transfers of financial assets. Pursuant to SFAS No. 140, a transfer of financial assets (or a portion of a financial asset) for cash or other proceeds should be accounted for as a “sale” only if, and to the extent that, the transferor surrenders control over those financial assets.

41. In that regard, GAAP provides that the transferor has surrendered control over transferred assets only if all of the following conditions are met:

- (a) Isolation: The transferred assets must have been isolated from the transferor; that is they are put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership;

- (b) Transferee can pledge or exchange the transferred assets: Each transferee has the right to pledge or exchange the assets it received, and no condition both: (1) constrains the transferee from taking advantage of its right to pledge or exchange; and (2) provides more than a trivial benefit to the transferor; and
- (c) Transferor does not effectively control the transferred assets: The transferor does not maintain effective control over the transferred assets through either: (1) an agreement that both entitles and obligates the transferor to repurchase or redeem them before their maturity; or (2) the ability to unilaterally cause the holder to return specific assets, other than through a cleanup call.

42. If these conditions are not met, SFAS No. 140 provides that the transfer may not be accounted for as a sale, and must instead be accounted for as a secured borrowing.

43. R&G's "sales" transactions of its non-conforming loans failed to meet the conditions set forth in SFAS 140 – a fact of which the Company's senior management was well aware of. R&G recently disclosed that an internal investigation conducted by outside legal counsel at the direction of the Company's Audit Committee determined that Defendants Galan and Sandoval, the CEO and CFO of R&G, were told by the Company's general counsel back in December 2003 that the "sales" to Doral, First BanCorp and other Puerto Rican banks were not "true sales," and that there would be a catastrophic impact on the Company's financial statements when the transactions were re-characterized as secured borrowings. Notwithstanding this fact, Galan and Sandoval continued to engage in these sham transactions and account for them as sales so that they could recognize hundreds of millions of dollars in fictitious gain on

sale income and fraudulently report "record earnings." Specifically, the Company's Form 8-K stated that:

the investigation found that in December 2003, an outside lawyer for the Company who is now its general counsel, was asked by the Company's former chief financial officer [Defendant Sandoval] to provide a legal opinion with respect to the treatment of certain mortgage loan sale transactions as "true sales". The investigation found that outside counsel, after legal research and analysis, informed the Company's former chief financial officer that he could not provide the requested opinion, did not believe that the transactions qualified as true sales, and believed that there would be a significant adverse impact on the Company's financial statements should the transactions be recharacterized as secured borrowings. The investigation found that outside counsel subsequently had a brief conversation with Mr. Galan in which he informed Mr. Galan that he had been asked to provide such an opinion but could not, and that he was concerned that the Company had a problem. (Emphasis Added.)

44. Moreover, when confronted with the fact that the Company's internal investigation had determined that general counsel had informed him back in December 2003 that the transactions were not true sales, Galan lied to the investigators, denying that any such conversation ever took place and telling the investigators that he was only first informed that outside counsel was ever consulted on "true sale"-related issues in 2006. As set forth in the R&G's December 18, 2006 press release, however, Galan's "denial that this conversation took place was contradicted by outside counsel's recollection and detailed billing records." Accordingly, the Board immediately removed Galan as the Company's CEO.

45. Moreover, First BanCorp, one of the two largest purchasers of these non-conforming mortgages from R&G, has confirmed that its "purchases" of the non-conforming loans from R&G were not really purchases, and that a transfer of ownership of these mortgages never occurred. In a press release dated October 21, 2005, First BanCorp specifically stated: "One issue under review by [its] Audit Committee is whether the mortgage transactions at issue were properly classified for accounting purposes as purchases of the mortgage loans by First Bank or whether they should have been treated as loans by First Bank to the other financial

institutions, secured by the mortgages. Although the Company's accounting analysis is not complete, First Bank has concluded that most of its transactions with one financial institution, R&G Mortgage Corp, did not qualify as true sales as a legal matter. Accordingly, these transactions may need to be accounted for as a secured loan to that financial institution.” (Emphasis added.)

46. In its restatement, First BanCorp made clear that all of its written agreements with R&G contained express unlimited recourse provisions, including provisions that expressly obligated R&G to either repurchase delinquent loans, or to guarantee the timely payment of principal and interest. As First BanCorp stated in its restatement, “[t]he incorrect accounting, in the case of transactions with R&G resulted from the fact [that] written contracts included unlimited recourse that tainted the true sales characterization.” (Emphasis added). Significantly, First BanCorp specifically distinguished its transactions with Doral, which involved oral agreements and side deals, from those with R&G, where “the written agreements included express recourse provisions.” As First BanCorp stated in its Amended Annual Report on Form 10-K/A for the year ended December 31, 2004:

[First BanCorp’s] Audit Committee’s review identified evidence that Doral had agreed orally and in emails to extend the recourse provision beyond the 24-month period included in the written agreements to recourse for the duration of the mortgage loans involved in the mortgage-related transactions with FirstBank. The Audit Committee found that neither the existence nor the terms of the oral agreements and emails were documented in the Corporation’s accounting records or communicated to the Corporation’s independent registered public accounting firm by neither the former CEO, former CFO, former executive vice-president responsible for the retail and mortgage banking business, or the former Treasurer. In contrast to the oral agreements and emails with Doral to extend the recourse period, the written agreements with R&G included express recourse provisions for the lives of the underlying mortgage loans and pass-through trust certificates. [...] (Emphasis added.)

47. Defendants Galan and Prats executed the “Mortgage Loan Purchase Agreements” with First BanCorp on behalf of R&G and, therefore, were well aware that the agreements

contained express unlimited recourse provisions. In fact, Galan and Prats initialed every numbered paragraph in the agreements they executed on behalf of R&G.

48. As the Company has also admitted, Defendants further inflated R&G's gain on sale income by round-tripping billions of dollars in mortgages to Doral. These sham sales to Doral involved generally contemporaneous purchases and sales of mortgage loans from and to Doral where the amounts purchased and sold were essentially identical. These transactions had no economic substance or legitimate business purpose, and were entered into solely to allow both companies to immediately recognize phantom income. According to a press release issued by R&G on October 3, 2006:

In the fourth quarter of 2004 and the first quarter of 2005, R&G Premier Bank of Puerto Rico, the Company's wholly-owned Puerto Rico commercial bank subsidiary ("RGP"), entered into two mortgage purchase agreements to purchase from DFC [Doral Financial Corporation] a total of \$1.0 billion in mortgage loans. At approximately the same time, Doral Bank entered into two mortgage purchase agreements to purchase from RGP a total of \$1.0 billion in mortgage loans. These transactions were originally accounted for by the parties as purchases of mortgage loans but have been subsequently recharacterized by the parties for accounting purposes as lending transactions secured by mortgage loans.

49. Doral's Audit Committee also concluded that there was "insufficient contemporaneous documentation to substantiate the business purpose for these transactions...."

50. As R&G has also now admitted, the Company's bogus sales of mortgages were not limited to First BanCorp and Doral. The October 3, 2006 press release further stated that:

Between October 2001 and June 2003, Westernbank entered into various mortgage purchase agreements to purchase from [R&G Mortgage] a total of \$106.2 million in mortgage loans. The sales were structured under variable rate arrangements. These transactions were originally accounted for as purchases of mortgage portfolios by Westernbank but have subsequently been recharacterized as secured borrowings for accounting purposes.

* * *

In November and December of 2005, RGP unwound three transactions with other Puerto Rico financial institutions. Like the DFC and WHI transactions described above, the transactions involved the transfer of pools of mostly residential mortgage loans that the Company had previously accounted for as sales to the other financial institutions but subsequently recharacterized as secured borrowings. These mortgages aggregated \$508.9 million. [...] As a result of the unwinding transactions, RGP repaid its secured borrowings to each of the three Puerto Rico financial institutions in question and took control of the mortgages which collateralized such borrowings.

* * *

The Company continues to negotiate with other Puerto Rico financial institutions with respect to other transactions that still have to be unwound. At August 31, 2006, the Company had loans with an aggregate principal balance of \$612.4 million underlying secured borrowings that had previously been characterized as sales. (Emphasis Added.)

51. Had R&G properly accounted for the mortgage transactions with Doral, First BanCorp and the other financial institutions as secured borrowings, rather than sales, it would have been unable to recognize hundreds of millions of dollars of phony income it claimed were generated by gains on these sales. The impact of Defendants' fraud on R&G's Class Period financial statements can be seen in the following chart:

Reporting Period	Reported Earnings	Reported Earnings Attributed to Gain on Sale	Approximate Actual Earnings (or Loss)
Q4 2002	\$27.1 million	\$27.1 million	0
Year End 2002	\$96.3 million	\$84.9 million	\$11.4 million
Q1 2003	\$29.1 million	\$33.0 million	(\$3.9 million)
Q2 2003	\$31.4 million	\$44.8 million	(\$13.4 million)
Q3 2003	\$34.3 million	\$30.2 million	\$4.1 million
Q4 2003	\$36.1 million	\$38.9 million	(\$2.8 million)
Year End 2003	\$131.0 million	\$146.9 million	(\$15.9 million)
Q1 2004	\$38.5 million	\$39.9 million	(\$1.4 million)

Reporting Period	Reported Earnings	Reported Earnings Attributed to Gain on Sale	Approximate Actual Earnings (or Loss)
Q2 2004	\$40.7 million	\$41.4 million	(\$700,000)
Q3 2004	\$40.9 million	\$54.5 million	(\$13.6 million)
Q4 2004	\$43.9 million	\$49.6 million	(\$5.7 million)
Year End 2004	\$160.2 million	\$175.5 million	(\$15.3 million)

VI. DEFENDANTS' FALSE AND MISLEADING STATEMENTS DURING THE CLASS PERIOD

52. On January 21, 2003, the first day of the Class Period, the Company issued a press release entitled "R&G Financial Reports Record Earnings for the Quarter and Year Ended December 31, 2002." The Company reported net income for the year ended December 31, 2002 of \$96.3 million, a 45% increase over 2001. The Company specifically attributed these "record earnings" to "increases in gain on sale and fees from mortgage loans." According to that press release:

R&G Financial Corporation (NYSE: RGF) ("the Company"), the financial holding company of R-G Premier Bank, Crown Bank, FSB, and R&G Mortgage Corp., today reported record earnings for the quarter and year ended December 31, 2002. For the year ended December 31, 2002, net income amounted to \$96.3 million, compared to income of \$66.3 million before the cumulative effect of a change in accounting principle for 2001, an improvement of 45%; consolidated earnings per diluted share were \$2.49, compared to \$1.85 per diluted share before the cumulative effect of a change in accounting principle for 2001, an increase of 35%. For the fourth quarter of 2002, net income amounted to \$27.1 million compared to \$20.1 million for the fourth quarter of 2001, an increase of 35%; consolidated earnings per diluted share were \$0.68, compared to \$0.55 per diluted share for the fourth quarter of 2001, an increase of 24%.

These strong earning results were achieved in spite of impairment charges and unscheduled amortization of \$9.2 million and \$5.7 million during the third and fourth quarter of 2002, respectively, on the Company's servicing asset, related to increases in mortgage prepayment rates as a result of lower interest rates for mortgage loans. The resulting decrease in earnings were more than offset by

increases in gain on sale and fees from mortgage loans, which is attributable to record volumes of mortgage loan originations and sales. Total loan production during the fourth quarter of 2002 was \$881 million, the highest amount of total loan production for any given quarter in the Company's history, representing a 28% increase compared to the same quarter a year ago. Total loan production for 2002 amounted to a record \$2.9 billion. The Company's servicing portfolio increased during the year to \$11.0 billion as of December 31, 2002. (Emphasis added). (Emphasis Added.)

53. In that press release, Defendant Galan commented favorably on the Company's "excellent results" and "record earnings:"

"We are pleased to report these excellent results and another quarter of record earnings, together with record assets and loan production. During 2002, our banking franchise grew very strongly, reaching record levels in part due to the successful acquisition of Crown Bank during the year, the ongoing expansion of our commercial lending portfolio, a segment in which we are competing very effectively, and our focus on internally originated loans. With the Crown Bank acquisition taken in consideration, banking assets grew 40% during the year to a record \$5.5 billion as of December 31, 2002, together with a 53% increase in the Company's loans portfolio to a record \$2.8 billion. We look forward to 2003 and are poised to continue to enhance shareholders' value through successful expansion across all business lines of the Company, and the continued successful integration of our Puerto Rico and continental US operations. (Emphasis added.)

54. On March 31, 2003, the Company filed its Form 10-K for the year ended December 31, 2002 with the SEC (the "2002 10-K"). The 2002 10-K was signed by Defendants Galan and Sandoval, and it reiterated the false financial information that had been announced in the January 21, 2003 press release.

55. The statements set forth in ¶¶52, 53 and 54 above were materially false and misleading because, among other reasons, Defendants fraudulently reported as income \$84.9 million attributed to gains on "sales" of non-conforming loans which, in reality, were not sales at all, but loans which R&G was obligated to repay. Without this phony income, R&G would have had net income of only approximately \$11.4 million for the year ended December 31, 2002, instead of net income of \$96.3 million. R&G's 2002 10-K was also false and misleading because it understated the Company's liabilities (including debt), overstated stockholders' equity

and falsely stated that R&G had adequate internal controls over its financial reporting process.

