

**17,241,000 Shares\***  
**Puerto Rico Mortgage-Backed & U.S. Government Securities Fund, Inc.**  
**Common Stock**

This Sixth Prospectus Supplement relates to all the shares of common stock issued by the Puerto Rico Mortgage-Backed & U.S. Government Securities Fund, Inc. (the “Fund”). **This Prospectus Supplement must be read in conjunction with the Prospectus dated November 3, 2004 (the “Prospectus”).** Capitalized terms used but not defined herein are defined in the Prospectus.

The Fund executed two investment advisory agreements on November 4, 2004. One of these agreements was with UBS Trust Company of Puerto Rico (“UBS TCPR”) and the other with R-G Premier Bank of Puerto Rico (“R-G Premier”) (the “Investment Advisory Contracts”). Pursuant to these Investment Advisory Contracts UBS TCPR and R-G Premier currently serve as co-investment advisors to the Fund.

Pursuant to the terms of the Investment Advisory Contracts, such agreements could be terminated at any time (i) by the vote of a majority of the Fund’s Independent Directors (as such term is defined in the Investment Advisory Contracts) or (ii) by the votes of a majority of the outstanding voting securities of the Fund upon sixty (60) days prior written notice to the applicable Investment Adviser.

Based on these terms on March 12, 2009 the Independent Fund Directors unanimously voted for the termination of the Investment Advisory Contract with R-G Premier to be effective on the close of business of June 15, 2009. The sixty (60) days prior written notice was sent to R-G Premier on April 16, 2009.

In addition, upon the effective date of the termination of the Investment Advisory Contract with R-G Premier, the Fund and UBS TCPR will enter into an addendum to the Investment Advisory Contract between them to clarify that UBS TCPR will be the sole investment advisor to the Fund thus eliminating all references to R-G Premier and stating that UBS TCPR will assume the obligations and duties that R-G Premier had under its terminated Investment Advisory Contract. The terms of this addendum will not affect the aggregate fees charged to the Fund for advisory fees by the investment advisor as disclosed in the Prospectus.

The date of this Prospectus Supplement is June 15, 2009

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\* Excluding Shares issued pursuant to its dividend reinvestment plan and shares repurchased by the Fund.

# 8,200,000 Shares

## Puerto Rico Mortgage-Backed & U.S. Government Securities Fund, Inc. Common Stock

**Investment Objective:** Puerto Rico Mortgage-Backed & U.S. Government Securities Fund, Inc. (the “Fund”) is a newly organized, non-diversified, closed-end management investment company. The Fund’s investment objective is to provide you with current income, consistent with the preservation of capital. No assurance can be given that the Fund will achieve its investment objective.

**Investment Policies:** The Fund will invest its assets in the following manner:

- At least 67% of the Fund’s total assets will be invested in taxable and tax-exempt securities issued by Puerto Rico issuers, including securities issued by the Commonwealth of Puerto Rico and its political subdivisions and instrumentalities, Mortgage Instruments (as defined herein), mortgage-backed and asset-backed securities, corporate obligations, and preferred stock (collectively, the “Puerto Rico Securities”). The Fund may invest up to 33% of its total assets in taxable and tax-exempt securities issued by the U.S. Government, its agencies and instrumentalities, non-Puerto Rico Mortgage Instruments, non-Puerto Rico mortgage-backed and asset-backed securities, corporate obligations or preferred stock of non-Puerto Rico issuers, municipal securities of issuers within the U.S., and in other non-Puerto Rico Securities which the Investment Advisers may select, consistent with the Fund’s investment objective and policies.

- At least 80% of the Fund’s total assets will be invested in (i) “Mortgage Instruments” which are comprised of whole residential non-conforming mortgage loans (the “Mortgage Loans”), securities issued by grantor trusts in connection with pooled Mortgage Loans (the “Units”) and participation certificates in pools of Mortgage Loans (the “Participation Certificates”); (ii) securities issued or guaranteed by the Government National Mortgage Association (“GNMA”), Federal National Mortgage Association (“FNMA”), Federal Home Loan Mortgage Corporation (“FHLMC”), and/or other mortgage-backed securities and collateralized mortgage obligations (“CMOs”) collateralized with securities issued or guaranteed by GNMA, FNMA or FHLMC; and (iii) securities issued or guaranteed by the U.S. Government, its agents and/or instrumentalities.

- Up to 45% of the Fund’s total assets will be invested in Mortgage Instruments whose timely payment of principal and interest is guaranteed by R&G Financial Corporation (“R&G Financial”) pursuant to a corporate guarantee of the obligations of R&G Mortgage Corporation (“R&G Mortgage”) or its affiliates under the corresponding servicing agreement for the Mortgage Loans. The Mortgage Loans will be originated or acquired by R-G Premier Bank of Puerto Rico or any of its affiliates and will be serviced by R&G Mortgage or any of its affiliates.

- At least 95% of the Fund’s total assets will be invested in securities and assets, including Mortgage Instruments, that at the time of purchase are rated investment grade by a nationally recognized statistical rating organization, or if not so rated, that the Fund’s Investment Advisers (as defined herein) determine to be of comparable credit quality.

**Investment Advisers:** UBS Asset Managers of Puerto Rico, a division of UBS Trust Company of Puerto Rico and R-G Portfolio Management, a division of R-G Premier Bank of Puerto Rico, will serve as the Fund’s co-investment advisers (the “Investment Advisers”).

**Risk Factors:** An investment in the Fund involves certain risks, including the risk of loss of some or all amounts invested. Since the Fund is expected to invest a substantial amount of its assets in Mortgage Instruments and other mortgage-backed securities, the Fund will bear the risks associated with investments in such securities such as extension, prepayment, foreclosure, reinvestment, and interest rate risks. Since the Fund may have large investments in a small number of issuers or types of securities, the Fund’s net asset value and yield may increase or decrease more than those of a diversified investment company. Certain conflicts of interest may exist among the Fund, the Investment Advisers, and their respective affiliates. It is anticipated that the Fund will invest a significant amount of its assets in Mortgage Instruments that have the guaranty of R&G Financial and are comprised of or secured by Mortgage Loans originated or acquired and serviced by affiliates of R&G Financial. The Fund may raise additional cash to invest by issuing preferred stock, debt securities, or other forms of leverage. Leverage is a speculative investment technique and may result in large changes in the net asset and market values of the Fund’s shares of Common Stock (the “Shares”) as well as increase the risk of your investment in the Fund. An investment in the Fund is not equivalent to an investment in its underlying securities. You should not view the Fund as a vehicle for trading purposes. Investments in the Shares are designed primarily for long-term investors. Investors will not receive certificates evidencing their ownership of the Shares. See “RISK FACTORS AND SPECIAL CONSIDERATIONS” and “SPECIAL LEVERAGE CONSIDERATIONS” in this Prospectus. This Prospectus contains important information about the Fund. You are encouraged to read this Prospectus in its entirety before deciding whether to invest and retain it for future reference.

**Possibility of Limited Market for the Shares:** The Shares are a new issue of securities. Therefore, prior to this offering, there has been no market for the Shares. UBS Financial Services Incorporated of Puerto Rico (“UBS Puerto Rico”) and R-G Investments Corporation (“R-G Investments”) currently intend to maintain a market for the Shares, although they are not obligated to do so, and may discontinue such activities at any time. No assurance can be given as to the liquidity of the market for the Shares as a result of such activities by UBS Puerto Rico and R-G Investments. If UBS Puerto Rico’s or R-G Investment’s activities are discontinued at any time, there may be no other market for the Shares. The Fund does not intend to list the Shares on any securities exchange. The Fund is not obligated to redeem or repurchase any Shares.

**Offering Limited to Residents of Puerto Rico; Shares May Only be Transferred to Residents of Puerto Rico:** The Shares are being offered exclusively to individuals who have their principal residence in Puerto Rico and to corporations and other business organizations whose principal office and principal place of business are in Puerto Rico and may only be transferred to such individuals or business organizations.

**THESE SECURITIES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE OFFICE OF THE COMMISSIONER OF FINANCIAL INSTITUTIONS OF THE COMMONWEALTH OF PUERTO RICO. THE OFFICE OF THE COMMISSIONER OF FINANCIAL INSTITUTIONS HAS NOT MADE ANY DETERMINATION REGARDING THE ACCURACY OR ADEQUACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.**

	<i>Public Offering Price</i> (1)	<i>Sales Load</i>	<i>Proceeds to Fund</i> <i>(before expenses)</i> (2)
Per Share .....	\$10.00	\$0.475	\$9.525
Total .....	\$82,000,000	\$3,895,000	\$78,105,000

(1) The price to the public after the initial closing, to be held on or about November 4, 2004, will be the greater of (i) \$10.00 or (ii) the then-current net asset value per Share plus applicable sales load.

(2) Before deduction of offering expenses payable by the Fund, estimated not to exceed \$300,000. The Underwriters may also purchase up to 1,230,000 additional Shares at the initial public offering price within 30 days from the date of the final closing to cover over-allotments. If such over-allotment is exercised, total proceeds to the Fund will amount to \$89,820,750 (before offering expenses). See “UNDERWRITING” in the main body of this Prospectus. See “ESTIMATED FUND EXPENSES” for a description of the various costs and expenses you can expect to bear, directly or indirectly.

**UBS Financial Services Incorporated of Puerto Rico** **R-G Investments Corporation**

The date of this Prospectus is November 3, 2004.