56. On April 21, 2003, R&G issued a press release entitled "R&G Financial Reports 35% Increase in Earnings for the Quarter Ended March 31, 2003." The Company reported net income for the first quarter of 2003 of \$29.1 million, and specifically attributed this increase in earnings to "increases in gain[s] on sale[s] and fees from mortgage loans." According to that press release:

R&G Financial Corporation (NYSE: RGF) ("the Company"), the financial holding company of R-G Premier Bank, Crown Bank, FSB, and R&G Mortgage Corp., today reported record financial results for the quarter ended March 31, 2003. Net income for the first quarter of 2003 amounted to \$29.1 million, compared to net income of \$21.5 million for the first quarter of 2002, an increase of 35%.

* * *

These strong earning results were achieved notwithstanding impairment charges and unscheduled amortization of \$10.8 million during the first quarter of 2003 on the Company's servicing asset, related to additional increases in mortgage prepayment rates during the period as a result of lower interest rates available for mortgage loans. The resulting decrease in earnings were more than offset by increases in gain on sale and fees from mortgage loans, which were attributable to record volumes of mortgage loan originations and sales. Total loan production during the first quarter of 2003 was \$1.0 billion, of which more than 90% was internally generated. Total loan production was the highest amount for any given quarter in the Company's history, representing a 76% increase compared to the same quarter a year ago.

Net gain on origination and sale of loans increased 86% to \$33.0 million during the quarter ended March 31, 2003 from \$17.7 million for the comparable 2002 period, due to the increased volume of mortgage loan originations and sales as well as higher margins in the sale of loans. This expanded level of loan originations reflects not only the increase in loan production volume due to lower rates for mortgage loans during the period, but also the increased number of mortgage offices of the Company and R&G Financial's added strength in the market for new residential mortgage loans. The Company has obtained a higher share of end loans as a result of R&G's continued growth in residential construction lending, which remains very strong both in Puerto Rico and Central Florida as high demand for housing continues in those markets. Loan originations in the Company's division for new housing during the first quarter of 2003 represented a new record for R&G Financial. (Emphasis added.)

57. In that press release, Defendant Galan commented favorably on the Company's strong earnings, touting the fact that they represented the thirteenth consecutive quarter that R&G had reported record earnings, and further assuring investors that such "record" results would continue:

We are very pleased to report these excellent results during the quarter ended March 31, 2003. This is now the 13th quarter in a row that we have achieved uninterrupted consecutive increases in earnings to record levels, and we will use our best efforts to continue to do so in the future. We look forward to adding value and improving returns for our stockholders. (Emphasis added.)

58. On May 15, 2003, the Company filed its Form 10-Q for the first quarter ended March 31, 2003 with the SEC (the "First Quarter 2003 10-Q"). The First Quarter 2003 10-Q was signed by Defendants Galan and Sandoval, and it reiterated the false financial information that had been announced in the April 23, 2003 press release.

59. The statements set forth in ¶¶56, 57 and 58 above were materially false and misleading because, among other reasons, Defendants fraudulently reported as income \$33.0 million attributed to gains on "sales" of non-conforming loans which, in reality, were not sales at all, but loans which R&G was obligated to repay. Without this phony income, R&G would have suffered a loss of approximately \$3.9 million for the second quarter of 2003, instead of net income of \$29.1 million.

60. On July 16, 2003, R&G issued a press release entitled "R&G Financial Reports Record Earnings for Second Quarter and Six Months Ended June 30, 2003." The Company reported net income for the second quarter of 2003 of \$31.4 million, a 37% increase when compared to net income for the same period of the prior year, and again represented that this increase was directly "attributable to record volumes of mortgage loan originations and sales." According to that press release:

R&G Financial Corporation ("the Company") (NYSE: RGF), the financial holding company of R-G Premier Bank, one of the fastest growing commercial banks in Puerto Rico, R-G Crown Bank, its federal savings bank with branches in the Orlando and Tampa/St. Petersburg Florida markets, and R&G Mortgage Corp, the second largest residential mortgage loan originator and servicer in Puerto Rico, today reported record earnings for the second quarter and first half of 2003.

For the first six months of 2003, net income amounted to \$60.6 million, compared to \$44.2 million 2002, an improvement of 37%. For the second quarter of 2003, net income amounted to \$31.4 million compared to \$22.6 million for the second quarter of 2002, an increase of 39%. For the six months of 2003, consolidated earnings per diluted share were \$1.54, compared to \$1.17 for 2002, an increase of 32%; for the second quarter of 2003, consolidated earnings per diluted share were \$0.80, compared to \$0.59 per diluted share for the second quarter of 2002, an increase of 36%.

These strong earning results were achieved notwithstanding impairment charges of \$27.5 million and \$16.7 million (included in operating expenses) during the first half and second quarter of 2003, respectively, on the Company's servicing asset. These charges reflect additional increases in mortgage prepayment rates during the period as a result of the continued low levels of interest rates. The resulting decrease in earnings was more than offset by increases in gain on sale and fees from mortgage loans, which were attributable to record volumes of mortgage loan originations and sales. Total loan production during the first half of 2003 was \$2.1 billion, a 61% increase over the first half in 2002; total loan production during the second quarter of 2003 was \$1.1 billion, a 49% increase. In both periods, over 90% of the total loan production was internally generated. Total loan production during the second quarter was the highest amount for any given quarter in the Company's history, surpassing the amount for the first quarter this year.

For the second quarter of 2003, gain on the origination and sale of loans increased 184% to \$44.8 million, while the Company's net interest income increased by 24% to \$44.6 million. For the first half of 2003, gain on the origination and sale of loans increased 133% to \$77.8 million, while the Company's net interest income increased by 28% to \$86.8 million. (Emphasis added.)

61. In that press release, Defendant Galan again commented favorably on the Company's "excellent results:"

We are pleased to report these excellent results during the quarter ended June 30, 2003. The increase in earnings reflects another strong quarter of loan production, surpassing the \$1 billion mark for the second consecutive quarter. Our loan portfolio has grown by close to \$250 million during the first half of 2003, due to

strong loan demand both in Puerto Rico and Central Florida, which position R&G very well for the future. As a result of these strong results, together with the continuing strong demand we are experiencing both in commercial and residential lending, we remain optimistic about our future performance. (Emphasis added.)

62. On August 14, 2003, the Company filed its Form 10-Q for the second quarter ended June 30, 2003 with the SEC (the "Second Quarter 2003 10-Q"). The Second Quarter 2003 10-Q was signed by Defendants Galan and Sandoval, and it reiterated the false financial information that had been announced in the July 16, 2003 press release.

63. The statements set forth in ¶¶60, 61 and 62 above were materially false and misleading because, among other reasons, Defendants fraudulently reported as income \$44.8 million attributed to gains on "sales" of non-conforming loans which, in reality, were not sales at all, but loans which R&G was obligated to repay. Without this phony income, R&G would have suffered a loss of approximately \$13.4 million.

64. On October 14, 2003, R&G issued a press release entitled "R&G Financial Reports Record Earnings for Third Quarter and Nine Months Ended September 30, 2003." The Company reported net income for the third quarter of 2003 of \$34.3 million. In the press release, the Company highlighted the fact that its net income represented a 37% increase when compared to the same period of the prior year. According to this press release:

R&G Financial Corporation (NYSE: RGF), ("the Company") the financial holding company of R-G Premier Bank, R-G Crown Bank and R&G Mortgage Corp, today reported record earnings for the third quarter and first nine months of 2003. For the first nine months of 2003, net income amounted to \$94.9 million, compared to \$69.2 million in 2002, an improvement of 37%. For the third quarter of 2003, net income amounted to \$34.3 million compared to \$25.0 million for the third quarter of 2002, an increase of 37%.

* * *

For the third quarter of 2003, gain on the origination and sale of loans increased 24% to \$30.2 million, while the Company's net interest income increased by 16% to \$47.7 million. For the first nine months of 2003, gain on the origination and

sale of loans increased 87% to \$108.0 million, while the Company's net interest income increased by 23% to \$134.5 million. (Emphasis added.)

65. In that press release, Defendant Galan again commented favorably on the Company's "excellent results," and assured investors that the Company's future remained bright:

We are pleased to report these excellent results during the quarter ended September 30, 2003. During the quarter, the Company achieved an exceptional quarter of loan production, reaching \$1.3 billion, the highest in the Company's history. A significant amount of these loans were added to the Company's loans portfolio, growing to about \$3.8 billion as of the end of the third quarter, or a \$1 billion increase since the beginning of the year. While a decrease in the volume of mortgage loan refinancings is expected in the future due to higher interest rates, the impact should not be substantial to the overall financial performance of the Company due to the continued strength in the Puerto Rico and Central Florida lending markets. Growth in the Company's banking and mortgage banking sectors should continue through ongoing expansion in commercial and residential lending, which leads us to remain optimistic about our future performance. (Emphasis added.)

66. On November 14, 2003, the Company filed its Form 10-Q for the third quarter ended September 30, 2003 with the SEC (the "Third Quarter 2003 10-Q"). The Third Quarter 2003 10-Q was signed by Defendants Galan and Sandoval, and it reiterated the false financial information that had been announced in the October 14, 2003 press release.

67. The statements set forth in ¶¶64, 65 and 66 above were materially false and misleading because, among other reasons, Defendants fraudulently reported as income \$30.2 million attributed to gains on "sales" of non-conforming loans for the quarter ended September 30, 2003, which, in reality, were not sales at all, but loans which R&G was obligated to repay. Without this phony income, R&G would have had net income of approximately only \$4.1 million for the third quarter of 2003 instead of net income of \$ 34.3 million. For the first nine months of 2003, R&G should have reported a loss of approximately \$13 million, rather than net income of \$108 million.

68. On January 20, 2004, R&G issued a press release entitled "R&G Financial

Reports Record Earnings for Fourth Quarter and Year Ended December 31, 2003.” (Emphasis added.) The Company reported net income for the fourth quarter of 2003 of \$36.1 million, a 33% increase over net income for the same period of the prior year. The Company further reported that net income for the year ended December 31, 2003 was \$131 million, compared to \$96.3 million in 2002, an increase of 36%. Once again, the Company attributed its “record earnings” to gains on the origination and sale of loans, which increased more than 40% when compared to the fourth quarter of 2002. According to that press release:

R&G Financial Corporation (NYSE: RGF) (“the Company”), the financial holding company of R-G Premier Bank, R-G Crown Bank and R&G Mortgage Corp., today reported record earnings for the fourth quarter and year ended December 31, 2003. For the year ended December 31, 2003, net income amounted to \$131.0 million, compared to \$96.3 million in 2002, an improvement of 36%. For the fourth quarter of 2003, net income amounted to \$36.1 million compared to \$27.1 million for the fourth quarter of 2002, an increase of 33%.

* * *

For the fourth quarter of 2003, gain on the origination and sale of loans increased 41% to \$38.9 million, while the Company's net interest income increased by 22% to \$53.4 million. For the year ended December 31, 2003, gain on the origination and sale of loans increased 72% to \$146.9 million, while the Company's net interest income increased by 23% to \$188.0 million. (Emphasis added.)

69. In that press release, Defendant Galan stated that he was “very pleased” with the Company’s “excellent results,” and further assured investors that 2004 would be another “strong year for R&G, with continued growth and profitability:”

We are very pleased to report these excellent results during the quarter and year ended December 31, 2003. During the quarter, the Company continued to successfully expand its loan portfolio, which is attributable both to general market growth coupled with the Company's ongoing penetration in residential and commercial lending in Central Florida and Puerto Rico. The loan portfolio grew to a record \$4.0 billion, or a 47% increase from the prior year-end, which positions the Company very well for its future performance. As a result, during the fourth quarter of 2003, the Company's net interest income alone grew an impressive 12% on a linked quarter basis (48% on an annual basis) 2004 should be another strong year for R&G, with continued growth and greater profitability.” (Emphasis added.)

70. The Company's announcement of its purported "record earnings" for 2003 had its desired impact on the price of R&G stock. Over the next several trading days, R&G stock increased more than 10%, from \$26.95 on January 20, 2004 to \$30.03 on January 26, 2004 -- the first time in the Company's history that the stock had closed above \$30.

71. On March 14, 2004, the Company filed its Form 10-K for the year ended December 31, 2003 with the SEC (the "2003 10-K"). The 2003 10-K was signed by Defendants Galan, Sandoval and Prats, and it reiterated the false financial information that had been announced in the January 20, 2004 press release.

72. The statements set forth in ¶¶68, 69 and 71 above were materially false and misleading because, among other reasons, Defendants fraudulently reported as income \$38.9 million attributed to gains on "sales" of non-conforming loans for the fourth quarter of 2003, which, in reality, were not sales at all, but loans which R&G was obligated to repay. Without this phony income, R&G would have had suffered a loss of approximately \$3.8 million for the fourth quarter of 2003 instead of net income of \$36.1 million. These statements were also false and misleading because, among other reasons, Defendants fraudulently included \$146.9 million from gains on "sales" of non-conforming loans for the year ended December 31, 2003, which, in reality, were not sales at all, but loans which R&G was obligated to repay. Without this phony income, R&G would have suffered a loss of \$15.9 million for fiscal 2003 instead of net income of \$131 million. R&G's 2003 10-K was also false and misleading because it understated the Company's liabilities (including debt), overstated stockholders' equity and falsely stated that R&G had adequate internal controls over its financial reporting process.

73. On April 19, 2004, R&G issued a press release entitled "R&G Financial Reports Record Earnings for First Quarter Ended March 31, 2004." (Emphasis added.) The Company

reported net income for the first quarter of 2004 of \$38.5 million, a 32% increase over net income for the same period of the prior year. According to that press release:

R&G Financial Corporation ("the Company") (NYSE: RGF), the financial holding company of R-G Premier Bank, R-G Crown Bank and R&G Mortgage Corp., today reported record earnings for the first quarter ended March 31, 2004. For the first quarter of 2004, net income amounted to \$38.5 million, compared to \$29.1 million for the first quarter in 2003, an increase of 32%.

* * *

For the first quarter of 2004, the Company's net interest income increased by 32% to \$55.7 million, due to an increase in earnings assets during the period, while gain on the origination and sale of loans increased 21% to \$39.9 million. (Emphasis added.)

74. In that press release, Defendant Galan again commented favorably on the Company's strong earnings:

We remain very positive about the Company's future prospects and the year 2004, which we continue to believe should be another strong year for R&G, with continued growth and greater profitability. (Emphasis added.)

75. On May 10, 2004, the Company filed its Form 10-Q for the first quarter ended March 31, 2004 with the SEC (the "First Quarter 2004 10-Q"). The First Quarter 2004 10-Q was signed by Defendants Galan and Sandoval, and it reiterated the false financial information that had been announced in the April 19, 2004 press release.

76. The statements set forth in ¶¶ 73, 74 and 75 above were materially false and misleading because, among other reasons, Defendants fraudulently reported as income \$39.9 million attributed to gains on "sales" of non-conforming loans for the first quarter of 2004, which, in reality, were not sales at all, but loans which R&G was obligated to repay. Without this phony income, R&G would have suffered a loss of approximately \$1.4 million for the first quarter of 2004 instead of net income of \$38.5 million.

77. On July 19, 2004, R&G issued a press release reporting "Record Earnings" for the

second quarter and six months ended June 30, 2004. The Company reported net income for the second quarter of 2004 of \$40.7 million, a 30% increase over net income for the same period of the prior year. According to that press release:

R&G Financial Corporation (the "Company") (NYSE:RGF), the financial holding company of R-G Premier Bank, R-G Crown Bank, and R&G Mortgage Corp, today reported record earnings for the second quarter and first half of 2004.

* * *

For the first six months of 2004, net income amounted to \$79.3 million, compared to \$60.6 million in 2003, an improvement of 31%. For the second quarter of 2004, net income amounted to \$40.7 million compared to \$31.4 million for the second quarter of 2003, an increase of 30%. For the six months of 2004, consolidated earnings per diluted share were \$1.39, compared to \$1.03 for 2003, an increase of 35%; for the second quarter of 2004, consolidated earnings per diluted share were \$0.72, compared to \$0.54 per diluted share for the second quarter of 2003, an increase of 33%.

* * *

For the second quarter of 2004, the Company's net interest income increased 26% to \$56.0 million, due primarily to an increase in earning assets during the period, while gain on the origination and sale of loans decreased 8% to \$41.4 million. While the Company's loan production during the 2004 quarter increased 4% to \$1.1 billion compared to 2003, the Company retained an increasing amount of its total production in its loan portfolio, in an effort to continue growing its future net interest income by expanding the volume of loans. For the first half of 2004, the Company's net interest income increased by 29% to \$111.7 million, while gain on the origination and sale of loans increased 4% to \$81.3 million. (Emphasis added.)

78. In that press release, Defendant Galan again touted the Company's "excellent results," which he attributed to gains on the sale of loans originated to R&G, and assured investors that the future for R&G was bright:

We are pleased to report these excellent results during the quarter ended June 30, 2004. The increase in earnings reflects another strong quarter of loan production, as we continue to benefit from strong loan demand both in Puerto Rico and Central Florida. Our loan portfolio has grown over \$450 million during the first half of 2004, which continues to position R&G very well for the future. As a result of these strong results, together with the continuing strong demand we are

experiencing both in commercial and residential lending, we remain optimistic about our future performance. (Emphasis added.)

79. On August 9, 2004, the Company filed its Form 10-Q for the second quarter ended June 30, 2004 with the SEC (the "Second Quarter 2004 10-Q"). The Second Quarter 2004 10-Q was signed by Defendants Galan and Sandoval, and it reiterated the false financial information that had been announced in the July 19, 2004 press release.

80. The statements set forth in ¶¶77, 78 and 79 above were materially false and misleading because, among other reasons, Defendants fraudulently reported as income \$41.4 million attributed to gains on "sales" of non-conforming loans for the second quarter of 2004, which, in reality, were not sales at all, but loans which R&G was obligated to repay. Without this phony income, R&G would have had suffered a loss of approximately \$700,000 for the second quarter of 2004, instead of net income of \$40.7 million.

81. On October 22, 2004, R&G issued a press release entitled "R&G Financial Reports Record Earnings for Third Quarter and Nine Months Ended September 30, 2004." The Company reported net income for the third quarter of 2004 of \$40.9 million, a 19% increase over net income for the same period of the prior year. According to that press release:

R&G Financial Corporation (NYSE: RGF) (the "Company"), the financial holding company of R-G Premier Bank, R-G Crown Bank and R&G Mortgage Corp, today reported record earnings for the third quarter and first nine months of 2004.

For the first nine months of 2004, net income amounted to \$120.2 million, compared to \$94.9 million in 2003, an improvement of 27%. For the third quarter of 2004, net income amounted to \$40.9 million, compared to \$34.3 million for the third quarter of 2003, an increase of 19%. For the nine months of 2004, consolidated earnings per diluted share were \$2.11, compared to \$1.62 for 2003, an increase of 30%. For the third quarter of 2004, consolidated earnings per diluted share were \$0.72, compared to \$0.59 per diluted share for the third quarter of 2003, an increase of 22%.

These excellent results were achieved notwithstanding trading losses of \$25.0 million and \$24.0 million during the nine months and quarter ended September

30, 2004, respectively, on derivative instruments held by the Company, including certain derivatives held for risk management purposes.

* * *

For the third quarter of 2004, the Company's net interest income increased 29% to \$61.4 million, due primarily to an increase in earning assets during the period, while gain on sale of loans increased 85% to \$54.5 million. For the first nine months of 2004, the Company's net interest income increased by 29% to \$173.1 million, while gain on sale of loans increased 27% to \$136.9 million. (Emphasis added.)

82. In that press release, Defendant Galan repeated what was by now his standard comment on the Company's financial results and operating condition:

The increase in earnings reflects another strong quarter of loan production as we continue to benefit from strong loan demand both in Puerto Rico and Central Florida, which continues to position R&G very well for the future. As a result of these strong results, together with the continuing strong demand we are experiencing both in commercial and residential lending, we remain optimistic about our future performance. (Emphasis added.)

83. The statements set forth in ¶¶81 and 82 above were materially false and misleading because, among other reasons, Defendants fraudulently reported as income \$54.5 million attributed to gains on "sales" of non-conforming loans for the third quarter of 2004, which, in reality, were not sales at all, but loans which R&G was obligated to repay. Without this phony revenue, R&G would have had suffered a loss of approximately \$13.6 for the third quarter of 2004 instead of net income of \$40.9 million.

84. On November 10, 2004, the Company filed a Form 12b-25 with the SEC which stated that the filing of its 10-Q for the third quarter of 2004 would be delayed so that R&G could "review[] certain information regarding past sale transactions to determine whether the application of SFAS 133 [Accounting for Derivative Instruments and Hedging Derivatives] to its residual interests is appropriate to events that occurred during the second and/or third quarter of 2004." R&G further stated in the Form 12b-25 that it "believes that the issues involved are not

material at this time and does not expect to restate its results for the quarter ended September 30, 2004. However, the Company is not filing its Quarterly Report on Form 10-Q for the period ended September 30, 2004 until it completes its review, which is expected to be completed shortly."

85. On November 15, 2004, R&G issued a press release announcing that it was revising downward its previously announced earnings for the third quarter of 2004. As a result of these revisions, R&G announced that its income for the quarter ended September 30, 2004 decreased by approximately \$3.9 million (or \$0.08 per diluted share) from what it reported in its October 22, 2004 press release. According to the press release, "the Company has concluded that it is appropriate to reduce by \$2.5 million its trading loss related to its residual interests classified as trading derivatives, for aggregate trading losses of \$21.5 million. In addition, the Company has determined that certain interest-only strips that are classified as available for sale securities were impaired. As such, the Company has recorded a permanent impairment charge of \$8.8 million in accordance with EITF 99-20, Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets, which is the primary reason for the change to previously released earnings information."

86. Also on November 15, 2004, the Company filed its Form 10-Q for the third quarter ended September 30, 2004 with the SEC (the "Third Quarter 2004 10-Q").

87. R&G's November 15, 2004 press release and Third Quarter 2004 10-Q were false and misleading because the financial results stated therein continued to be materially inflated, and because these public disclosures continued to conceal the true nature of the Company's fraudulent accounting. Indeed, these disclosures made no reference to the fact that R&G's loan "sales" were really not sales.

88. On January 24, 2005, R&G issued a press release entitled "R&G Financial Reports Record Earnings for Fourth Quarter and Year Ended December 31, 2004." (Emphasis added.) The Company reported net income for the fourth quarter of 2004 of \$43.9 million, a 22% increase over net income for the same period of the prior year. The Company further reported that net income for the year ended December 31, 2004 was \$160.2 million, compared to \$131 million in 2003, an increase of 22%. For the year ended December 31, 2003, consolidated earnings per diluted share were \$2.81, compared to \$2.25 for 2003, an increase of 25%. According to that press release:

R&G Financial Corporation (NYSE: RGF) (the "Company"), the financial holding company of R-G Premier Bank, R-G Crown Bank and R&G Mortgage Corp, today reported record earnings for the fourth quarter and year ended December 31, 2004.

For the year ended December 31, 2004, net income amounted to \$160.2 million, compared to \$131.0 million in 2003, an improvement of 22%. For the fourth quarter of 2004, net income amounted to \$43.9 million compared to \$36.1 million for the fourth quarter of 2003, an increase of 22%. For the year ended December 31, 2004, consolidated earnings per diluted share were \$2.81, compared to \$2.25 for 2003, an increase of 25%; for the fourth quarter of 2004, consolidated earnings per diluted share were \$0.78, compared to \$0.63 per diluted share for the fourth quarter of 2003, an increase of 24%.

* * *

For the year ended December 31, 2004, the Company's net interest income increased by 23% to \$230.9 million, due primarily to an increase in earning assets during the period, while gain on sale of loans increased 19% to \$175.5 million. For the fourth quarter of 2004, the Company's net interest income increased 8% to \$57.8 million, while gain on sale of loans increased 27% to \$49.6 million. (Emphasis added.)

89. In that press release, Defendant Galan again commented favorably on the Company's strong earnings:

We are pleased to report another strong quarter of earning and loans production. We ended 2004 with record assets of \$10.2 billion, resulting from continued strong demand in residential and commercial lending both in Puerto Rico and

Central Florida, as evidenced by our \$1.5 billion record loan production during the fourth quarter of 2004... (Emphasis added.)

90. On March 16, 2005, the Company filed its Form 10-K for the year ended December 31, 2004 with the SEC (the "2004 10-K"). The 2004 10-K was signed by Defendants Galan, Sandoval and Prats, and it reiterated the false financial information that had been announced in the January 20, 2004 press release.

91. The statements set forth in ¶¶88, 89 and 90 above were materially false and misleading because, among other reasons, Defendants fraudulently reported as income \$49.6 million attributed to gains on "sales" of non-conforming loans for the fourth quarter of 2004, which, in reality, were not sales at all, but loans which R&G was obligated to repay. Without this phony income, R&G would have suffered a loss of approximately \$5.7 million for the fourth quarter of 2004 instead of net income of \$43.9 million. These statements were also materially false and misleading because, among other reasons, Defendants fraudulently reported as income \$175.5 million attributed to gains on "sales" of non-conforming loans for the year ended December 31, 2004, which, in reality, were not sales at all, but loans which R&G was obligated to repay. Without this phony income, R&G would have suffered a loss of approximately \$15.3 million for the year ended December 31, 2004, instead of net income of \$160.2 million. R&G's 2004 10-K was also false and misleading because it understated the Company's liabilities (including debt), overstated stockholders' equity and falsely stated that R&G had adequate internal controls over its financial reporting process.

VII. THE TRUTH BEGINS TO EMERGE

92. Fueled by Defendants' repeated pronouncements of "record earnings" and "exceptional" financial results, by the end of 2004, R&G stock had reached record highs, closing at an all-time high of \$40.75 per share on December 1, 2004. By March 2005, shortly after the

Company announced its “record” results for 2004, the stock was still trading above \$37. Then, on March 15, 2005, the market began to become aware of possible issues with respect to R&G’s accounting. On that day, Doral, which was R&G’s principal competitor in Puerto Rico, filed its 2004 Form 10-K. Like R&G, Doral derived a significant portion of its income from gains on the sale of loans which it originated, and the market understood that both banks (which were the two largest banks in Puerto Rico, headquartered within miles of each other in Hato Rey, San Juan, and used PwC as their outside auditors) likely accounted for the gains on sale in the same fashion. Indeed, when it came to sales of loans, R&G and Doral were among each others’ best customers – many of the sales which Doral reportedly made during the Class Period were to R&G, and many of the sales which R&G reportedly made were to Doral. The market therefore understood that, to the extent Doral was improperly accounting for gains on sale of loans, it was likely that R&G was also improperly accounting for these transactions.