*(continued from previous page)*

**THESE SECURITIES HAVE NOT BEEN REGISTERED WITH THE SECURITIES AND EXCHANGE COMMISSION UNDER THE U.S. SECURITIES ACT OF 1933, OR WITH ANY OF THE VARIOUS STATES OR JURISDICTIONS, AND THE FUND HAS NOT BEEN REGISTERED UNDER THE U.S. INVESTMENT COMPANY ACT OF 1940. THESE SECURITIES ARE BEING OFFERED EXCLUSIVELY TO INDIVIDUALS WHOSE PRINCIPAL RESIDENCE IS IN PUERTO RICO, AND TO CORPORATIONS AND OTHER BUSINESS ORGANIZATIONS WHOSE PRINCIPAL OFFICE AND PRINCIPAL PLACE OF BUSINESS ARE IN PUERTO RICO.**

**AN INVESTMENT IN THE FUND IS NEITHER INSURED NOR GUARANTEED BY THE U.S. GOVERNMENT OR THE GOVERNMENT OF THE COMMONWEALTH OF PUERTO RICO. PROSPECTIVE INVESTORS SHOULD BE AWARE THAT THESE SECURITIES ARE NOT AN OBLIGATION OF OR GUARANTEED BY UBS FINANCIAL SERVICES INCORPORATED OF PUERTO RICO, R&G FINANCIAL CORPORATION, UBS TRUST COMPANY OF PUERTO RICO, R-G INVESTMENTS CORPORATION, R-G PREMIER BANK OF PUERTO RICO, OR ANY OF THEIR RESPECTIVE AFFILIATES. THESE SECURITIES ARE NOT DEPOSITS OR OBLIGATIONS OF, OR ARE GUARANTEED OR ENDORSED BY, ANY BANK OR OTHER INSURED DEPOSITORY INSTITUTION AND ARE NOT INSURED BY THE FEDERAL DEPOSIT INSURANCE CORPORATION, THE FEDERAL RESERVE BOARD, OR ANY OTHER GOVERNMENT AGENCY.**

You will bear certain costs, directly or indirectly, related to sales load, organizational and offering expenses, investment advisory fees, and administration fees, as well as other Fund operating expenses described herein.

You should rely only on the information contained in this Prospectus. The Fund has not authorized anyone to provide you with different information. You should not assume that the information contained in this Prospectus is accurate as of any date other than the date on the front of this Prospectus. This Prospectus does not constitute an offer to sell, or a solicitation of an offer to buy, any securities in any circumstances in which such offer or solicitation is unlawful.

## SUMMARY

The following is a summary of more detailed information included elsewhere in this Prospectus. You should read the entire Prospectus and carefully consider information set forth under the headings “RISK FACTORS AND SPECIAL CONSIDERATIONS” and “SPECIAL LEVERAGE CONSIDERATIONS.”

### The Fund

Puerto Rico Mortgage-Backed & U.S. Government Securities Fund, Inc. (the “Fund”) is a newly organized, non-diversified, closed-end management investment company registered under the Puerto Rico Investment Companies Act, as amended. The Fund is a corporation organized under the laws of the Commonwealth of Puerto Rico.

### Investment Objective and Policies

The Fund’s investment objective is to provide you with current income, consistent with the preservation of capital. **There is no assurance that the Fund will achieve its investment objective.**

- At least 67% of the Fund’s total assets will be invested in taxable and tax-exempt securities issued by Puerto Rico issuers, including securities issued by the Commonwealth of Puerto Rico and its political subdivisions and instrumentalities, Mortgage Instruments (as defined below), mortgage-backed and asset-backed securities, corporate obligations, and preferred stock (the “Puerto Rico Securities”). The Fund may invest up to 33% of its total assets in taxable and tax-exempt securities issued by the U.S. Government, its agencies and instrumentalities, non-Puerto Rico Mortgage Instruments, non-Puerto Rico mortgage-backed and asset-backed securities, corporate obligations or preferred stock of non-Puerto Rico issuers, municipal securities of issuers within the U.S., and in other non-Puerto Rico Securities which the Investment Advisers may select, consistent with the Fund’s investment objective and policies.
- At least 80% of the Fund’s total assets will be invested in (i) “Mortgage Instruments” which are comprised of whole residential non-conforming mortgage loans (the “Mortgage Loans”), securities issued by grantor trusts in connection with pooled Mortgage Loans (the “Units”) and participation certificates in pools of Mortgage Loans (the “Participation Certificates”); (ii) securities issued or guaranteed by the Government National Mortgage Association (“GNMA”), Federal National Mortgage Association (“FNMA”), Federal Home Loan Mortgage Corporation (“FHLMC”), and/or other mortgage-backed securities and collateralized mortgage obligations (“CMOs”) collateralized with securities issued or guaranteed by GNMA, FNMA or FHLMC; and (iii) securities issued or guaranteed by the U.S. Government, its agents and instrumentalities.
- Up to 45% of the Fund’s total assets will be invested in Mortgage Instruments whose timely payment of principal and interest is guaranteed by R&G Financial Corporation (“R&G Financial”) pursuant to a corporate guarantee of the obligations of R&G Mortgage Corporation (“R&G Mortgage”) or its affiliates under the corresponding servicing agreement for the Mortgage Loans. The Mortgage Loans will be originated or acquired by R-G Premier Bank of Puerto Rico (“R-G Premier”) or any of its affiliates and will be serviced by R&G Mortgage Corporation or any of its affiliates.
- At least 95% of the Fund’s total assets will be invested in securities and assets, including Mortgage Instruments, that at the time of purchase are rated investment grade by a nationally recognized statistical rating organization, or if not so rated, that the Fund’s Investment Advisers (as defined herein) determine to be of comparable credit quality.

See “INVESTMENT OBJECTIVE AND POLICIES” in the main body of this Prospectus.

### The Offering

The Fund is initially offering the number of shares of its common stock (the “Shares”) set forth on the cover page of this Prospectus through UBS Financial Services Incorporated of Puerto Rico (“UBS Puerto Rico”) and R-G Investments Corporation (“R-G Investments;” and together with UBS Puerto Rico in their capacity as underwriters of the Shares, the “Underwriters”). The Underwriters may commit to purchase the Shares at one or more closings to be held in San Juan, Puerto Rico. It is anticipated that the initial closing may take place on or about November 4, 2004, and other closings may take place thereafter. The Underwriters may also purchase up to 1,230,000 additional Shares to cover “over-allotments.”

The initial public offering price is \$10.00 per Share. After the initial closing, the offering price will be the greater of (i) \$10.00 or (ii) the then-current net asset value per Share plus applicable sales load. The minimum investment in the initial public offering is 100 Shares. See “UNDERWRITING” in the main body of this Prospectus.

**Offering Limited to  
Puerto Rico Residents;  
Restrictions on  
Transfer**

The Shares are being offered for sale exclusively to individuals who have their principal residence in Puerto Rico and to corporations and other business organizations whose principal office and principal place of business are in Puerto Rico. In connection with your purchase of the Shares, you will be required to deliver to one of the Underwriters or dealers a letter of representation in the form of Appendix D attached to this Prospectus. The Shares may be sold, pledged, hypothecated, or otherwise transferred exclusively to residents of Puerto Rico. If you cease to be a Puerto Rico resident, you will no longer have available to you the tax benefits that make the Fund an attractive investment. In such case, you have an obligation to notify the Fund or the Underwriters of such change in residency within 30 days from ceasing to be a resident of Puerto Rico and to liquidate your investment in the Shares as soon as it becomes economically feasible. Furthermore, you must agree not to purchase more Shares. See “OFFERING LIMITED TO PUERTO RICO RESIDENTS; RESTRICTIONS ON TRANSFER.”

**Special Leverage  
Considerations**

The Fund may raise additional capital to invest by issuing preferred stock, debt securities, or other forms of leverage, representing no more than 50% of the Fund’s total assets immediately after such issuance. The Fund intends to start its leverage program after the completion of the offering of the Shares.

Use of leverage is a speculative investment technique and involves risk to a greater extent than if you invested in a non-leveraged fund, including the possibility of greater fluctuations, up or down, in both the net asset and the market values of your investment in the Shares. The effects of leverage may cause you to lose all or a portion of the amount invested. See “RISK FACTORS AND SPECIAL CONSIDERATIONS” and “SPECIAL LEVERAGE CONSIDERATIONS.”

**Management of  
the Fund**

UBS Asset Managers of Puerto Rico, a division of UBS Trust Company of Puerto Rico (“UBS TCPR”) and R-G Portfolio Management, a division of R-G Premier, will serve as the Fund’s co-investment advisers (collectively, the “Investment Advisers”) and together will receive an annual investment advisory fee not to exceed 0.75% of the Fund’s average weekly gross assets.

UBS TCPR will also serve as the Fund’s administrator (in such capacity, the “Administrator”) as well as its transfer agent, registrar, and dividend disbursing and shareholder servicing agent, custodian of the Fund’s assets and trustee (the “Trustee”) of one or more “grantor trusts,” organized under the laws of Puerto Rico (the “Trusts”), and will hold the pool of Mortgage Loans secured by properties located in Puerto Rico which will issue the Units. As Administrator, UBS TCPR will receive a separate annual fee not to exceed 0.15% of the Fund’s average weekly gross assets. See “ESTIMATED FUND EXPENSES” below and “MANAGEMENT OF THE FUND” and “PORTFOLIO TRANSACTIONS — Transaction Involving Affiliates.”

UBS TCPR will serve as the custodian of all the Fund’s securities, including the custodian of the Units and the Participation Certificates. UBS TCPR may engage R-G Premier as sub-custodian in certain other circumstances. UBS TCPR may also engage other sub-custodians.