93. Doral’s 2004 Form 10-K disclosed the assumptions that Doral had been using to calculate the “gains” from the sale of its loans to R&G and others. Doral’s disclosures immediately caused the market to begin to question those assumptions. On March 17, 2005, Doral held a conference call with analysts and investors to discuss the issues raised concerning the assumptions disclosed in its 10-K. During that call, Doral’s management attempted to stem the decline in Doral’s stock by reassuring analysts that the assumptions it used were “sound.” However, the explanations provided for Doral’s assumptions during this call only raised greater questions and skepticism regarding the Company’s assumptions. Following the call, Wachovia Securities issued a report noting the “overly aggressive [IO valuation] assumptions” used by Doral, downgrading Doral to “Under-perform” and lowering earnings estimates for 2005.

94. Throughout March and April 2005, the price of both Doral and R&G common

stock declined precipitously, as the market became increasingly concerned of accounting improprieties at both companies. Thus, between March 15, 2005 (when Doral filed its 2004 Form 10-K) and April 19, 2005 (when Doral announced that it would have to restate its financial statements), R&G stock declined 35%, falling from \$35.58 on March 15 to \$23.18 on April 25. During this time period, a number of analysts specifically attributed the decline in R&G to investor concerns about the Company's accounting. For example, on April 12, 2005, Friedman Billings Ramsey issued a report which noted that, in response to Doral's disclosures, "investors have questioned the methods" used by R&G to account for gains from its loan sales transactions. Similarly, a research report issued by Cohen Bros. Securities recognized that, after Doral's disclosures, investors in R&G were anticipating that R&G would have to restate its financial statements as well.

95. The market's concerns about R&G proved to be well-founded. On April 25, 2005 (only six days after Doral announced its restatement), R&G announced that it would have to restate its financial statements for 2003 and 2004 because the Company had been using an improper "valuation methodology" to record gains on sale. The restatement was massive, wiping out virtually all of the gains the Company had recorded from the sale of its loans. The Company further disclosed that it had retained outside counsel to commence an investigation into these improprieties, and that the SEC had commenced an "informal investigation." According to the press release:

R&G Financial Corporation (NYSE: RGF - News; "R&G Financial") announced today that after consultation with its independent accountants and firms with experience in valuation issues, the Company has determined to review the independent market valuations used in valuing residual interests retained in securitization transactions of the Company. The Company stated that it is revising its valuation methodology used in valuing these interests that are presented in the Company's audited consolidated financial statements. The Company reached this determination after discussions with its independent

accountants, which the Company initiated on Tuesday, April 19th and culminated on Friday, April 22nd.

As of December 31, 2004, the Company had reported in its recently-issued audited consolidated financial statements an aggregate of \$190 million of residual interests retained. Under the methodology used to prepare the audited consolidated financial statements, the Company had taken impairment charges on its residual interests amounting to \$20.3 million and \$11.90 million during the third and fourth quarters of 2004, respectively. An additional impairment charge for the first quarter of 2005 of \$30.1 million had been estimated by the Company under the methodology it had been using.

The Company is considering alternative valuation methodologies. Depending on the valuation methodology used, the Company has preliminarily estimated that the fair value of its residual interests would be reduced as of December 31, 2004 by an amount equal to between approximately \$90 million to \$150 million (\$55 million and \$90 million after taxes, respectively). Any such reduction would be a non-cash charge to the Company's consolidated statement of operations. The Company has not yet determined how such net impact will be distributed among the affected periods.

The Company has concluded that previously filed interim and audited financial statements for the periods from January 1, 2003 through December 31, 2004, would be materially affected as a result of the revision in the valuation methodologies being contemplated, and therefore, the financial statements for the periods included therein should be restated. The Company's independent accountants have not yet performed audit procedures on any revised estimates.

As a result of these events, the Company will delay the release of its earnings for the first quarter of 2005. The Company intends to release its unaudited earnings for the first quarter of 2005 and the restated results for prior periods as soon as practicable. As part of this process, the Company will be reviewing the management report on internal control over financial reporting for 2004. The Company has also retained Sullivan & Cromwell LLP as its special counsel to advise the Company on legal issues arising from the valuation of its residual interests retained on securitization transactions. (Emphasis added.)

96. On April 26, 2005, the first trading day after this announcement, R&G's stock price fell from \$23.18 to \$15.04, or 35.1%, on unusually heavy volume of 5.8 million shares.

97. The Company's April 25 disclosure, while a partial disclosure of the fraud, continued to falsely represent the true state of affairs at R&G. Indeed, that press release downplayed the reasons for the restatement, attributing it to errors in the Company's "valuation

methodology,” rather than to the fact that these transactions were not true sales. As a result, the Company created the false impression that these transactions were legitimate, when they were not. Had the market known the truth about the Company’s “gains on sale” of mortgages, the stock would have fallen even further.

98. On April 29, 2005, the Company filed another Form 8-K with the SEC, which reiterated the information in the April 25 press release and further stated that, on April 28, 2005, the Audit Committee of R&G’s Board of Directors concluded that the previously filed interim and audited financial statements for the periods from January 1, 2003 through December 31, 2004, should no longer be relied on. In addition, R&G stated that the Company’s management had concluded that, due to the magnitude of the estimated reduction to the fair value of its residual interests, Management’s Report on Internal Control Over Financial Reporting set forth on page 63 of the Company’s 2004 10-K had to be restated and should no longer be relied on. According to this 8-K, R&G determined that it had a material weakness in internal controls over financial reporting as of December 31, 2004 relating to the lack of effective controls over the valuation of the Company’s residual interests and, as a result, R&G’s management expected that the Company would receive an adverse opinion on internal control over financial reporting from its auditors, Defendant PwC.

99. On July 27, 2005, the Company announced that its Audit Committee had determined that the Company’s financial statements for 2002 also had to be restated and should no longer be relied upon. The Company further disclosed that it had hired an investment banking firm to value the retained residual interests from its mortgage loan sale transactions and had hired another independent registered public accounting firm as a consultant to review the valuation process and the conclusions reached. In addition, R&G stated that its Audit Committee

had retained a second law firm, Fried, Frank, Harris, Jacobson & Shriver LLP, and a financial services consulting firm, Promontory Financial Group, LLP, to conduct an investigation into the circumstances surrounding the valuation of the retained interests. R&G further stated that "due to the complex nature of the review and the need for all valuations and any resulting adjustments to our audited consolidated financial statements to be reviewed and accepted by PriceWaterhouseCoopers LLP," it did not expect to timely file its quarterly report on Form 10-Q for the quarter ended June 30, 2005. The Company also disclosed that it now expected that the effect of the restatement would be substantially greater than it originally estimated and would reduce stockholders' equity by \$190 million to \$220 million, of which \$160 million related to the adjustments for retained residual interests.

100. On August 24, 2005, R&G disclosed that the Board of Directors had removed Defendant Sandoval from his position as CFO and placed him on an indefinite leave of absence.

101. On August 25, 2005, First BanCorp - the purported "purchaser" of many of R&G's non-conforming mortgages - announced that it had received a letter from the SEC indicating that the agency was conducting an informal inquiry into its accounting for, among other things, mortgage loans purchased by First BanCorp from "two other financial institutions" (R&G and Doral) during the calendar years 2000 through 2004, the terms of these transactions and the accounting for these transactions.

102. On August 26, 2005, R&G issued an 8-K press release to "correct" a statement made by Defendant Galan that had appeared in the August 26, 2005 edition of the American Banker. Galan had told that publication that Defendant Sandoval was not fired for cause and was not found to have committed any wrongdoing. In response to these false statements, R&G immediately issued the 8-K, which stated that "the remarks attributed to Mr. Galan do not reflect

the views of the Company, its board of directors or its Audit Committee.”

103. By early October 2005, R&G stock had declined further in response to the disclosures, to approximately \$11 per share.

104. On October 21, 2005, First BanCorp made a further announcement concerning the investigation undertaken by its audit committee regarding the matters inquired into by the SEC. In that press release, First BanCorp disclosed for the first time that its transactions with R&G did not qualify as true sales. Specifically, First BanCorp stated: "One issue under review by the Audit Committee is whether the mortgage transactions at issue were properly classified for accounting purposes as purchases of the mortgage loans by First Bank or whether they should have been treated as loans by First Bank to the other financial institutions, secured by the mortgages. Although the Company's accounting analysis is not complete, First Bank has concluded that most of its transactions with one financial institution, R&G Mortgage Corp, did not qualify as true sales as a legal matter. Accordingly, these transactions may need to be accounted for as a secured loan to that financial institution." (Emphasis added.) This announcement by First Bank was the first disclosure to the market that the transactions between R&G and First BanCorp were not actually "sales."

105. On October 24, 2005, R&G announced that the SEC had launched a formal investigation into its accounting practices.

106. In response to the announcements on October 21 and October 24, 2005, the price of R&G stock declined another \$2.30, from \$11.70 on October 21, 2005 to \$9.40 on October 26, 2005, a decline of 19.7%.

107. In an article in the June 16, 2006 issue of Caribbean Business, Defendant Galan stated that he expected that R&G would complete its restatement by the end of that summer. On

July 3, 2006, R&G again issued a press release on Form 8-K to “clarify and supplement” the statements Galan had made to Caribbean Business. The 8-K stated that the Company believed that it was unlikely that the restatement of its consolidated financial statements for the years ended December 31, 2002 through 2004 would be completed by the end of the summer. Instead, the Company stated that it expected that the restatement would be completed in the fourth quarter of 2006.

108. On October 3, 2006, R&G announced by press release that the NYSE had granted the Company’s request for up to a six-month extension of time, or until April 3, 2007, to file its restated financial statements and 2005 Annual Report on Form 10-K.

109. On December 18, 2006, R&G revealed that the internal investigation performed in connection with the restatement discovered that, not only had the Company improperly recorded secured borrowing transactions as sales during the Class Period, but that its most senior officers, Defendants Galan and Sandoval, knew that these transactions were not true sales and that recording them as sales would cause a significant adverse impact on the Company’s financial condition if they were required to be restated. As a result of these revelations, R&G’s Board fired Galan as President and CEO of the Company.

110. On February 13, 2007, R&G announced that it did not believe it would be able to file its restated financial statements or its 2005 year-end financial statement by the April 3, 2007 deadline imposed by the NYSE. The Company further announced that its restatement was going to be materially larger than previously announced, and that the aggregate reductions to its stockholders’ equity as a result of the restatement would now be between \$300 to \$320 million – or almost 50% greater than previously disclosed.

111. Following R&G’s announcement on February 13, 2007, the NYSE announced

that it had determined that R&G's Class B shares should be suspended from trading prior to the opening of the Exchange on February 22, 2007.

112. In the aftermath of the February 13, 2007 disclosure, analysts following the Company cut their ratings on R&G stock. Specifically, Cohen & Company issued a report shortly after the Company's disclosure downgrading R&G stock from a "hold" to a "sell" and attributing the downgrade to the increased size of the restatement and the NYSE's anticipated de-listing of R&G from the Exchange. Think Equity Partners LLC also cut its rating to a "sell" on the morning of February 13 and reduced its price target for R&G stock from \$7 per share to \$5 per share.

113. On February 13, 2007, in response to the Company's press release issued that morning and the NYSE's announcement that it would de-list R&G's stock, the price of R&G common stock dropped another \$2.02, from \$7.20 to \$5.68, or 26.23%, on heavy volume.

VIII. THE COMPANY'S VIOLATIONS OF GAAP

114. In order to inflate the Company's financial results during the Class Period and the price of R&G stock, Defendants caused the Company to falsely report its financial results for years 2002, 2003 and 2004 by, among other things, overstating revenue and income.

115. The Company has admitted that its financial statements issued during the Class Period were false when issued and that the overstatement of revenue and income was material, such that the Company's 2002, 2003 and 2004 financial statements should no longer be relied on, were not a fair presentation of R&G's results, and were presented in violation of GAAP and SEC rules.

116. GAAP are those principles recognized by the accounting profession as the conventions, rules and procedures necessary to define accepted accounting practice at a particular time. SEC Regulation S-X (17 C.F.R. § 210.4-01(a)(1)) states that financial statements

filed with the SEC which are not prepared in compliance with GAAP are presumed to be misleading and inaccurate, despite footnote or other disclosure. Regulation S-X requires that interim financial statements must also comply with GAAP, with the exception that interim financial statements need not include disclosure which would be duplicative of disclosures accompanying annual financial statements. 17 C.F.R. § 210.10-01(a).

117. The fact that R&G is restating its financial statements is an admission that the financial statements originally issued were false and that the overstatement of, among other things, revenue and income were material. Pursuant to GAAP, as set forth in Accounting Principles Board ("APB") Opinion No. 20, the type of restatement announced by R&G is to correct for material errors in its previously issued financial statements. See APB No. 20, ¶¶ 17-13. The restatement of past financial statements is a disfavored method of recognizing an accounting change as it dilutes confidence by investors in the financial statements, it makes it difficult to compare financial statements and it is often difficult, if not impossible, to generate the numbers when restatement occurs. See APB No. 20, ¶14. Thus, GAAP provides that financial statements should only be restated in limited circumstances, i.e., when there is a change in the reporting entity, there is a change in accounting principles used or to correct an error in previously issued financial statements. R&G's restatement will not be due to a change in reporting entity or a change in accounting principle, but rather to errors in previously issued financial statements. Thus, the restatement is an admission by R&G that its previously issued financial results and its public statements regarding those results were materially false.

118. Due to these accounting improprieties, the Company presented its financial results and statements in a manner which violated GAAP. As stated above, R&G's transactions failed to meet the applicable accounting standards for a sale. Therefore the Company's financial

results and statements were presented in a manner that violated FASB's Statement of Financial Accounting Standards ("SFAS") No. 140 – the primary relevant GAAP relating to transfers of financial assets. As described above in ¶¶40-43, pursuant to SFAS No. 140, a transfer of financial assets (or a portion of a financial asset) for cash or other proceeds should be accounted for as a "sale" only if, and to the extent that, the transferor surrenders control over those financial assets.

119. In addition, the Company presented its financial results and statements in a manner which, among other things, also violated the following fundamental accounting principles:

- (a) The principle that interim financial reporting should be based upon the same accounting principles and practices used to prepare annual financial statements was violated (APB No. 28, ¶10);
- (b) The principle that financial reporting should provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit and similar decisions was violated (FASB Statement of Concepts No. 1, ¶34);
- (c) The principle that financial reporting should provide information about the economic resources of an enterprise, the claims to those resources, and effects of transactions, events and circumstances that change resources and claims to those resources was violated (FASB Statement of Concepts No. 1, ¶40);
- (d) The principle that financial reporting should provide information about how management of an enterprise has discharged its stewardship

responsibility to owners (stockholders) for the use of enterprise resources entrusted to it was violated. To the extent that management offers securities of the enterprise to the public, it voluntarily accepts wider responsibilities for accountability to prospective investors and to the public in general (FASB Statement of Concepts No. 1, ¶50);

- (e) The principle that financial reporting should provide information about an enterprise's financial performance during a period was violated. Investors and creditors often use information about the past to help in assessing the prospects of an enterprise. Thus, although investment and credit decisions reflect investors' expectations about future enterprise performance, those expectations are commonly based at least partly on evaluations of past enterprise performance (FASB Statement of Concepts No. 1, ¶42);
- (f) The principle that financial reporting should be reliable in that it represents what it purports to represent was violated. That information should be reliable as well as relevant is a notion that is central to accounting (FASB Statement of Concepts No. 2, ¶¶58-59);
- (g) The principle of completeness, which means that nothing omitted from the information that may be necessary to insure that it validly represents underlying events and conditions, was violated (FASB Statement of Concepts No. 2, ¶79); and
- (h) The principle that conservatism be used as a prudent reaction to uncertainty to try to ensure that uncertainties and risks inherent in business situations are adequately considered was violated. The best way to avoid

injury to investors is to try to ensure that what is reported represents what it purports to represent (FASB Statement of Concepts No. 2, ¶¶95, 97).

120. Further, the undisclosed adverse information concealed by Defendants during the Class Period is the type of information which, because of SEC regulations, regulations of the national stock exchanges and customary business practice, is expected by investors and securities analysts to be disclosed and is known by corporate officials and their legal and financial advisors to be the type of information that is expected to be and must be disclosed.

IX. PWC'S PARTICIPATION IN THE FRAUD

121. During the Class Period, PwC's San Juan office served as the outside auditors for R&G, First BanCorp and Doral.

122. Doral and First BanCorp have issued massive restatements of their previously issued financial statements due in substantial part to their fraudulent accounting for the "sales" and "purchases" of mortgages with R&G. As a result of its fraudulent accounting for the same transactions, R&G has been working on its restatement for almost two years. R&G, Doral and First BanCorp are also all the subject of U.S. Federal investigations and have agreed to oversight by U.S. regulators stemming from their improper accounting for these "sales" and "purchases" of pooled mortgage loans.

123. PwC issued clean and unqualified audit opinions to R&G, First BanCorp and Doral for every one of the year-end financial statements that all three of these financial institutions have now admitted were materially false and misleading. As described herein, PwC performed auditing procedures so deficient, and engaged in such an egregious refusal to see the obvious or to investigate the doubtful, that its audits of R&G amounted to no audit at all.

**A. PwC's Materially False and Misleading Statements
During the Class Period**

124. PwC issued the following materially false and misleading clean and unqualified audit report, dated February 28, 2003, regarding R&G's financial statements for fiscal 2002:

In our opinion, the accompanying consolidated statements of financial condition and the related consolidated statements of income, of comprehensive income, of changes in stockholders' equity, and of cash flows present fairly, in all material respects, the financial position of R&G Financial Corporation (the Company) and its subsidiaries as of December 31, 2002 and 2001, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

125. PwC issued the following materially false and misleading clean and unqualified audit report, dated March 5, 2004, regarding R&G's financial statements for fiscal 2003 and 2002:

In our opinion, the accompanying consolidated statements of financial condition and the related consolidated statements of income, of comprehensive income, of changes in stockholders' equity, and of cash flows present fairly, in all material respects, the financial position of R&G Financial Corporation (the Company) and its subsidiaries at December 31, 2003 and 2002, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2003 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting

principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

126. PwC issued the following materially false and misleading clean and unqualified audit report, dated March 15, 2005, regarding R&G's financial statements for fiscal 2004, 2003 and 2002:

We have completed an integrated audit of R&G Financial Corporation's 2004 consolidated financial statements and of its internal control over financial reporting as of December 31, 2004 and audits of its 2003 and 2002 consolidated financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

Consolidated financial statements

In our opinion, the consolidated statements of financial condition and the related consolidated statements of income, of comprehensive income, of changes in stockholders' equity and of cash flows present fairly, in all material respects, the financial position of R&G Financial Corporation and its subsidiaries at December 31, 2004 and 2003, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2004 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

Internal control over financial reporting

Also, in our opinion, management's assessment, included in Management's Report on Internal Control Over Financial Reporting appearing on page 32 of the 2004 Annual Report to Shareholders that the Company maintained effective internal control over financial reporting as of December 31, 2004 based on criteria established in "Internal Control - Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO),

is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2004, based on criteria established in "Internal Control - Integrated Framework" issued by COSO. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management's assessment and on the effectiveness of the Company's internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

127. Contrary to PwC's representations, as explained herein, the statements set forth in ¶¶124, 125 and 126 above were materially false and misleading in numerous respects, including that (1) R&G's financial statements for fiscal years 2002, 2003 and 2004 had not been prepared in accordance with U.S. GAAP; and (2) PwC's audit of R&G's financial statements for these years had not been performed in accordance with U.S. GAAS.

B. PwC Knew or Recklessly Disregarded that Its "Audits" of R&G's Class Period Financial Statements Were Not Conducted in Accordance with Auditing Standards

128. In certifying R&G's financial statements, Defendant PwC falsely represented that its audits were conducted in accordance with GAAS. In fact, PwC violated GAAS in numerous respects during the course of its "audits" of R&G's financial statements during the Class Period.

129. For example, GAAS, as set forth in AU §326, required PwC to:

- Obtain sufficient competent evidential matter through inspection, observation, inquiries and confirmations to afford a reasonable basis for an opinion regarding the financial statements under audit;
- Consider whether specific audit objectives have been achieved in

evaluating evidential matter;

- Be thorough in the search for evidential matter and unbiased in its evaluation;
- Design audit procedures to obtain competent evidential matter; and
- Consider relevant evidential matter regardless of whether it appears to corroborate or to contradict the assertions in the client's financial statements.

130. In violation of the above standards, and contrary to the representations in its audit reports on R&G's financial statements, PwC did not obtain, or failed to sufficiently review, competent evidential matter to support the assertions in R&G's financial statements during the Class Period.

131. Had PwC obtained sufficient competent evidential matter in the course of "auditing" R&G's financial statements during the Class Period, it would have learned, if it did not already know, of R&G's myriad, material violations of GAAP, as alleged herein.

132. In addition to the foregoing violations of GAAS, PwC violated at least the following standards of GAAS in "auditing" R&G's financial statements during the Class Period:

- (a) General Standard No. 3, which requires that due professional care be exercised by the auditor in the performance of the audit and the preparation of the audit report. Due professional care also requires that the auditor maintain professional skepticism in the course of auditing a client's financial statements. PwC conducted its "audits" of R&G's financial statements with such lack of care that it permitted systemic internal control deficiencies to exist over a multi-year period. Indeed, GAAS, in AU §322, required PwC to make appropriate inquiries of R&G's

Internal Audit personnel in the performance of its audits of R&G's financial statements.

- (b) Standard of Field Work No. 2, which required PwC to make a proper study of existing internal controls, including accounting, financial and managerial controls, to determine whether reliance thereon was justified, and if such controls are not reliable, to expand the nature and scope of the auditing procedures to be applied. The standard provides that a sufficient understanding of an entity's internal control structure be obtained to adequately plan the audit and to determine the nature, timing and extent of tests to be performed.
- (c) AU §316, which required PwC to plan and perform its audits in a manner that reasonably assured that R&G's Class Period financial statements were free from misstatements caused by error or fraud. PwC failed to adequately plan and perform its audit procedures in a manner reasonably designed to identify the numerous financial and accounting improprieties alleged herein. Such failures by PwC permitted R&G to issue materially false and misleading financial statements over a five year period.
- (d) GAAS Standard of Reporting No. 1, which requires the audit report to state whether the financial statements are presented in accordance with GAAP. PwC's audit reports falsely represented that R&G's fiscal year 2002, 2003 and 2004 financial statements were presented in conformity with GAAP, which as described herein was untrue.

- (e) GAAS Standard of Reporting No. 4, which requires that, when an opinion on the financial statements as a whole cannot be expressed, the reasons therefore must be stated. PwC was required to state that no opinion could be issued by it on R&G's fiscal year 2002, 2003 or 2004 financial statements or issue an adverse opinion stating that such financial statements were not fairly presented in conformity with GAAP. PwC's failure to make such a qualification, correction, modification and/or withdrawal of its audit opinions was a violation of GAAS, including the fourth standard of reporting. PwC also failed to require R&G to restate its Class Period financial statements to correct the numerous violations of GAAP alleged herein.
- (f) GAAS General Standard No. 2, which requires that independence in mental attitude is to be maintained by the auditor in all matters related to the audit.
- (g) GAAS General Standard No. 1, which requires that audits be performed by persons having adequate technical training and proficiency.
- (h) GAAS Standard of Field Work No. 1, which requires that the audit is to be adequately planned and that assistants should be properly supervised; and
- (i) GAAS Standard of Reporting No. 2, which requires that the audit report identify circumstances in which GAAP has not been consistently observed.

133. In certifying R&G's financial statements, Defendant PwC falsely represented that it conducted its audits of R&G's financial statements in accordance with each of the above-noted

auditing standards.

C. PwC Knew or Recklessly Disregarded that Its “Audit” Report on R&G’s 2004 System of Internal Control over Financial Reporting was Materially Misstated

134. As noted above, Defendant PwC’s “audit” report dated March 15, 2005, stated, among other things, that “the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2004”

135. This conclusion was purportedly reached after PwC: (1) obtained an understanding of R&G’s internal control over financial reporting; (2) evaluated management’s assessment of such system of internal control; (3) tested and evaluated the design and operation effectiveness of the internal control system; and (4) performed such other procedures as it deemed necessary.

136. Prior to issuing its report on R&G’s 2004 system of internal control, the Public Company Accounting Oversight Board (“PCAOB”), in its Auditing Standard (“AS”) No. 2, required that PwC obtain an in depth understanding of, and conduct an extensive evaluation of management’s process of assessing the effectiveness of R&G’s internal control over financial reporting.

137. In obtaining an understanding of R&G’s internal control over its financial reporting, AS No. 2 required that PwC:

- Make inquiries of appropriate management, supervisory, and staff personnel;
- Inspect company documents;
- Observe the application of specific controls;
- Trace transactions through the information system relevant to financial reporting;
- Understand R&G’s control environment, which sets the tone of an organization and is the foundation of all other components of internal control including integrity, ethical values, and commitment to competence;

- Understand the risk of errors or fraud that could result in material financial statement misstatements by, among other things, identifying and analyzing significant estimates recorded in R&G's financial statements;
- Understand the control activities that R&G's management implemented to prevent or detect errors or fraud that could result in material misstatement in the accounts and disclosures and related assertions of the financial statements;
- Understand management's information and communication systems and processes;
- Understand management's monitoring of all controls, including control activities, which management identified and designed to prevent or detect material misstatement in the accounts and disclosures and related assertions of the financial statements;
- Identify significant accounts and disclosures, both quantitatively and qualitatively; and
- Perform "walkthroughs" for each major class of transactions, in which the auditor traces a transaction from origination through the company's information systems until it is reflected in the company's financial reports.

138. After complying with the above-noted requirements, AS No. 2 required PwC to thoroughly test and evaluate R&G's systems design and operation effectiveness by:

- Identifying the Company's control objectives in each area;
- Identifying the controls that satisfy each objective;
- Determining whether properly operating controls can effectively prevent or detect errors of fraud could result in material misstatements in the financial statements;
- Testing controls by inquiring of appropriate personnel, inspection of relevant documentation, observation of the Company's operations, and reperformance of the application of the control;
- Performing tests of controls over a period of time to determine whether, as of the date specified in management's report, the controls necessary for achieving the objectives of the control criteria are operating effectively;
- Communicate all identified significant deficiencies and material weaknesses in controls to the audit committee in writing;
- Obtain sufficient evidence about whether the Company's internal control over financial reporting, including the controls for all internal control components, is

operating effectively. In determining the extent of procedures to perform, the auditor should design the procedures to provide a high level of assurance that the control being tested is operating effectively. In making this determination, the auditor is required to: (1) subject manual controls to more extensive testing than automated controls; and (2) assess the complexity of the controls, the significance of the judgments that must be made in connection with their operation, and the level of competence of the person performing the controls that is necessary for the control to operate effectively. As the complexity and level of judgment increase or the level of competence of the person performing the control decreases, the extent of the auditor's testing should increase; and

- Conduct the audit of internal control over financial reporting and the audit of the financial statements with professional skepticism.