UBS TCPR is an affiliate of UBS Puerto Rico and UBS AG. R-G Premier is a banking subsidiary of R&G Financial and an affiliate of R-G Investments. You should be aware that certain conflicts of interest may exist among the Fund, the Investment Advisers, and their respective affiliates.

**Risk Factors**

- *General.* The Fund’s investments may be adversely affected by the performance of U.S., Puerto Rico, and foreign investment securities markets which may be, in turn, influenced by other factors,

including the level of interest rates, the rate of inflation, politics, fiscal policy, and current events. Because the Fund invests in investment securities, the Fund's net asset value may fluctuate due to market conditions, and as a result you may experience a decline in the value of your investment in the Fund and lose money.

- *Lack of Operating History.* The Fund is a newly organized, non-diversified, closed-end management investment company with no prior operating history. Additionally, R-G Premier has not previously served as an investment adviser to an investment company. The Fund may not succeed in meeting its investment objective.

- *Conflicts of Interest Risk.* The Fund is not registered under the U.S. Investment Company Act of 1940 and is, therefore, not subject to the restrictions regarding, among other things, transactions between the Fund and UBS Puerto Rico or its affiliates (including UBS TCPR and UBS AG) and R&G Financial or its affiliates (including R-G Premier, R-G Investments and R&G Mortgage), as well as investment in or deposits with such affiliates. There are significant transactions and relationships between the Fund and R-G Premier and its affiliates (including, but not limited to, the purchase of Mortgage Instruments, the servicing of the Mortgage Loans, investment advisory services, the Guaranty (as defined herein) and underwriting) which may give rise to conflicts of interests between them. The Fund may be adversely affected by such conflicts of interests. It is also anticipated that the Fund will engage in transactions, such as securities purchase and sale transactions and repurchase agreement transactions, directly with UBS Puerto Rico, R-G Investments or any of their respective affiliates.

- *Mortgage Instruments and Mortgage-Backed Securities Risk.* Mortgage Instruments and mortgage-backed securities have many of the risks of traditional debt securities but, in general, differ from investments in traditional debt securities in that, among other things, principal may be prepaid at any time due to prepayments by the obligors on the underlying obligations. Because the Fund is expected to invest a significant amount of its assets in Mortgage Instruments and mortgage-backed securities, the Fund will bear the risks associated with investments in mortgage-backed securities and mortgage loans such as extension, prepayment, foreclosure, reinvestment and interest rate risks. Prepayments might result in reinvestment of the proceeds of such prepayments at interest rates that are lower than the prepaid obligations. The rate of prepayments is influenced by a variety of economic, geographic, demographic and other factors, including, among others, prevailing mortgage interest rates, local and regional economic conditions and home owner mobility. Generally, however, prepayments will increase during periods of declining interest rates and decrease during periods of rising interest rates. The decrease in the rate of prepayments during periods of rising interest rates results in the extension of the duration of Mortgage Instruments and mortgage-backed securities, which makes them more sensitive to changes in interest rates and more likely to decline in value (this is known as extension risk). The changes in the expected rate of prepayment on Mortgage Instruments and mortgage-backed securities may adversely affect their actual yield.

In addition, it is important to note that mortgage-backed or other securities issued or guaranteed by FNMA, FHLMC or a Federal Home Loan Bank are supported only by the credit of those entities and are not supported by the full faith and credit of the United States.

- *Interest Rate Risk.* The value of fixed income securities such as those in which the Fund may invest generally can be expected to fall when interest rates rise and to rise when interest rates fall. Interest rate risk is the risk that interest rates will rise and that, as a result, the value of the Fund's investments will fall. The Fund is subject to interest rate risk. Because market interest rates are currently near their lowest levels in many years, there is a greater risk that the Fund's portfolio will decline in value. Prices of longer term fixed income securities generally change more in response to interest rate changes than prices of shorter term fixed income securities. Because the Fund will invest primarily in long term fixed income securities, the net asset value and market price per Share will fluctuate more in response to changes in market interest rates than if the Fund invested primarily in shorter term fixed income securities.

- *Liquidity and Restrictions on the Transfer of the Shares.* The Shares may only be offered, sold, or otherwise transferred to Puerto Rico residents. Shareholders who cease to be Puerto Rico residents will

no longer have available to them the tax benefits that make the Fund an attractive investment and those Shareholders will have an obligation to liquidate their Shares as soon as it becomes economically feasible to do so. The Shares are a new issue of securities, and therefore, prior to this offering, there has been no market for the Shares. No assurance can be given as to the liquidity of, or the trading market for, the Shares as a result of any activities undertaken by the Underwriters.

- *Geographic Concentration Risk.* At least 67% of the Fund's total assets will be invested in securities of Puerto Rico issuers. Consequently, the Fund is more susceptible to economic, political, regulatory, and other factors adversely affecting issuers in Puerto Rico than an investment company that is not so concentrated in Puerto Rico issuers.

- *Non-Diversification Risk.* A relatively high percentage of the Fund's total assets will be invested in obligations of a limited number of Puerto Rico issuers. Consequently, the Fund's net asset value and its yield may increase or decrease more than that of a more diversified investment company as a result of changes in the market's assessment of the financial condition and prospects of such Puerto Rico issuers.

### **Risks Relating to R&G Financial**

R&G Financial is issuing a corporate guaranty in connection with the Mortgage Instruments (the "Guaranty"). Pursuant to the Guaranty, R&G Financial will guarantee the timely payment of principal and interest on the Mortgage Instruments. Neither the Guaranty nor the Shares will be rated by any credit rating agency. The Fund's rights under the Guaranty will be subject to R&G Financial's creditworthiness and the corresponding risk that R&G Financial will be unable to satisfy its obligations thereunder. See "THE MORTGAGES AND THE POOLING OF MORTGAGES – The Guaranty Agreement." In connection therewith, risks affecting the financial condition of R&G Financial represent risks to an investor in the Shares which he or she should be aware of. For additional information in connection with R&G Financial please refer to Appendix A hereto.

The following are risks relating to R&G Financial:

- *Increases in Interest Rates Reduce Demand for New Mortgage Loan Originations and Refinancings.* Higher interest rates increase the cost of mortgage loans to consumers and reduce demand for mortgage loans, which negatively impacts R&G Financial's profits. Based on historical experience, R&G Financial expects a decrease in demand for mortgage loans as interest rates increase. Reduced demand for mortgage loans results in reduced loan originations and lower gain on the sale of mortgage loans. Demand for refinancings is particularly sensitive to increases in interest rates.

- *Increases in Interest Rates Reduce Net Interest Income.* Increases in short-term interest rates reduce net interest income, which is an important part of earnings. Net interest income is the difference between the interest received on earning assets and the interest paid on borrowings. When interest rates rise, R&G Financial must pay more in interest on its borrowings while interest earned on its assets does not rise as quickly, which causes its profits to decrease.

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

- *Increases in Interest Rates May Reduce the Value of Mortgage Loans and Securities Holdings.* Increases in interest rates may reduce the value of R&G Financial's financial assets and have an adverse impact on its earnings and financial condition.

- *Decreases in Interest Rates May Adversely Affect the Value of the Servicing Asset of R&G Financial.* Decreases in interest rates lead to increases in the prepayment of mortgages by borrowers, which may reduce the value of R&G Financial's servicing asset.

- *Default Risk in Connection With Loan Originations of R&G Financial's Banking Subsidiaries.* Both R-G Premier and R-G Crown Bank, a federal savings bank with operations in the State of Florida ("R-G Crown") are subject to the risk of loss from mortgage loan defaults and foreclosures with respect to the loans originated for their respective portfolios.

- *Increase in Credit Risk Exposure as a Consequence of the Increase in Construction and Commercial Lending Activities.* R-G Premier has increased its emphasis on residential construction, commercial real estate, and commercial business lending, which is likely to increase overall credit risk. R&G Financial intends to continue its business plan with R-G Crown in Florida. Banks generally charge higher interest rates on commercial and residential construction loans than on residential mortgage loans because larger loan losses are expected in this line of business.

- *Adverse Conditions in Puerto Rico Could Negatively Impact the Operations of R&G Financial.* The business activities and credit exposure of R&G Financial have historically been concentrated in Puerto Rico customers. While the acquisition of R-G Crown has facilitated a diversification of overall lending concentration, R-G Crown is subject to similar concentration risks in the Florida markets in which it operates.

- *Changes in Applicable Laws.* As a Puerto Rico chartered financial holding company, R&G Financial as well as its various subsidiaries, are each subject to federal and local governmental supervision and regulation. There are laws and regulations which restrict transactions between R&G Financial and its various subsidiaries. Any change in such regulations, whether by regulatory authorities or as a result of legislation subsequently enacted by the Congress of the United States or the Puerto Rico legislature, could have a substantial impact on the operations of R&G Financial.

See "RISK FACTORS AND SPECIAL CONSIDERATIONS" and "SPECIAL LEVERAGE CONSIDERATIONS" in the main body of this Prospectus, for a more detailed description of the risk considerations that may be relevant to you.

**Dividends and Other  
Distributions; Dividend  
Reinvestment Plan**

The Fund intends to distribute monthly dividends of substantially all of its net investment income (which reflects amounts declared and paid as dividends on preferred stock as well as interest paid on outstanding debt securities or other forms of leverage). The net capital gains realized by the Fund, if any, may be retained by the Fund, as permitted by Puerto Rico law, unless the Fund's Board of Directors determines that the net capital gains will also be distributed.