139. In its April 29, 2005 press release, R&G admitted that it had ineffective internal controls:

[O]n April 28, 2005, the Audit Committee of the Board of Directors of the Company met and concluded that the previously filed interim and audited financial statements for the periods from January 1, 2003 through December 31, 2004, should no longer be relied on. In addition, the Company's management has concluded that, due to the magnitude of the estimated reduction to the fair value of its residual interests, Management's Report on Internal Control Over Financial Reporting set forth on page 63 of the Company's 2004 Annual Report should be restated and should no longer be relied on. Although management has not yet completed its analysis of the impact of this situation on the Company's internal controls over financial reporting management has determined that the Company had a material weakness in internal control over financial reporting as of December 31, 2004 relating to the lack of effective controls over the valuation of the Company's residual interests. A material weakness is a control deficiency, or a combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. The existence of one or more material weaknesses as of December 31, 2004 precludes management from concluding that the Company's internal controls over financial reporting were effective as of year end. As a result, management expects that the Company will receive an adverse opinion on internal control over financial reporting from its independent registered public accounting firm. (Emphasis Added.)

140. R&G further stated that at the time it files its restatement, it expects that PwC will issue an adverse report on its internal controls over financial reporting as of December 31, 2004. Had PwC actually "audited" R&G's system of internal control over its financial reporting in accordance with the standards established by the PCAOB, it would have discovered, if it did not

already know, that R&G's "sales" to First BanCorp and Doral were really loans.

D. Additional Allegations of Scienter as Against PwC

141. In conducting its quarterly reviews and yearly audits for R&G, PwC was obligated to review the written agreements for the transactions between R&G and First BanCorp in order to obtain sufficient competent evidential matter to support R&G's accounting for these "sales" during each quarter of the Class Period. Had PwC done so, it would have uncovered the fraud. As First BanCorp has explicitly admitted, the fact that the transactions did not constitute true sales was readily apparent from the face of these contracts. As First BanCorp stated in its restatement, "[t]he incorrect accounting, in the case of transactions with R&G resulted from the fact [that] written contracts included unlimited recourse that tainted the true sales characterization." (Emphasis added.)

142. First BanCorp's restatement made clear that all of its written agreements with R&G contained express recourse provisions, including provisions that expressly obligated R&G to either repurchase delinquent loans, or to guarantee the timely payment of principal and interest. Significantly, First BanCorp specifically distinguished its transactions with Doral, which involved oral agreements and side deals, from those with R&G, where "the written agreements included express recourse provisions." Accordingly, PwC either recklessly failed to review these written agreements, or did so and knowingly allowed R&G to continue to engage in these sham transactions. As First BanCorp stated in its Amended Annual Report on Form 10-K/A for the year ended December 31, 2004:

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

The purchase prices for most of the mortgage loans and pass-through trust certificates were the principal amounts of the mortgage loans and the pass-through trust certificates. The written agreements for the mortgage-related transactions with Doral and R&G included recourse provisions. The agreements with Doral provided that Doral would either repurchase or substitute mortgages that became 120 days or more delinquent within the first 24-month period after the purchase, with a limit on the repurchase obligation related to commercial mortgage loans of no more than 10% of the principal amount of such commercial mortgage loans. The first few agreements executed with R&G stated that R&G would repurchase all delinquent mortgage loans, for an unspecified period of time. Thereafter, all of the R&G agreements provided that R&G guaranteed timely payment of principal and interest.

* * *

[First BanCorp's] Audit Committee's review identified evidence that Doral had agreed orally and in emails to extend the recourse provision beyond the 24-month period included in the written agreements to recourse for the duration of the mortgage loans involved in the mortgage-related transactions with FirstBank. The Audit Committee found that neither the existence nor the terms of the oral agreements and emails were documented in the Corporation's accounting records or communicated to the Corporation's independent registered public accounting firm by neither the former CEO, former CFO, former executive vice-president responsible for the retail and mortgage banking business, or the former Treasurer. In contrast to the oral agreements and emails with Doral to extend the recourse period, the written agreements with R&G included express recourse provisions for the lives of the underlying mortgage loans and pass-through trust certificates. [...]

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

143. The fact that PwC served as the auditor for both R&G and First BanCorp also supports a strong inference of scienter. Each and every quarter, PwC had at least two

opportunities to review the pertinent contracts from both sides of the transactions, yet either recklessly failed to do so, or did so and knowingly allowed the Company to continue to engage in these sham transactions. Indeed, in light of the fact that PwC was the auditor of both R&G and First BanCorp (as well as Doral), its failure to uncover the fraud is even more egregious.

144. Further evidence establishing that PwC knew or recklessly disregarded that R&G's financial statements were false and misleading is the fact that, as described above, Defendants Galan and Sandoval, R&G's CEO and CFO respectively, received a legal opinion from the Company's outside counsel in December 2003 that these transactions were not true sales. PwC had access to that same legal opinion, and the same concerns which prompted Defendants Golan and Sandoval to seek that opinion should have prompted PwC to investigate. Indeed, PwC should have obtained its own legal opinion as to the status and legitimacy of the mortgage loan sale transactions at issue herein.

145. The massive size of R&G's restatement, and the restatements of Doral and First BanCorp, also constitutes evidence of PwC's scienter. R&G has now admitted that the restatement will impact its financial statements for fiscal 2002, 2003 and 2004. This represents virtually the entire period during which R&G engaged in these sham sale transactions and accounting improprieties, which allowed R&G to recognize hundreds of millions of dollars in fictitious gain on sale income and continue to fraudulently report "record earnings." The significant value of the revenues generated by these transactions as compared to the Company's yearly net income required PwC to review the underlying contracts. The fact that PwC signed off on R&G's accounting for these transactions involving huge dollar amounts suggests that PwC knew or recklessly disregarded the supporting documentation in conducting its audits.

146. Another fact which supports a strong inference of scienter is the fact that R&G

announced the restatement only a few weeks after PwC completed its 2004 audit and issued a clean audit opinion on those financial statements (the audit opinion was issued March 15, 2005, and the restatement was announced on April 26, 2005). The fact that the restatement was issued so soon after the audit opinion was issued is evidence that the facts which rendered R&G's financial statements false and misleading existed at the time PwC issued its opinion and were readily available to PwC. Further, the fact that R&G had to revise downward its previously announced earnings for the third quarter of 2004 and delay the filing of its Form 10-Q for that quarter should also have been a "red flag" to PwC that there were issues surrounding R&G's accounting practices.

147. PwC's San Juan office enjoyed a lucrative, long-standing business relationship with R&G for which PwC has received millions of dollars in fees for auditing, tax and other services it rendered to R&G. These fees were particularly important to the partners in PwC's San Juan office, as their standing within the firm and their incomes were dependent on the continued business from R&G. PwC participated in the wrongdoing alleged herein in order to retain R&G as a client and to protect the fees it received from the Company. Furthermore, not only did PwC participate in the wrongdoing alleged herein in order to retain R&G as a client and to protect the lucrative fees it received from R&G, but it did so in order to protect and retain the fees it received from Doral and First BanCorp. In fact, for its fiscal years 2002 through 2005, the fees paid by R&G, Doral and First BanCorp to PwC totaled in excess of \$13 million.

148. As a result of its failure to properly report on R&G's Class Period financial statements, PwC utterly failed in its role as an auditor and each audit it conducted of R&G amounted to no audit at all.

X. LOSS CAUSATION/ECONOMIC LOSS

149. During the Class Period, as detailed herein, Defendants engaged in a scheme to

deceive the market and embarked on a course of conduct that artificially inflated the price of R&G securities and operated as a fraud or deceit on Class Period purchasers of R&G securities by misrepresenting the Company's financial results. When Defendants' misrepresentations and fraudulent conduct were disclosed and became apparent to the market, the price of R&G securities fell precipitously as the prior artificial inflation came out of the price of R&G securities. As a result of their purchases of R&G securities during the Class Period, Lead Plaintiffs and other members of the Class suffered economic loss, i.e., damages, under the federal securities laws.

150. By improperly reporting R&G's financial results, Defendants presented a misleading picture of R&G's business and financial performance. During the Class Period, Defendants repeatedly touted R&G's "record earnings." These claims of "record earnings" caused and maintained the artificial inflation in the price of R&G securities during the Class Period until the whole truth of R&G's financial condition was accurately revealed to the market.

151. Defendants' materially false and misleading statements had the intended effect and caused R&G's stock price to trade at inflated levels throughout the Class Period, reaching as high as \$40.75 per share on December 1, 2004 and falling to \$5.68 per share on February 13, 2007, a loss of approximately 86% of the Company's market capitalization.

152. The decline in the price of R&G securities, as detailed herein, was a direct result of the nature and extent of Defendants' material false and misleading statements being revealed to investors and the market. The timing and magnitude of the decline in the price of R&G stock and other R&G securities negates any inference that the loss suffered by Lead Plaintiffs and other Class members was caused by changed market conditions, macroeconomic or industry factors or Company-specific facts unrelated to Defendants' conduct, as detailed herein. The

economic loss, i.e., damages, suffered by Lead Plaintiffs and other members of the Class, was a direct result of Defendants' fraudulent scheme to artificially inflate the price of R&G securities and the subsequent significant decline in the value of R&G stock and other R&G securities when Defendants' prior misrepresentations and other fraudulent conduct was revealed.

**XI. APPLICABILITY OF PRESUMPTION OF RELIANCE:
FRAUD-ON-THE-MARKET DOCTRINE**

153. At all relevant times, the market for R&G's securities was an efficient market for the following reasons, among others:

- (a) R&G's Class B common stock met the requirements for listing, and was listed and actively traded on the NYSE, a highly efficient and automated market;
- (b) As a public company, R&G filed periodic public reports with the SEC;
- (c) R&G regularly communicated with public investors via established market communication mechanisms, including through regular disseminations of press releases on the national circuits of major newswire services and through other wide-ranging public disclosures, such as communications with the financial press and other similar reporting services; and
- (d) R&G was followed by numerous securities analysts employed by major brokerage firms who wrote reports which were distributed to the sales force and certain customers of their respective brokerage firms. Each of these reports was publicly available and entered the public marketplace.

154. As a result of the foregoing, the market for R&G's securities promptly digested current information regarding R&G from all publicly available sources and reflected such information in R&G's stock price. Under these circumstances, all purchasers of R&G securities

during the Class Period suffered similar injury through their purchase of R&G securities at artificially inflated prices and a presumption of reliance applies.

XII. NO SAFE HARBOR

155. The statutory safe harbor provided for forward-looking statements under certain circumstances does not apply to any of the allegedly false statements pleaded in this complaint. Many of the specific statements pleaded herein were not identified as “forward-looking statements” when made. To the extent there were any forward-looking statements, there were no meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the purportedly forward-looking statements. Alternatively, to the extent that the statutory safe harbor does apply to any forward-looking statements pleaded herein, Defendants are liable for those false forward-looking statements because at the time each of those forward-looking statements was made, the particular speaker knew that the particular forward-looking statement was false, and/or the forward-looking statement was authorized and/or approved by an executive officer of R&G who knew that those statements were false when made.

COUNT I

For Violations of §10(b) of the 1934 Act and Rule 10b-5 (Against R&G and the Officer Defendants)

156. Lead Plaintiffs repeat and reallege each of the allegations set forth above as if fully set forth herein. This Count is asserted against R&G and the Officer Defendants for violations of Section 10(b) of the Exchange Act, 15 U.S.C. §78j(b), and Rule 10b-5, 17 C.F.R. § 240.10b-5, promulgated thereunder.

157. Throughout the Class Period, R&G and each of the Officer Defendants, individually and in concert, directly and indirectly, by the use of means or instrumentalities of

interstate commerce and/or of the mails and a national securities exchange, engaged and participated in a continuous course of conduct that operated as a fraud and deceit upon Lead Plaintiffs and the Class; made various untrue and/or misleading statements of material facts and omitted to state material facts necessary in order to make the statements, in light of the circumstances under which they were made, not misleading; made the above statements with knowledge that they were false and/or a severely reckless disregard for the truth; and employed devices, and artifices to defraud in connection with the purchase and sale of securities, which were intended to, and during the Class Period, did: (i) deceive the investing public, including Lead Plaintiffs and other Class members, regarding, among other things, R&G's financial results, including but not limited to R&G's income and financial condition; (ii) artificially inflate and maintain the market price of R&G securities; and (iii) cause plaintiffs to purchase R&G securities at artificially inflated prices.

158. Defendant R&G and the Officer Defendants, as the top executive officers of R&G, are liable as direct participants in the wrongs complained of herein. Through their positions of control and authority as officers of R&G, the Officer Defendants were able to control and did control the content of the public statements alleged herein and, with actual knowledge or in reckless disregard of the accounting improprieties at R&G, they caused the above complained of public statements to contain material misstatements and omissions of material facts as alleged herein.

159. Defendant R&G is liable for each of the materially false and misleading statements set forth herein, including each of the statements of the Officer Defendants, under the principles of *respondeat superior*.

160. In addition, the false and misleading statements made in the Company's published documents (including, but not limited to, its press releases and SEC filings) constitute "group published information," which the Officer Defendants were responsible for creating. During their respective terms of employment at R&G, the Officer Defendants had direct involvement in the daily business of the Company and participated in the preparation and dissemination of R&G's "group published information."

161. More particularly, Defendants Galan, Sandoval and Prats are liable for the materially false and misleading statements that were contained within "group published information" during the Class Period, as alleged above, including:

- (a) The false and misleading statements in R&G's January 21, 2003 press release;
- (b) The false and misleading statements in R&G's Form 10-K, filed with the SEC on March 31, 2003;
- (c) The false and misleading statements in R&G's April 21, 2003 press release;
- (d) The false and misleading statements in R&G's Form 10-Q, filed with the SEC on May 15, 2003;
- (e) The false and misleading statements in R&G's July 16, 2003 press release;
- (f) The false and misleading statements in R&G's Form 10-Q, filed with the SEC on August 14, 2003;
- (g) The false and misleading statements in R&G's October 14, 2003 press release;

- (h) The false and misleading statements in R&G's Form 10-Q, filed with the SEC on November 14, 2003;
- (i) The false and misleading statements in R&G's January 20, 2004 press release;
- (j) The false and misleading statements in R&G's Form 10-K, filed with the SEC on March 14, 2004;
- (k) The false and misleading statements in R&G's April 19, 2004 press release;
- (l) The false and misleading statements in R&G's Form 10-Q, filed with the SEC on May 10, 2004;
- (m) The false and misleading statements in R&G's July 19, 2004 press release;
- (n) The false and misleading statements in R&G's Form 10-Q, filed with the SEC on August 9, 2004;
- (o) The false and misleading statements in R&G's October 22, 2004 press release;
- (p) The false and misleading statements in R&G's November 15, 2004 press release;
- (q) The false and misleading statements in R&G's Form 10-Q, filed with the SEC on November 15, 2004;
- (r) The false and misleading statements in R&G's January 24, 2005 press release;
- (s) The false and misleading statements in R&G's Form 10-K, filed with the SEC on March 16, 2005; and

- (t) The false and misleading statements in R&G's April 25, 2005 press release.

162. Throughout the Class Period, Defendants Galan and Sandoval signed all the Company's false and misleading SEC filings referenced above and Defendant Prats signed R&G's Form 10-Ks filed on March 31, 2003 (for fiscal year 2002), March 14, 2004 (for fiscal year 2003) and March 16, 2005 (for fiscal year 2004).

163. The above allegations establish a strong inference that the Company and each of the Officer Defendants acted with scienter in misrepresenting the Company's income and the Company's financial condition during the Class Period. Throughout the Class Period, R&G and the Officer Defendants caused the Company's reported financial results, including reports of R&G's income, to be materially false and misleading.

164. The unraveling of facts at First BanCorp and Doral provide additional evidence that R&G and the Officer Defendants knowingly engaged in a series of concerted acts, practices and/or a course of businesses that operated as a fraud or deceit. R&G and First BanCorp (or Doral or any other Puerto Rican financial institution involved in the purported mortgage loan "sales") needed to act consistently in order to successfully book inflated gains on sale in connection with the sham "sales." Indeed, if one side of the deal booked it as a loan while the other side booked it as a sale, the inconsistency would have alerted regulators and bank examiners. In connection with the First BanCorp and Doral transactions, First BanCorp, Doral and R&G each booked the transactions as sales, when the deals should have been booked as loans pursuant to GAAP and, in particular, FASB 140.

165. As a result of these facts, R&G and the Officer Defendants knew or, but for their reckless disregard of these facts, should have known that the statements, set forth above,

regarding R&G's income and its publicly reported financial results were materially false and misleading.

166. The following additional facts further support a strong inference that Defendant Galan acted with scienter:

- (a) Galan founded R&G in 1972 and was President and Chief Executive Officer of the Company until he was removed from this position in December 2006. He remains Chairman of the Board and a director of R&G;
- (b) Galan assisted in the preparation of the false financial statements and repeated the contents therein to the market;
- (c) Galan executed certain of the "Mortgage Loan Purchase Agreements" agreements with First BanCorp on behalf of R&G and, therefore, was well aware that the agreements contained unlimited recourse provisions;
- (d) Galan knew the adverse non-public information about the business of R&G, as well as its finances, markets and present and future business prospects, via his access to internal corporate documents, conversations and connections with other corporate officers and employees, attendance at management and Board meetings and committees thereof and via reports and other information provided to him in connection therewith;
- (e) Three former employees of R&G interviewed during Lead Plaintiffs' investigation confirmed that Defendants Galan, Sandoval and Prats, in conjunction with other key R&G employees, were intimately involved in

and directed the Company's strategy and accounting relating to its mortgage-related assets;²

- (f) Galan signed certifications pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 for every quarterly report on Form 10-Q and every annual report on Form 10-K that R&G filed with the SEC during the Class Period. Galan also signed certifications pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 for every annual report filed with the SEC during the Class Period. In sum and substance, the certifications falsely stated that the financial statements, and other financial information included in those reports fairly presented in all material respects the financial condition and results of operations of R&G;
- (g) Galan was the single largest beneficiary of R&G's purported success, its artificially inflated stock price, and the fruits of the fraudulent scheme, as he owned approximately 42% of R&G's outstanding stock throughout the Class Period. During the Class Period, Galan received, among other financial benefits, millions of dollars from dividends paid by R&G to common stockholders;
- (h) As the Company has now admitted, Galan was specifically informed in December 2003 that the purported "sales" of pooled, non-conforming mortgage loans did not actually qualify as true sales, and should not have

² The three employees held the following positions at R&G: (i) Confidential Witness #1 (CW#1) worked in financial control at R&G Premier Bank for 12 years beginning in 1991 and was the Assistant Controller at R&G Premier Bank until his departure; (ii) Confidential Witness #2 (CW#2) was an accountant at R&G Premier Bank for approximately 8 years until her departure in 2001; and (iii) Confidential Witness #3 (CW#3) worked in the accounting and treasury departments at R&G Premier Bank for over 12 years beginning in 1993.

been accounted for as such, and that there would be a “significant adverse impact” on the Company’s financial statements when the transactions were re-characterized as secured borrowings rather than true sales;

- (i) According to the Company’s December 18, 2006 press release, Galan denied that the above-referenced conversation with legal counsel took place when he was first confronted with the results of the Company’s independent investigation. Further, he claimed that he was first informed in 2006 that such outside counsel was ever consulted on “true sale”-related issues. However, as set forth in the Company’s press release, Galan’s “denial that this conversation took place was contradicted by outside counsel’s recollection and detailed billing records;” and
- (j) As a result of the foregoing, the Company’s Board of Directors removed Galan from his positions as President and CEO of R&G effective as of December 31, 2006.

167. The following additional facts further support a strong inference that Defendant Sandoval acted with scienter:

- (a) Defendant Sandoval was Executive Vice President and Chief Financial Officer of R&G during the Class Period. Sandoval had served as the Chief Financial Officer of R&G since 1997 and as a Senior Vice President since 1998;
- (b) Sandoval assisted in the preparation of the false financial statements and repeated the contents therein to the market;

- (c) Sandoval knew the adverse non-public information about the business of R&G, as well as its finances, markets and present and future business prospects, via his access to internal corporate documents, conversations and connections with other corporate officers and employees, attendance at management and Board meetings and committees thereof and via reports and other information provided to him in connection therewith;
- (d) Sandoval signed certifications pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 for every quarterly report on Form 10-Q and every annual report on Form 10-K that R&G filed with the SEC during the Class Period. Sandoval also signed certifications pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 for every annual report filed with the SEC during the Class Period. In sum and substance, the certifications falsely stated that the financial statements, and other financial information included in those reports fairly presented in all material respects the financial condition and results of operations of R&G;
- (e) CW #1, CW #2 and CW #3 confirmed that Defendant Sandoval, in conjunction with other key employees, was intimately involved in and directed R&G's strategy and accounting regarding the Company's mortgage-related assets;
- (f) As the Company has now admitted, Sandoval was specifically informed by counsel in December 2003 that the purported "sales" of pooled, non-conforming mortgage loans did not actually qualify as true sales, and should not have been accounted for as such, and that there would be a

“significant adverse impact” on the Company’s financial statements when the transactions were re-characterized as secured borrowings rather than true sales; and

- (g) On August 24, 2005, R&G’s Board of Directors removed Defendant Sandoval from his positions with the Company and placed him on an indefinite leave of absence. On January 4, 2006, Sandoval tendered his resignation on terms other than those requested by R&G’s Board of Directors. R&G did not accept Sandoval’s purported resignation. Consequently, Sandoval’s employment with the Company and its subsidiaries was terminated effective January 5, 2006.

168. The following additional facts further support a strong inference that Defendant Prats acted with scienter:

- (a) Defendant Prats was a director, the Vice Chairman of the Board of Directors of the Company, and President of R&G, R&G Mortgage and Premier Bank during the Class Period. Prats was a director of R&G Mortgage and Executive Vice President of R&G Mortgage Corp. and the Mortgage Store. Prats was also Vice Chairman of the Board of Directors of R&G Premier Bank and a director of R-G Investments and Crown Bank;
- (b) CW #1, CW #2 and CW #3 confirmed that Defendant Prats, in conjunction with other key employees, was intimately involved in and directed R&G’s strategy and accounting regarding the Company’s mortgage-related assets;

- (c) Prats executed certain of the "Mortgage Loan Purchase Agreements" agreements with First BanCorp on behalf of R&G and, therefore, was well aware that the agreements contained unlimited recourse provisions;
- (d) Prats knew the adverse non-public information about the business of R&G, as well as its finances, markets and present and future business prospects, via his access to internal corporate documents, conversations and connections with other corporate officers and employees, attendance at management and Board meetings and committees thereof and via reports and other information provided to him in connection therewith;
- (e) Prats assisted in the preparation of the false financial statements and repeated the contents therein to the market; and
- (f) After the fraud had been announced, Prats resigned from his positions as an officer and a director of the Company and its subsidiaries.

169. Further, the Officer Defendants had direct involvement in the day to day operations of the Company and, therefore, are presumed to have had, and to have exercised, the power to control or influence the dissemination of the particular false and misleading statements giving rise to the securities violations as alleged herein.

170. As a result of the dissemination of the materially false and misleading information and failure to disclose material facts, as set forth above, R&G stock was sold in the public market at artificially inflated prices during the Class Period. In ignorance of the materially false and misleading nature of the reports and statements described above, Lead Plaintiffs and the Class relied to their detriment on the statements described above and/or the integrity of the

market prices as reflecting the completeness and accuracy of the information disseminated in connection with their purchases of R&G's stock.

171. The prices of R&G stock declined materially upon the various partial public disclosures of the true facts about the fraudulent and improper practices which had inflated the price of R&G stock and which material facts had been misrepresented and/or concealed as alleged herein. Lead Plaintiffs and the Class have suffered substantial damages as a result of their purchases of R&G stock.

172. The claim was brought within two years after the discovery of this fraud and within five years of the making of the statements alleged herein to be materially false and misleading.

173. By virtue of the foregoing, R&G and the Officer Defendants violated Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder.

COUNT II

For Violations of §10(b) of the 1934 Act and Rule 10b-5 (Against Defendant PwC)

174. Lead Plaintiffs repeat and reallege each of the allegations set forth above as if fully set forth herein. This Count is asserted against PwC for violations of Section 10(b) of the Exchange Act, 15 U.S.C. §78j(b), and Rule 10b-5, 17 C.F.R. § 240.10b-5, promulgated thereunder.

175. Throughout the Class Period, PwC directly and indirectly, by the use of means or instrumentalities of interstate commerce and/or of the mails and a national securities exchange, engaged and participated in a continuous course of conduct that operated as a fraud and deceit upon Lead Plaintiffs and the Class; made various untrue and/or misleading statements of material

facts and omitted to state material facts necessary in order to make the statements, in light of the circumstances under which they were made, not misleading; made the above statements with a severely reckless disregard for the truth; and employed devices, and artifices to defraud in connection with the purchase and sale of securities, which were intended to, and, during the Class Period, did: (i) deceive the investing public, including Lead Plaintiffs and other Class members, regarding, among other things, R&G's financial results, including but not limited to R&G's income and financial condition; (ii) artificially inflate and maintain the market price of R&G securities; and (iii) cause plaintiffs to purchase R&G securities at artificially inflated prices.

176. Defendant PwC, as the auditors of R&G, are liable as participants in the wrongs complained of herein. As the auditors of R&G, PwC was able to control and did control the content of the public statements alleged herein and, with actual knowledge, or but for its reckless disregard, of the accounting improprieties at R&G, PwC caused the above complained of public statements to contain material misstatements and omissions of material facts as alleged herein.

177. More particularly, Defendant PwC is liable for the following materially false and misleading statements it made during the Class Period:

- (a) The clean audit opinion dated February 23, 2003 and incorporated into R&G's financial statements for the year ended December 31, 2002 on Form 10-K filed with the SEC on March 31, 2003;
- (b) The clean audit opinion dated March 5, 2004 and incorporated into R&G's financial statements for the year ended December 31, 2003 on Form 10-K filed with the SEC on March 14, 2004; and

- (c) The clean audit opinion dated March 15, 2005 and incorporated into R&G's financial statements for the year ended December 31, 2004 on Form 10-K filed with the SEC on March 16, 2005.