The Fund will establish a dividend reinvestment plan under which all holders of the Shares will have all dividends and other distributions on their Shares paid in cash, unless such Shareholders elect to have the dividends and distributions reinvested in additional Shares. There will be no charge to participants for reinvesting dividends or other distributions. UBS TCPR's fees for the handling of reinvestment of distributions will be paid by the Fund. See "DIVIDENDS AND OTHER DISTRIBUTIONS; DIVIDEND REINVESTMENT PLAN."

**Share Repurchases**

Although the Shareholders will not have the right to require the Fund to redeem their Shares, the Fund may take action to repurchase Shares in the open market or make tender offers for its Shares at their net asset value. See "REPURCHASE OF THE SHARES BY THE FUND."

**Taxation**

See "TAXATION" for a summary of the material Puerto Rico and U.S. tax considerations that may be relevant to prospective investors in the Fund.



## ESTIMATED FUND EXPENSES

The following tables are intended to assist you in understanding the various costs and expenses you can expect to bear, directly or indirectly, by investing in the Shares.

### Shareholder Transaction Expenses

Sales Load (as a percentage of the initial public offering price).....	4.75%
Dividend Reinvestment Plan Fee.....	None

### Annual Fund Operating Expenses (as a percentage of average weekly gross assets)<sup>(1)</sup>

Investment Advisory Fees .....	0.75%
Administration Fees.....	0.15%
Other Expenses <sup>(2)</sup> .....	0.10%
Total Annual Fund Operating Expenses <sup>(3)</sup> .....	1.00%

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- (1) Investment advisory and administration fees, which are indirectly paid entirely by you as owner of the Shares, will be charged as a percentage of average weekly gross assets, including the assets purchased with the proceeds of leverage. Therefore, the dollar amount of fees indirectly paid by you (and the level of fees, as a percentage of your investment in the Fund) will increase proportionally with the amount of leverage issued by the Fund. For example, if the Fund were to issue debt or preferred stock in an amount equal to the total net proceeds received by the Fund from the issuance of its common stock, the dollar amount of the investment advisory and administration fees indirectly paid by you (and the level of these fees, as a percentage of your investment in the Fund) would be twice the amount that would be payable if the Fund issued no debt or preferred stock. In addition, if the Fund issues debt or other forms of leverage, it will incur interest costs, which are indirectly paid entirely by you, and which are not reflected in the above table. See “SPECIAL LEVERAGE CONSIDERATIONS.” Assuming leverage in the amount of approximately 50% of the Fund’s total assets including assets acquired with the amount borrowed at an annual interest rate (including dividends on preferred stock) of 2% payable on such leverage, and based on market rates as of the date of this Prospectus, the annual return on the assets that the Fund’s portfolio must experience (net of expenses) in order to cover such interest payments would be 2%. The actual cost of leverage (including dividends on preferred stock) will be based on market rates at the time the Fund undertakes a leveraging strategy, and such actual cost of leverage may be higher or lower than that assumed, as more fully described herein.
- (2) “Other Expenses” have been estimated for the first fiscal year of operations and include, among others, custodian and transfer agency fees, organizational expenses, fees for certain shareholder services, legal, regulatory, and accounting fees, printing costs, and registration fees.
- (3) Investment advisory and administration fees may be voluntarily waived or reimbursed in whole or in part by UBS TCPR and/or R-G Premier, as applicable, from time to time. There is no assurance that any such waiver or reimbursement, if commenced, will be continued. However, items included under the caption “Other Expenses” will not be waived.

## Example

The following is intended to assist you in understanding the various costs that you will bear directly or indirectly as owner of the Shares. The example assumes payment by the Fund of operating expenses at the levels set forth in the table on the previous page.

You would pay the following expenses on a \$1,000 investment, assuming (i) the deduction of 4.75% initial sales load at the time of purchase, (ii) a 5% annual return, (iii) all dividends and distributions reinvested at net asset value, and (iv) the deduction of the total annual Fund operating expenses and of the cost of leverage, as described above, remaining the same for the years shown.

	<u>One Year</u>	<u>Three Years</u>	<u>Five Years</u>	<u>Ten Years</u>
Assuming No Leverage	\$57	\$78	\$100	\$164
Assuming Leverage of 50% of the Fund's total assets	\$67	\$107	\$150	\$269

This example also provides you with a means for comparison with the expense levels of other investment companies with different fee structures over varying investment periods. To facilitate such comparison, the Fund has used a 5% annual return assumption. **The Fund's annual return may be greater or less than 5%. This example should not be considered a representation of future expenses. Actual expenses may be greater or less than those shown for purposes of this example.**

## RISK FACTORS AND SPECIAL CONSIDERATIONS

The main risks of investing in the Fund are described below. **Any of these risks may cause you to lose money.**

*General.* The Fund's investments may be adversely affected by the performance of U.S., Puerto Rico, and foreign investment securities markets which may be, in turn, influenced by other factors, including the level of interest rates, the rate of inflation, politics, fiscal policy, and current events. Because the Fund invests in investment securities, the Fund's net asset value may fluctuate due to market conditions, and as a result you may experience a decline in the value of your investment in the Fund and lose money.

*Lack of Operating History.* The Fund is a newly organized, non-diversified, closed-end management investment company with no previous operating history. Additionally, R-G Premier has not previously served as an investment adviser to an investment company. The Fund may not succeed in meeting its investment objective.

*Conflicts of Interest Risk.* The Fund is not registered under the U.S. Investment Company Act of 1940, as amended (the "1940 Act"), and therefore is not subject to the restrictions contained in that statute regarding, among other things, transactions between the Fund and UBS Puerto Rico or its affiliates (including UBS TCPR and UBS AG) or R&G Financial or its affiliates (including R-G Premier, R&G Mortgage and R-G Investments), as well as investment in or deposits with such affiliates.

UBS Asset Managers of Puerto Rico, a division of UBS TCPR ("UBS AMPR"), and R-G Portfolio Management, a division of R-G Premier ("R-G Portfolio Management" and, together with UBS AMPR, the "Investment Advisers") will act as co-investment advisers to the Fund. UBS TCPR is also the Administrator as well as the Trustee of the initial trust issuing the Units (the "Initial Trust"). UBS AMPR in its capacity as investment adviser and UBS TCPR in its capacity as administrator to the Fund, as well as UBS Puerto Rico, R-G Investments and their respective affiliates (including R-G Premier) may engage, at the present or in the future, in business transactions with or related to any one of the issuers of the Fund's investment assets, or with competitors of such issuers, as well as provide them with investment banking, asset management, trust, or advisory services, including merger and acquisition advisory services. It is anticipated that UBS Puerto Rico and R&G Financial will enter into an agreement whereby they agree to sponsor the Fund and future funds that they may structure together in the future. These activities may present a conflict between any such affiliated parties and the interests of the Fund. Any such affiliated parties may also publish or may have published research reports on one or more of such issuers and may have expressed opinions or provided recommendations inconsistent with the purchasing or holding of the securities of such issuers. Any of these activities may affect the market value of the securities issued by them and therefore, will affect the value of the Shares. Moreover, the Investment Advisers are not registered under the U.S. Investment Advisers Act of 1940, as amended, and are therefore, not subject to the restrictions imposed on investment advisers thereunder.

The transactions between the Fund and R-G Premier or its affiliates, may give rise to additional conflicts between any such affiliated parties and the interests of the Fund. The Mortgage Instruments are comprised of mortgages originated or acquired by R-G Premier or any of its affiliates. The Fund will purchase Mortgage Instruments from R-G Premier and/or its affiliates. R-G Portfolio Management, a division of R-G Premier will provide advice to the Fund regarding whether to purchase, and the price to pay for, such Mortgage Instruments from R-G Premier. Consequently, R-G Portfolio Management's obligation to the Fund may conflict with its potential objective of maximizing the value that R-G Premier receives for selling Mortgage Instruments or reducing credit risks in R-G Premier's loan portfolio. Because R-G Portfolio Management will provide advice to the Fund regarding the valuation and creditworthiness of its Mortgage Instruments, the Mortgage Instruments may potentially be sold to the Fund at a price higher than the market value of such Mortgage Instruments and/or be of lower credit quality than is desirable for the Fund. Further, R&G Mortgage, an affiliate of R-G Premier, or any of R&G Mortgage's affiliates, will service the Mortgage Loans and the Mortgage Loans underlying the Units and the Participation Certificates in the Fund's portfolio pursuant to the Master Servicing Agreement. R&G Mortgage is also an affiliate of an underwriter of the Fund's Shares, R-G Investments. These affiliations could cause a conflict with R&G Mortgage and its duties to the Fund under the Master Servicing Agreement. A similar conflict exists with R-G Premier acting as custodian of the whole mortgage loans underlying the Units. Additionally, R&G Financial, the financial holding company and parent company of R-G Premier, will issue a corporate guarantee of the obligations of R&G Mortgage or its affiliates under the corresponding servicing agreement for the Mortgage Loans. More specifically, R&G Financial will guarantee the timely payment of principal and interest of the Mortgage Instruments if R&G Mortgage, as servicer, is unable to make an advance with respect to the mortgage loans as described in this prospectus. This affiliation could cause the conflict that among other things, R&G Mortgage, as servicer, may not determine a mortgage loan is delinquent in a timely manner in order to avoid triggering R&G Financial's responsibilities and obligations under the Guaranty. Similarly, R&G Mortgage would have an incentive to attempt to cause the Fund to otherwise delay or forego its remedies under the Guaranty. See "MANAGEMENT OF THE FUND – Conflicts of Interest."

In addition, it is anticipated that the Fund will engage in transactions, such as securities purchase and sale transactions and repurchase agreement transactions, directly with UBS Puerto Rico, R-G Premier, R-G Investments or any of their affiliates. For most securities purchased by the Fund, one of those entities may be the only dealer, or one of only a few dealers, in the securities being purchased or sold by the Fund. In that event, independent sources for valuation or liquidity of a security may be limited or nonexistent, and UBS Puerto Rico and/or R-G Investments might have a conflict of interest with respect to the valuation provided, which also could affect the market price of the Shares. The Fund is expected to invest a substantial portion of its assets in those securities. The Fund may also invest in securities issued by its affiliates, or make deposits with those affiliates. As a result of the above transactions and other dealings, the interest of UBS Puerto Rico and R-G Investments, affiliates of the Investment Advisers, may conflict with those of the Fund as to the price and other terms of transactions in which they engage. Portfolio transactions between the Fund and UBS Puerto Rico and/or its affiliates, and the Fund and R&G Financial and/or its affiliates, will be executed pursuant to terms and conditions comparable to those with unrelated third parties in the ordinary course of its investment activities. The Investment Advisers and their affiliates also have interests in, or business relationships with other companies in which the Fund invests and those may conflict with those of the Fund. In addition, the investment advisory fee payable to the Investment Advisers during periods in which the Fund is utilizing leverage will be higher than when it is not doing so because the fee is calculated as a percentage of average weekly gross assets, including assets purchased with leverage. Because the asset base used for calculating the investment advisory fee is not reduced by aggregate indebtedness incurred in leveraging the Fund, the Investment Advisers may have a conflict of interest in formulating a recommendation to the Fund as to whether and to what extent to use leverage.

As a result of the transactions and other dealings referred to above, the interests of the Investment Advisers and/or their affiliates may conflict with those of the Fund. In addition, while the Investment Advisers will seek to allocate potential investments among the Fund and other advisory clients in an equitable manner, the procedures used occasionally may adversely affect the Fund.

*Liquidity and Restrictions on the Transfer of the Shares.* The Shares have not been registered with the U.S. Securities and Exchange Commission under the U.S. Securities Act of 1933, as amended (the “1933 Act”), and the Fund has not been registered under the 1940 Act. Consequently, the Shares may be offered, sold, or otherwise transferred exclusively to individuals whose principal residence is in Puerto Rico, or to corporations and other business organizations whose principal office and place of business are in Puerto Rico. Prior to the initial sale or subsequent transfer of the Shares, each purchaser will be required to represent in writing to the Fund, the Underwriters, or the Administrator that the above conditions to purchase are satisfied. Appendix D to this Prospectus contains, in letter form, the substance of the representations that must be made prior to the purchase and delivery of such Shares. Such restrictions shall remain in effect until such time as the Fund shall determine, based on an opinion of legal counsel, that they are no longer necessary in order to preserve an exemption for the Shares from the registration requirements of the 1933 Act, and for the Fund under the 1940 Act. Shareholders who cease to be residents of Puerto Rico (as described above) will no longer have available the tax benefits that make the Fund an attractive investment and will have an obligation to liquidate their Shares as soon as it becomes economically feasible to do so.

The Shares are a new issue of securities. Therefore, prior to this offering, there has been no market for the Shares. UBS Puerto Rico and R-G Investments (collectively, the “Underwriters”) currently intend to maintain a market for the Shares commencing after the final closing of the initial public offering of the Shares, although they are not obligated to do so. No assurance can be given as to the liquidity of, or the trading market for, the Shares as a result of any activities undertaken by the Underwriters. Such purchases and sales, if commenced, may be discontinued at any time. If at any time the Underwriters (and other dealers, if any) cease to maintain a market, the Shares will become illiquid until a market is reestablished.

*Market Price of Shares.* The market price of the Shares will be determined by such factors as relative demand for and supply of such Shares in the market, general economic and market conditions, and other factors beyond the control of the Fund. The Fund cannot predict whether the Shares will trade at, below, or above net asset value or their respective offering price. There may be few or no market-makers for the Shares. UBS Puerto Rico and R-G Investments may be the only firms maintaining a market for the Shares, and from time to time, due to regulatory constraints or otherwise, UBS Puerto Rico and R-G Investments may cease to maintain a market for the Shares, which could result in illiquidity of the Shares. Shares of closed-end investment companies such as the Fund frequently trade at prices lower than their net asset value. This characteristic of shares of closed-end funds is a risk separate and distinct from the risk that the Fund’s net asset value may decrease. Net asset value will be reduced following the offering of the Shares by the amount of the underwriting discount and the offering expenses paid by the Fund.

Puerto Rico investment companies that are similar to the Fund have sometimes, but not always, traded at a price equal to or greater than their net asset value. This can happen when the yield on the net asset value per Share is higher than yields generally

available in the market for comparable securities, and the market price will tend to reflect this by trading higher than the net asset value per Share to adjust the yield to a comparable market rate. There is no assurance, however, that this will continue with those similar companies in the future or that the experience of the Fund will replicate that of those similar Puerto Rico investment companies. Accordingly, the Shares may not be suitable to all investors as they are designed primarily for long-term investors, and investors in the Shares should not view the Fund as a vehicle for trading purposes.

*Risks Related to the Mortgage Instruments – Units and Participation Certificates.* In the event R&G Financial defaults on its obligations under the Guaranty or R&G Mortgage as servicer fails to distribute moneys received under the Master Servicing Agreement, payment of principal and interest on the Mortgage Instruments depends on the payment capacity of the individual debtors in the Mortgage Loans underlying the Mortgage Instruments. Borrower defaults may adversely affect the yield on the Units and the Participation Certificates and accordingly, the yield of the Fund. The rate of delinquencies or defaults on the mortgage loans will affect (i) the aggregate amount of distributions on the Units and the Participation Certificates; (ii) their yield to maturity; (iii) the rate of principal payments; and (iv) their weighted average life. If losses on the Mortgage Loans exceed the aggregate principal amount of the Units and/or the Participation Certificates, they will suffer a loss equal to the full amount of such excess (up to their outstanding principal amounts). Additionally, delinquencies and defaults on the mortgage loans may significantly delay the receipt of distributions by the Fund on the Units and the Participation Certificates, unless certain advances are made to cover delinquent payments. The Mortgage Loans are originated or acquired pursuant to credit granting policies adopted by R-G Premier, R&G Mortgage and/or its affiliates and not by the Fund. The Fund has not passed upon the credit worthiness of any of said debtors.

The Units solely represent interests in the issuer trust fund and the Participation Certificates solely represent interest in a pool of mortgages and they do not represent interests or obligations of R&G Mortgage or its affiliates (other than the obligations of R&G Financial under the Guaranty). The Units and the Participation Certificates will not be insured or guaranteed by any governmental agency or instrumentality. There will be no recourse to R-G Premier or any other entity, except as described under “THE MORTGAGES AND THE POOLING OF THE MORTGAGES – The Guaranty Agreement” herein.

*Risks Related to the Mortgage Instruments – The Mortgage Loans.* The Mortgage Loans underlying the Mortgage Instruments and the Mortgage Loans that the Fund may acquire are nonconforming mortgage loans. Nonconforming loans are loans that may not be sold to the Federal National Mortgage Association (“FNMA”) or the Federal Home Loan Mortgage Corporation (“FHLMC”). See “Appendix H – Types of Mortgage Loans.”

An overall decline in the residential real estate market in Puerto Rico could adversely affect the value of the mortgage loans underlying the Mortgage Instruments such that the outstanding principal balance of a mortgage loan equals or exceeds the value of the related mortgaged properties. A decline in the residential real estate market in Puerto Rico could arise from adverse economic developments, changes in the real estate market where the mortgaged properties securing the mortgage loans are located, changes in governmental rules and fiscal policies, or acts of nature (such as hurricanes) which may result in uninsured losses of property. A rise in interest rate over a period of time and the general condition of the mortgaged properties as well as other factors may have the effect of reducing the value of the mortgaged properties from the appraised value at the time the mortgage loan was originated. If there is a reduction in value of the mortgaged properties, the ratio of amount of the mortgage loan to the value of the mortgaged properties may increase over what it was at the time the mortgage loan was originated. Such an increase may reduce the likelihood of liquidation proceeds being sufficient to satisfy the mortgage loan.

Even assuming that the mortgaged properties provide adequate security for the mortgage loans underlying the Mortgage Instruments, substantial delay could be encountered in connection with the liquidation of defaulted mortgage loans and corresponding delays in the receipt of related proceeds. Further, liquidation expenses (such as legal fees, real estate taxes, and maintenance and preservation expenses) will reduce the proceeds in a liquidation.

*Mortgage-Backed Securities and CMO Risk.* Mortgage-backed securities and CMOs have many of the risks of traditional debt securities but, in general, differ from investments in traditional debt securities in that, among other things, principal may be prepaid at any time due to prepayments by the obligors on the underlying obligations. As a result, the Fund may receive principal repayments on these securities earlier or later than anticipated by the Fund. In the event of prepayments that are received earlier than anticipated, the Fund may be required to reinvest such prepayments at rates that are lower than the anticipated yield of the prepaid obligation. The rate of prepayments is influenced by a variety of economic, geographic, demographic and other factors, including, among others, prevailing mortgage interest rates, foreclosure rate, prepayment penalties, local and regional economic conditions and home owner mobility. Generally, however, prepayments will increase during periods of declining interest rates and decrease during periods of rising interest rates. The decrease in the rate of prepayments during periods of rising interest rates results in the extension of the duration of mortgage-backed securities, which makes them more sensitive to changes in interest rates

and more likely to decline in value (this is known as extension risk). Since it is expected that a significant portion of the assets of the Fund will be invested in mortgage-backed securities, the Fund may be subject to these risks and other risks related to such securities to a significant degree, which might cause the market value of the Fund's investments to fluctuate more than otherwise would be the case. In addition, it is important to note that CMOs, mortgage-backed or other securities issued or guaranteed by the FNMA, the FHLMC or a Federal Home Loan Bank are supported only by the credit of these entities and are not supported by the full faith and credit of the United States.