178. As described above, PwC acted with scienter throughout the Class Period, in that it either had actual knowledge of the misrepresentations and omissions of material facts set forth herein, or acted with reckless disregard for the truth in that they failed to ascertain and to disclose the true facts regarding the R&G's mortgage transactions, even though such facts were available to them.

179. The following facts, among others, detailed above, indicate a strong inference that PwC acted with scienter:

- (a) R&G's myriad material violations of GAAP;
- (b) PwC's numerous violations of GAAS;
- (c) PwC's access to, and knowledge of R&G's internal accounting records, confidential and non-public business documents, and employees;
- (d) the express terms of the written agreements between R&G and First BanCorp, which provided for unlimited recourse;
- (e) the fact that PwC had at least two opportunities during the R&G and First BanCorp audits to review the pertinent contracts between R&G and First BanCorp;
- (f) the fact that PwC had at least two opportunities during the R&G and Doral audits to review the pertinent contracts between R&G and Doral;
- (g) the legal opinion from the Company's outside counsel in December 2003 stating that these transactions were not true sales;

- (h) the massive size of R&G's restatement, the restatements of Doral and First BanCorp, and the number of years of misstated financials involving transactions between these banks;
- (i) the significant value of the income generated by these transactions as compared to the Company's yearly net income required PwC review the underlying contracts;
- (j) the significant size of assets involved in the purported sales;
- (k) the lack of contemporaneous documentation supporting the accounting for the "round-trip" transactions with Doral;
- (l) the fact that R&G announced the restatement only a few weeks after PwC completed its audit of R&G's 2004 year-end financial statements and issued a clean audit opinion on those financial statements; and
- (m) PwC's lucrative, long-standing business relationships with R&G, Doral and First BanCorp.

180. As a result of these facts, PwC knew or, but for its reckless disregard of these facts, should have known that its statements, set forth above, regarding R&G's publicly reported financial results were materially false and misleading.

181. As a result of the dissemination of the materially false and misleading information and failure to disclose material facts, as set forth above, R&G stock was sold in the public market at artificially inflated prices during the Class Period. In ignorance of the materially false and misleading nature of the reports and statements described above, Lead Plaintiffs and the Class relied to their detriment on the statements described above and/or the integrity of the

market prices as reflecting the completeness and accuracy of the information disseminated in connection with their purchases of R&G's stock.

182. The prices of R&G stock declined materially upon the various partial public disclosures of the true facts about the fraudulent and improper practices which had inflated their prices and which material facts had been misrepresented and/or concealed as alleged herein. Lead Plaintiffs and the Class have suffered substantial damages as a result of their purchases of R&G stock.

183. The claim was brought within two years after the discovery of this fraud and within five years of the making of the statements alleged herein to be materially false and misleading.

184. By virtue of the foregoing, PwC violated Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder.

COUNT III

For Violation of §20(a) of the 1934 Act (Against the Officer Defendants)

185. Lead Plaintiffs repeat and re-allege each and every allegation contained above as if fully set forth herein. This Count is asserted against the Officer Defendants for violations of Section 20(a) of the Exchange Act.

186. The Officer Defendants acted as controlling persons of R&G within the meaning of §20(a) of the 1934 Act.

187. Lead Plaintiffs repeat and reallege each of the allegations set forth above as if fully set forth herein.

188. R&G committed a primary violation of Section 10(b) of the Exchange Act, 15 U.S.C. §78j(b), and Rule 10b-5, 17 C.F.R. § 240.10b-5, promulgated thereunder, by making the

false and misleading statements of material facts, identified above, in connection with the purchase or sale of securities, which constituted a fraud on the market and were, therefore, presumed to have been relied upon by Lead Plaintiffs and the Class. At the time that it made these false and misleading statements, the Company either knew of, or recklessly disregarded, their falsity.

189. Each of the Officer Defendants had direct control and/or supervisory involvement in the operations of the Company prior to and during the Class Period, and therefore had the power to control or influence the particular transactions giving rise to the violations of the Exchange Act by the Company as alleged herein, and exercised the same.

190. By reason of their status as officers and members of the Board of Directors of R&G during the Class Period, the Officer Defendants are "controlling persons" of R&G within the meaning of Section 20(a) of the Exchange Act because they had the power and influence to cause the Company to engage in the unlawful conduct complained of herein. Because of their positions of control, the Officer Defendants were able to, and did, directly or indirectly, control the conduct of R&G's business, the accounting treatment for its mortgage transactions with First BanCorp, Doral and other financial institutions, the information contained in its filings with the SEC, and public statements about its business.

191. Each of the Officer Defendants was provided with or had access to copies of the Company's reports, press releases, public filings and other statements alleged by Lead Plaintiffs to be misleading prior to and/or shortly after these statements were issued and had the ability to prevent the issuance of the statements or cause the statements to be corrected.

192. As set forth above, each of the Defendants named in this Count controlled R&G, which violated Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder by its

acts and omissions as alleged in this complaint. By virtue of their positions as controlling persons, these Defendants are liable pursuant to Section 20(a) of the Exchange Act. As a direct and proximate cause of the wrongful conduct set forth in this Count, Lead Plaintiffs and other members of the Class suffered damages in connection with their purchases of the Company's shares during the Class Period.

193. In particular, the following facts provide further evidence of the Officer Defendants' control over the Company:

Galan

- (a) Defendant Galan was President and Chief Executive Officer of the Company during the Class Period. He remains Chairman of the Board and a director of R&G. Moreover, Galan is the sole holder of the Company's Class A shares and owned an approximately 42% stake in the Company and had approximately 59.28% of the voting power of the Company throughout the Class Period. As a result, Galan has the power to elect and remove all of R&G's board of directors and management and determine the outcome of substantially all other matters to be decided by a vote of stockholders;
- (b) As the Company explicitly acknowledged in SEC filings, R&G qualified as a "controlled company" due to Galan's ownership interest in the Company;
- (c) Galan knew the adverse non-public information about the business of R&G, as well as its finances, markets and present and future business prospects, via his access to internal corporate documents, conversations

and connections with other corporate officers and employees, attendance at management and Board meetings and committees thereof and via reports and other information provided to him in connection therewith;

- (d) CW #1, CW #2 and CW #3 confirmed that Defendant Galan, in conjunction with other key employees, directed R&G's strategy regarding the Company's mortgage-related assets; and
- (e) Due to his control over R&G, Galan was able to cause the Company to ignore the December 2003 advice of outside counsel that the "sales" of pooled, non-conforming mortgage loans did not constitute true sales and engage in the fraudulent scheme alleged herein.

Sandoval

- (a) Defendant Sandoval was Executive Vice President and Chief Financial Officer of R&G during the Class Period. Sandoval had served as the Chief Financial Officer of R&G since 1997 and as a Senior Vice President since 1998;
- (b) Sandoval knew the adverse non-public information about the business of R&G, as well as its finances, markets and present and future business prospects, via his access to internal corporate documents, conversations and connections with other corporate officers and employees, attendance at management and Board meetings and committees thereof and via reports and other information provided to him in connection therewith;

- (c) CW #1, CW #2 and CW #3 confirmed that Defendant Sandoval, in conjunction with other key employees, directed R&G's strategy regarding the Company's mortgage-related assets; and
- (d) Due to his control over R&G, Sandoval was able to cause the Company to ignore the December 2003 advice of outside counsel that the "sales" of pooled, non-conforming mortgage loans did not constitute true sales and engage in the fraudulent scheme alleged herein.

Prats

- (a) Defendant Prats was a director, the Vice Chairman of the Board of Directors of the Company, and President of R&G, R&G Mortgage and Premier Bank during the Class Period. Prats was a director of R&G Mortgage and Executive Vice President of the Mortgage Store. Prats was also Vice Chairman of the Board of Directors of R&G Premier Bank and a director of R-G Investments and Crown Bank;
- (b) Prats knew the adverse non-public information about the business of R&G, as well as its finances, markets and present and future business prospects, via his access to internal corporate documents, conversations and connections with other corporate officers and employees, attendance at management and Board meetings and committees thereof and via reports and other information provided to him in connection therewith; and

- (c) CW #1, CW #2 and CW #3 confirmed that Defendant Prats, in conjunction with other key employees, directed R&G's strategy regarding the Company's mortgage-related assets.

COUNT IV

For Violation of §20(a) of the Exchange Act) (Against the Audit Committee Defendants)

194. Lead Plaintiffs repeat and re-allege each and every allegation contained above as if fully set forth herein. This Count is asserted against the Audit Committee Defendants for violations of Section §20(a) of the Exchange Act.

195. The Audit Committee Defendants acted as controlling persons of R&G within the meaning of §20(a) of the Exchange Act.

196. R&G committed primary violations of Section 10(b) of the Exchange Act, 15 U.S.C §78j(b), and Rule 10b-5, 17 C.F.R. §240.10b-5, promulgated thereunder, by making the false and misleading statements of material facts, identified above, in connection with the purchase or sale of securities, which constituted a fraud on the market and were, therefore, presumed to have been relied upon by the Lead Plaintiffs and the Class. At the time they made these false and misleading statements, each of these Defendants either knew of, or recklessly disregarded, their falsity.

197. By reason of their status as members of the Audit Committee of R&G during the Class Period, the Audit Committee Defendants are "controlling persons" of R&G within the meaning of Section 20(a) of the Exchange Act because they had the power and influence to control, and did control, directly and indirectly, the contents of the public statements disseminated by the Company. In particular, the Audit Committee Defendants had the power to control the Company's publicly reported financial results during the Class Period, which the

Company has now admitted were materially false and misleading. Significantly, Audit Committee Defendants Fernandez and Rivera-Arreaga signed R&G's Annual Reports on Form 10-K for fiscal years 2002, 2003 and 2004 and Audit Committee Defendant Colon-Carlo signed R&G's Form 10-K for fiscal years 2003 and 2004.

198. The Audit Committee Defendants were provided with or had access to the Company's reports, press releases, public filings and other statements alleged by Lead Plaintiffs to be misleading prior to and/or shortly after these statements were issued and had the ability to prevent the issuance of the statements or cause the statements to be corrected.

199. As set forth above, each of Audit Committee Defendants controlled R&G, which violated Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder by its acts and omissions alleged in this Complaint. By virtue of their positions as controlling persons, the Audit Committee Defendants are liable pursuant to Section 20(a) of the Exchange Act. As a direct and proximate cause of the wrongful conduct set forth in this Count, Lead Plaintiffs and other members of the Class suffered damages in connection with their purchases of the Company's shares during the Class Period.

200. In particular, according to R&G's filings with the SEC during the Class Period, the role of its Audit Committee was to "oversee[] the Company's auditing, accounting, financial reporting and internal control functions and select[], engage[] and compensate[] the Company's independent accountants." R&G further stated that its Audit Committee "monitors the quality of the Company's critical accounting principles."

201. R&G's SEC Filings also stated that "[i]n discharging its duties, the Audit Committee:

- meets independently with the Company's compliance staff, contracted internal auditors, the Company's independent accountants and the Company's senior management;
- reviews the general scope of the Company's accounting, financial reporting, annual audit and internal audit program, matters relating to internal control systems and the results of the annual audit;
- receives, retains and evaluates complaints by the Company's employees with respect to any Company accounting, internal accounting controls and auditing matters; and
- resolves any disagreements between the Company's management and the Company's independent accountants."

202. Moreover, the Audit Committee approved a formal Charter setting forth its responsibilities. The Charter was publicly disclosed to the shareholders as part of the Company's proxy statement filed on April 1, 2005 with the SEC and required the Audit Committee to perform, among others, the following functions: (1) understand the accounting policies used by the Company and approve their application; (2) review and discuss with management and the independent auditors the Company's audited financial statements and recommend to the Board of Directors whether such financial statements shall be included in the Company's annual reports on Form 10-K and quarterly reports on Form 10-Q; (3) meet with the Company's legal experts to review legal matters that have a significant impact on the Company's financial reports; (4) be directly responsible for the appointment and approval and oversight of the audit work of the Company's independent public auditors; (5) cause to be maintained an appropriate internal audit program covering the Company by internal auditors who report to the Committee and the Board of Directors and review the internal auditor's reports; and (6) review the Company's internal accounting controls.

203. By reason of their positions on the Audit Committee, the Audit Committee Defendants had access to many of the same facts that R&G, the Officer Defendants, and PwC

had access to and that necessitated the restatement. In particular, the Audit Committee had access to the contracts between R&G and First BanCorp, which on their face contained unlimited recourse provisions that rendered the transactions as secured borrowings, rather than true sales as R&G had characterized them, and acted to conceal the same, or knowingly or recklessly authorized and approved the concealment of the same.

PRAYER FOR RELIEF

WHEREFORE, Lead Plaintiffs pray for judgment as follows:

- A. Declaring this action to be a proper class action pursuant to Rule 23 of the Federal Rules of Civil Procedure;
- B. Awarding Lead Plaintiffs and the members of the Class damages, including interest;
- C. Awarding Lead Plaintiffs reasonable costs, including attorneys' fees, and
- D. Awarding such equitable/injunctive or other relief as the Court may deem just and proper.

JURY DEMAND

Lead Plaintiffs demand a trial by jury.

Dated: February 20, 2007
New York, New York



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