CMOs may be specially structured in a manner that provides a variety of investment characteristics, such as yield, effective maturity and interest rate sensitivity. As market conditions change, however, and particularly during periods of rapid or unanticipated changes in market interest rates, the ability of a CMO class to provide the anticipated investment characteristics and performance may be significantly reduced. These changes can result in volatility in the market value, and in some instances reduced liquidity, of the CMO class.

*Asset-Backed Securities Risk.* Asset-backed securities present risks similar to those of mortgage-backed securities. The frequent absence of a government guarantee creates greater exposure to the credit risk on the underlying obligations and depending on the structure, the credit risk of the sponsor of such obligations.

*Interest Rate Risk.* The value of fixed income securities or assets such as those in which the Fund may invest generally can be expected to fall when interest rates rise and to rise when interest rates fall. Interest rate risk is the risk that interest rates will rise, and that as a result the value of the Fund's investments will fall. The Fund is subject to interest rate risk. Because interest rates are currently near their lowest levels in many years, there is a greater risk that interest rates will rise and that as a result the Fund's portfolio will decline in value. Prices of longer term fixed income securities (or assets) generally change more in response to interest rate changes than prices of shorter term fixed income securities (or assets). Because the Fund will invest primarily in long term fixed income securities and assets, the net asset value and market price per Share of its common stock will fluctuate more in response to changes in market interest rates than if the Fund invested primarily in shorter term fixed income securities. In addition, during periods of rising interest rates, the average life of certain types of securities or assets may be extended because of the right of the issuer to defer payments or make slower than expected principal payments. This may lock in a below market interest rate, increase the security's (or asset's) duration (the estimated period until the security (or asset) is paid in full), and reduce the value of the security or asset. This is known as extension risk. The Fund is subject to extension risk. Conversely, during the periods of declining interest rates, the issuer of a security (or asset) may exercise its option to prepay principal earlier than scheduled in order to refinance at lower interest rates, forcing the Fund to reinvest in lower yielding securities or assets. This is known as prepayment risk. The Fund is subject to prepayment risk. This tendency of issuers to refinance debt with high interest rates during periods of declining interest rates may reduce the positive effect of declining interest rates on the market value of the Fund's securities or assets. Finally, the Fund's use of leverage by the issuance of preferred stock, debt securities and other instruments, as discussed below, may increase the risks described above. See "SPECIAL LEVERAGE CONSIDERATIONS."

*Risks of Preferred Stock.* Investments in preferred stock present certain special risks. One of them is that the issuers of preferred stock are not legally required to pay dividends when scheduled, even if they have sufficient funds to do so, and therefore these securities have greater payment risk than other securities in which the Fund may invest. In the case of cumulative preferred stock, missed dividends only have to be paid upon the liquidation of the company, and only after payment of the company's creditors. In the case of non-cumulative preferred stock, missed dividends never have to be paid. However, the issuer is normally prohibited from paying dividends on its common stock unless all or some of its preferred dividends have been paid. Preferred stock is subordinated in right of payment to all other creditors of the issuer, and therefore is subject to greater credit risk than debt instruments. Also, holders of preferred stock usually have no voting rights, except in very limited circumstances. Shares of preferred stock may be substantially less liquid (they may have a more limited secondary market and may therefore be more difficult to sell) than other securities in which the Fund could invest, such as U.S. government securities. Shares of preferred stock are usually redeemable at the option of the issuer. As with any fixed income security, a redemption may negatively impact the return of the security to the holder. The Fund may invest up to 5% of its total assets in preferred stock that is unrated or rated below investment grade.

*Illiquid Securities and Assets.* Illiquid securities and assets are securities or assets that cannot be sold within a reasonable period of time, not to exceed seven days, in the ordinary course of business at approximately the amount that the Fund has valued the securities or assets. There presently are a limited number of participants in the market for certain Puerto Rico securities or other securities or assets that the Fund may own, including the Mortgage Instruments. That and other factors may cause certain securities to have periods of illiquidity. Illiquid securities include, among other things, securities subject to legal or contractual restrictions on resale that hinder the marketability of the securities. There are no limitations on the Fund's investment in illiquid

securities. The Fund may also continue to hold, without limitation, securities or other assets that become illiquid after the Fund invests in them. To the extent the Fund owns illiquid securities or other illiquid assets, the Fund may not be able to sell them easily, particularly at a time when it is advisable to do so to avoid losses. Certain of the securities in which the Fund intends to invest, such as shares of preferred stock, may be substantially less liquid than other types of securities in which the Fund may invest. Illiquid securities and assets may trade at a discount from comparable, more liquid investments.

*Valuation Risk.* There may be few or no dealers making a market in certain securities and assets owned by the Fund, particularly with respect to the Mortgage Instruments and securities of Puerto Rico issuers including, but not limited to, investment companies. Dealers making a market in those securities may not be willing to provide quotations on a regular basis to the Fund's Investment Advisers. Therefore, it may be particularly difficult to value those securities. When market quotations for securities held by the Fund are not readily available from any such independent dealers, the Fund's administrator will be responsible for obtaining quotations for such securities from various sources, including UBS Puerto Rico and R-G Investments and/or any of their affiliates. As a result, the interests of UBS Puerto Rico and R-G Investments may conflict with those of the Fund as to the price and other terms of transactions among them.

*Political Risk.* Political or regulatory developments in Puerto Rico and in the United States could adversely affect the tax status of dividends and/or interest paid on the Fund's securities. These developments could also cause the value of the Fund's investments to fall.

*Geographic Concentration Risk.* The Fund is exposed to certain risks resulting from the reduced geographic diversification of its portfolio. The Fund's assets are invested primarily in securities of Puerto Rico issuers. Consequently, the Fund in general is more susceptible to economic, political, regulatory or other factors adversely affecting issuers in Puerto Rico than an investment company that is not concentrated in Puerto Rico issuers. Also, the Fund's ability to achieve its investment objective and to comply with applicable law is dependent upon the availability of securities and assets of Puerto Rico issuers. If those obligations are unavailable or are only available at a price unreasonably above their market value or at interest rates inconsistent with the Fund's investment objective, it may harm the Fund's performance.

*Non-Diversification Risk.* A relatively high percentage of the Fund's total assets will be invested in obligations of a limited number of Puerto Rico issuers. Consequently, the Fund's net asset value and its yield may increase or decrease more than that of a more diversified investment company as a result of changes in the market's assessment of the financial condition and prospects of such Puerto Rico issuers. The Fund will also be more susceptible to any single economic, political, or regulatory occurrence in Puerto Rico than a more widely diversified fund.

*Fixed Income Securities Generally.* The yield on fixed income securities such as those in which the Fund may invest depends on a variety of factors, including general market conditions for such securities, the financial condition of the issuer, the size of the particular offering, and the maturity, credit quality and rating of the security. Generally, the longer the maturity of those securities, the higher its yield and the greater the changes in its yields both up and down. The market value of fixed income securities normally will vary inversely with changes in interest rates. Such changes in the Fund's net asset value, in particular, also might affect the price of the Shares. The unique characteristics of certain types of securities may also make them more sensitive to changes in interest rates.

*Repurchase Agreement Risk.* If a repurchase agreement counterparty defaults, the Fund may suffer time delays and incur costs or possible losses in connection with the disposition of the securities underlying the repurchase agreement. In the event of default, instead of the contractual fixed rate of return, the rate of return to the Fund will depend on intervening fluctuations of the market values of the underlying securities and the accrued interest thereon. In such an event, the Fund would have rights against the counterparty for breach of contract with respect to any losses resulting from those market fluctuations.

*Municipal Obligations Risk.* Certain of the municipal obligations in which the Fund may invest present their own distinct risks. These risks may depend, among other things, on the financial situation of the government issuer, or in the case of industrial development bonds and similar securities, on that of the entity supplying the revenues that are intended to repay the obligations. It is also possible that, as a result of litigation or other conditions, the power or ability of issuers or those other entities to meet their obligations for the repayment of principal and payment of interest may be materially and adversely affected.

*Special Risks of Hedging Strategies.* The Fund may use a variety of derivative instruments including securities options, financial future contracts, options on future contracts and other interest rate protection transactions such as swap agreements, to attempt to hedge its portfolio of assets and enhance its return. Successful use of most derivative instruments depends upon the

Investment Advisers' ability to predict movements of the overall securities and interest rate markets. There can be no assurance that any particular hedging strategy will succeed, or that the Fund will employ such strategy with respect to all or any portion of its portfolio. Some of the derivative strategies that the Fund may use to enhance its return are riskier than its hedging transactions and have speculative characteristics. Such strategies do not attempt to limit the Fund's risk of loss. See "Appendix G – Hedging and Related Income Strategies."

*Derivative Instruments.* In order to attempt to hedge various portfolio positions or to enhance its return, the Fund may invest up to 5% of its total assets in certain instruments which are or may be considered derivatives. Subject to the approval of the Fund's Board of Directors (the "Board of Directors"), such 5% limit may be exceeded only for the purpose of hedging. Derivative instruments, because of their increased volatility and potential leveraging effect (without being subject to the Fund's leverage limitations), may adversely affect the Fund. For example, investments in indexed securities, including, among other things, securities linked to an equities or commodities index and inverse floating rate securities, may subject the Fund to the risks associated with changes in the particular indices, which may include reduced or eliminated interest payments and losses of invested principal. Such investments, in effect, may also be leveraged, thereby magnifying the risk of loss. There is no assurance that the Investment Advisers will employ any hedging strategy, and even where such derivative investments are used for hedging purposes, there can be no assurance that the hedging transactions will be successful or will not result in losses. If the Fund invests in derivative instruments, it could lose more than the principal amount invested.

For example, utilization of options and futures transactions involves the risk of imperfect correlation in movements in the price of such options and futures and the movements in the price of the securities or interest rates which are the subject of the hedge. Municipal derivatives may also be subject to the same risks as floating rate municipal obligations generally, as well as risks of adverse tax determinations, or in the case of municipal derivatives used for hedging purposes, risks similar to those for other hedging strategies.

*Transactions with Counterparties.* The Fund will engage in swap and other financial transactions directly with other counterparties. This subjects the Fund to the credit risk that a counterparty will default on an obligation to the Fund. Such a risk contrasts with transactions done through exchange markets, wherein credit risk is reduced through the collection of variation margin and through the interposition of a clearing organization as the guarantor of all transactions. Clearing organizations transform the credit risk of individual counterparties into the more remote risk of the failure of the clearing organization.

*Short Sales.* The Fund may engage in short sales of securities "against the box" to defer realization of gains or losses for tax or other purposes. A short sale "against the box" occurs when the Fund owns an equal amount of the securities sold short or owns securities convertible into or exchangeable, without payment of any further consideration, for securities of the same issue as, and equal amount to, the securities sold short.

*Securities Lending.* Securities lending involves the risk that there may be a delay in the recovery of securities or even loss of rights in the collateral, among other things, should the borrower of the securities fail financially or become insolvent.

*Changes in Applicable Law.* Legislation affecting Puerto Rico Securities, assets other than Puerto Rico Securities, Puerto Rico and U.S. investment companies, taxes, and other matters related to the business of the Fund are continually being considered by the Puerto Rico Legislature and the U.S. Congress. Moreover, the determinations made and the waivers and rulings granted by the Office of the Commissioner of Financial Institutions (the "OCFI") to the Fund, do not constitute a precedent binding thereon. There can be no assurance that legislation enacted or regulations promulgated after the date hereof will not have an adverse effect on the operations of the Fund, the economic value of the Shares, or the tax consequences of the acquisition or redemption of Shares.

### **Risks Relating to R&G Financial**

R&G Financial is a Puerto Rico chartered diversified financial holding company that, through its wholly-owned subsidiaries, is engaged in banking, mortgage banking, securities and insurance brokerage activities. R&G Financial, currently in its 32<sup>nd</sup> year of operations, operates 32 bank branches mainly located in the northeastern section of Puerto Rico, 15 bank branches in the Orlando and Tampa/St. Petersburg Florida markets, 5 mortgage and 6 commercial lending offices in the continental United States, and 55 mortgage offices in Puerto Rico, including 26 facilities located within R-G Premier's branches. R&G Financial is issuing the Guaranty in connection with the Servicing of the Mortgage Loans. Pursuant to the Guaranty, R&G Financial will guarantee timely payments of principal and interest of the Mortgage Instruments by issuing its corporate guaranty for the obligations of R&G Mortgage or its affiliates under the corresponding servicing agreement for the Mortgage Loans. See "THE



MORTGAGES AND THE POOLING OF THE MORTGAGES – The Guaranty Agreement.” In that connection, risks relating to R&G Financial, especially credit risks, are relevant risks that an investor in the Shares should be aware. As of November 3, 2004, R&G Financial’s senior unsecured long-term debt is rated BBB by Fitch Ratings, a nationally recognized credit rating organization. However, neither the Guaranty nor the Shares will be rated by any credit rating agency. Moreover, the Fund’s rights under the Guaranty will be subject to R&G Financial’s creditworthiness and the corresponding risk that R&G Financial will be unable to satisfy its obligations thereunder. See “RISK FACTORS AND SPECIAL CONSIDERATIONS - Risks relating to R&G Financial.” Appendix E sets forth the ratings and their definitions by the different credit rating organizations. For additional information about R&G Financial please refer to Appendix A hereto.

The following are risks relating to R&G Financial:

*Increases in Interest Rates Reduce Demand for New Mortgage Loan Originations and Refinancings.* Higher interest rates increase the cost of mortgage loans to consumers and reduce demand for mortgage loans, which negatively impacts profits. Based on historical experience, R&G Financial expects a decrease in demand for mortgage loans as interest rates increase. Reduced demand for mortgage loans results in reduced loan originations and lower gain on sale of loans. Demand for refinancings is particularly sensitive to increases in interest rates.

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

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

*Increases in Interest Rates May Reduce the Value of Mortgage Loans and Securities Holdings.* Increases in interest rates may reduce the value of R&G Financial’s financial assets and have an adverse impact on its earnings and financial condition. R&G Financial owns a substantial portfolio of mortgage loans and mortgage-backed securities, which have both fixed and adjustable interest rates. The market value of an obligation with a fixed interest rate generally decreases when prevailing interest rates rise, which may have an adverse effect on R&G Financial’s earnings and financial condition. In addition, the market value of an obligation with an adjustable interest rate can be adversely affected when interest rates increase due to a lag in the implementation of repricing terms as well as due to caps, which may limit the amount of increase in the obligation’s interest rate.

*Decreases in Interest Rates May Adversely Affect the Value of the Servicing Asset of R&G Financial.* Decreases in interest rates lead to increases in the prepayment of mortgages by borrowers, which may reduce the value of R&G Financial’s servicing asset. The servicing asset is the estimated present value of the fees R&G Financial expects to receive on the mortgages serviced over their expected term. If prepayments increase above expected levels, the value of the servicing asset decreases because the amount of future fees expected to be received decreases. R&G Financial may be required to recognize this decrease in value by taking a charge against its earnings, which would cause its profits to decrease. R&G Financial has experienced an increase in prepayments of mortgages as interest rates have decreased dramatically during the past two years, which has impacted the value of its servicing asset. Accordingly, R&G Financial recognized impairment charges on its servicing portfolio of \$7.8 million for the nine months ended September 30, 2004. R&G Financial believes, based on historical experience that the amount of prepayments and related impairment charges should decrease as interest rates increase. There is no assurance, however, as to when and to what extent interest rates will rise to levels which would materially impact prepayments.

*Default and Recourse Risk in Connection With Loan Originations.* From the time R&G Financial funds the mortgage loans it originates for third parties to the time it sells them, R&G Financial is generally at risk for any mortgage loan defaults. Once the mortgage loan is sold, the risk of loss from mortgage loan defaults and foreclosures passes to the purchaser or insurer of the mortgage loans. However, in the ordinary course of business, R&G Financial makes representations and warranties to the purchasers and insurers of mortgage loans. If a borrower defaults on a mortgage loan and there has been a breach of any of these representations or warranties, R&G Financial may become liable for the unpaid principal of, and interest on, the defaulted mortgage loan and may be required to repurchase the mortgage loan and bear any subsequent loss on the mortgage loan. In addition, with respect to the non-conventional mortgage loans originated by R&G Financial, which are subsequently securitized and sold, from time to time, R&G Financial provides recourse in the event of mortgage loan defaults and/or foreclosures or certain documentation deficiencies. At September 30, 2004, there were \$1.8 billion of loans subject to such recourse provisions.

*Default Risk in Connection With Loan Originations of R&G Financial's Banking Subsidiaries.* Both R-G Premier and R-G Crown are subject to the risk of loss from mortgage loan defaults and foreclosures with respect to the loans originated for their respective portfolios. Notwithstanding the care with which loans are originated, industry experience indicates that a portion of a bank's loans will become delinquent and a portion of the loans will require partial or entire charge-off. Regardless of the underwriting criteria utilized by R-G Premier and R-G Crown, losses may be experienced as a result of various factors beyond each bank's control, including, among others, changes in market conditions affecting the value of collateral and problems affecting the credit of the borrower. Due to the concentration of R-G Premier and R-G Crown's loans in Puerto Rico and Florida, respectively, adverse economic conditions in Puerto Rico and Florida could result in a decrease in the value of either bank's loan portfolio and underlying collateral. Although loan delinquencies have historically been higher in Puerto Rico than in the continental United States, loan charge-offs have historically been lower than in the continental United States.

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

*Increase in Credit Risk Exposure as a Consequence of the Increase in Construction and Commercial Lending Activities.* R-G Premier has increased its emphasis on residential construction, commercial real estate and commercial business lending, which is likely to increase overall credit risk. R&G Financial intends to continue this business plan with R-G Crown in Florida. Banks generally charge higher interest rates on commercial and residential construction loans than on residential mortgage loans, because larger loan losses are expected in this business line. Generally, commercial and construction loans are considered to be riskier than residential mortgage loans because they have larger balances to a single borrower or group of related borrowers. In addition, the borrower's ability to repay a commercial and a construction loan depends, in the case of a commercial loan, on the successful operation of the business or the property securing the loan and, in the case of a construction loan, on the successful completion and sale or operation of the project. If R-G Premier or R-G Crown experienced loan losses that are higher than its allowance for loan losses, the profits and financial condition of R&G Financial would be adversely affected.

*Risks in Servicing Loans for Others.* R&G Financial is also affected by mortgage loan delinquencies and defaults on mortgage loans that are serviced for third parties. Under certain types of servicing contracts, the servicer must forward all or part of the scheduled payments to the owner of the mortgage loan, even when mortgage loan payments are delinquent. Also, to protect their liens on mortgaged properties, owners of mortgage loans usually require the servicer to advance mortgage and hazard insurance and tax payments on schedule even though sufficient escrow funds may not be available. The servicer will generally recover its advances from the mortgage owner or from liquidation proceeds when the mortgage loan is foreclosed. However, in the interim, the servicer must absorb the cost of funds advanced during the time the advance is outstanding. Further, the servicer must bear the increased costs of attempting to collect on delinquent and defaulted mortgage loans. In addition, if a default is not cured, the mortgage loan will be repaid as a result of foreclosure proceedings. As a consequence, R&G Financial is required to forego servicing income from the time such loan becomes delinquent, and into the future.

*Adverse Conditions in Puerto Rico Could Negatively Impact the Operations of R&G Financial.* The business activities and credit exposure of R&G Financial have historically been concentrated with customers in Puerto Rico. Accordingly, the financial condition and results of operations of R&G Financial have been dependent to a significant extent upon the economic conditions prevailing in Puerto Rico, including the effect of such economic conditions on real estate values. Any significant adverse economic developments in Puerto Rico, and, in particular, any decline in real estate values, could result in a downturn in loan originations, an increase in the level of nonperforming assets and a reduction in the value of R&G Financial's loans, real estate owned and mortgage servicing portfolio. While the acquisition of R-G Crown has facilitated a diversification of overall lending concentration, R-G Crown is subject to similar concentration risks in the Florida markets in which it operates.

*Origination Business of R&G Financial Could be Adversely Affected if it Cannot Maintain Access to Stable Funding Sources.* R&G Financial's business requires continuous access to various funding sources. While R-G Premier and R-G Crown are able to fund their operations through deposits as well as through longer, term borrowings from the Federal Home Loan Bank, and other alternative sources, the business of R&G Mortgage has been significantly dependent upon short-term borrowings under

warehousing lines. Certain of these warehousing lines of credit require the maintenance of minimum levels of net worth and debt service and limit the amount of indebtedness that may be incurred and dividends that may be declared.

While R&G Financial expects to have continued access to credit from the foregoing sources of funds, there can be no assurance that such financing sources will continue to be available or will be available on favorable terms. In the event that the warehousing lines of credit of R&G Financial's subsidiaries are reduced or eliminated and R&G Financial is not able to replace such lines on a cost-effective basis, R&G Financial would be forced to curtail or cease its mortgage origination business, which would have a material adverse effect on its operations and financial condition. Although R&G Financial's subsidiaries could also potentially access borrowings from its banks, any such borrowings would be subject to, and limited by, certain regulatory restrictions which apply to transactions between banks and its affiliates, including certain of its subsidiaries.

*Defaults on Commercial Real Estate and Commercial Construction Loans Could Adversely Affect the Financial Condition and Results of Operations of R&G Financial.* R&G Financial's total loan portfolio has grown significantly in recent years, from \$1.6 billion at December 31, 1999 to \$4.8 billion at September 30, 2004. While over fifty percent of the loan portfolio continues to be secured by residential properties, an increasing amount is comprised of commercial real estate loans and commercial construction and land acquisition loans.

At September 30, 2004, the commercial real estate loans amounted to \$880.2 million, or 16.8% of R&G Financial's total loan portfolio, while the construction portfolio amounted to \$798.4 million or 15.3% of the loan portfolio. Because such loans are relatively unseasoned, many of the loans may be too new to demonstrate problems. While R&G Financial attempts to mitigate these risks in commercial real estate lending through stringent underwriting criteria and in the case of construction loans, by limiting originations to primarily residential properties, no assurance can be made that an increase in delinquencies and defaults will not occur. Defaults on these loans could negatively effect the financial condition and results of operations of R&G Financial.

*Loss of the Services of Key Individuals within R&G Financial.* The success of R&G Financial has been largely dependent on Víctor J. Galán, Chairman of the Board and Chief Executive Officer, and Ramón Prats, Vice Chairman of the Board and President. The future success of R&G Financial will also depend, to a great extent, upon the services of Mr. Galán and Mr. Prats. R&G Financial believes that the prolonged unavailability or the unexpected loss of the services of Mr. Galán and/or Mr. Prats could have a material adverse effect upon the company, as attracting suitable replacements may involve significant time and/or expense.

*Changes in Applicable Laws.* R&G Financial, as a Puerto Rico chartered financial holding company, and its various subsidiaries, are each subject to federal and local governmental supervision and regulation. There are laws and regulations which restrict transactions between R&G Financial and its various subsidiaries. Any change in such regulations, whether by applicable regulators or as a result of legislation subsequently enacted by the Congress of the United States or the applicable local legislatures, could have a substantial impact on the operations of R&G Financial.

## **THE FUND**

Puerto Rico Mortgage-Backed & U.S. Government Securities Fund, Inc. (the “Fund”) is a newly-organized, non-diversified, closed-end management investment company. It is a corporation organized under the laws of the Commonwealth of Puerto Rico (“Puerto Rico”) and will operate as a registered investment company under the Puerto Rico Investment Companies Act, as amended. In addition, the Fund is subject to a ruling (the “Commissioner’s Ruling”) issued by the Office of the Commissioner of Financial Institutions (“OCFI”). See “RULING OF THE COMMISSIONER.” The Fund’s principal office is located at American International Plaza, Tenth Floor, 250 Muñoz Rivera Avenue, San Juan, Puerto Rico 00918, and its telephone number is (787) 773-3888.

## **THE OFFERING**

The Fund is initially offering the number of shares of its common stock (the “Shares”) set forth in the cover of this Prospectus through UBS Financial Services Incorporated of Puerto Rico (“UBS Puerto Rico”) and R-G Investments Corporation (“R-G Investments”), in their capacity as underwriters (the “Underwriters”). The Underwriters will commit to purchase the Shares at several closings to be held in San Juan, Puerto Rico. It is anticipated that the initial closing will take place on or about the date set forth on the cover of this Prospectus (the “Initial Closing”), and other closings may take place thereafter. The Fund may increase the number of Shares offered to the public at any time. The Underwriters will also be granted an option to purchase up to 1,230,000 additional Shares offered by the Fund solely to cover over-allotments.

The public offering price will be the greater of (i) \$10.00 or (ii) the then current net asset value per Share plus the applicable sales load.

The minimum number of Shares an investor may purchase is 100. See “UNDERWRITING.”

### **OFFERING LIMITED TO PUERTO RICO RESIDENTS; RESTRICTIONS ON TRANSFER OF THE SHARES**

The Shares have not been registered under the U.S. Securities Act of 1933, as amended (the “1933 Act”), or under the securities laws of any other state or jurisdiction. The Fund is not registered under the U.S. Investment Company Act of 1940, as amended (the “1940 Act”). The Shares are being offered exclusively to individuals who have their principal residence in Puerto Rico and to corporations and other business organizations that have their principal office and principal place of business in Puerto Rico (collectively, “Puerto Rico Residents”). The Shares may only be subsequently sold, pledged, hypothecated, or otherwise transferred to Puerto Rico Residents.

All purchasers and transferees of the Shares will be required to deliver to the Underwriters or a dealer a letter of representation in the form of Appendix D attached to this Prospectus in which such purchaser or transferee represents that it is a Puerto Rico Resident. The Underwriters and any dealers will be contractually obligated to the Fund to obtain such letter of representation in proper form. Any transfer of the Shares to a transferee who has not so provided such a letter will be null and void.

Shareholders who cease to be Puerto Rico Residents will no longer have available the tax benefits that make the Fund an attractive investment. In such case, within 30 days from ceasing to be Puerto Rico Residents, such Shareholders have an obligation to notify the Underwriters or dealers and liquidate their investment in the Shares as soon as it becomes economically feasible to do so. Furthermore, such Shareholders agree not to purchase more Shares. These restrictions shall remain in effect until such time as the Fund shall determine, based on an opinion of counsel, that the restrictions are no longer necessary in order to preserve an exemption from the registration requirements of the 1933 Act and the 1940 Act.

## USE OF PROCEEDS

The proceeds to the Fund of this public offering, assuming that the Fund issues only the number of Shares specified on the cover page of this Prospectus, is set forth on the cover page of this Prospectus, before payment of offering expenses (which are estimated not to exceed \$300,000), including legal counsel fees. Organizational expenses, which will also be paid by the Fund in the first year of operations, are estimated not to exceed \$200,000. Such proceeds will be invested in accordance with the Fund's investment objective and policies on or before the first anniversary of the Fund's registration as an investment company with the OCFI (the "Anniversary Registration Date"). Pending such investment, such proceeds may be invested temporarily in cash and short-term U.S. Government securities (as used herein, "U.S. Government Securities" includes direct obligations of the U.S., as well as securities issued by agencies and instrumentalities of the U.S.), and other securities selected by UBS Asset Managers of Puerto Rico ("UBS AMPR"), a division of UBS Trust Company of Puerto Rico ("UBS TCPR") and R-G Portfolio Management, a division of R-G Premier Bank of Puerto Rico ("R-G Premier") as the Fund's co-investment advisers (the "Investment Advisers"). Failure to invest the proceeds of this offering in accordance with the Fund's investment objective and policies on or before the Anniversary Registration Date may give rise to administrative sanctions and penalties imposed by the OCIF.

## INVESTMENT OBJECTIVE AND POLICIES

The Fund's investment objective is to provide you with current income, consistent with the preservation of capital. **There is no assurance that the Fund will achieve its investment objective.**

At least 67% of the Fund's total assets will be invested in taxable and tax-exempt securities issued by Puerto Rico issuers, including securities issued by the Commonwealth of Puerto Rico and its political subdivisions and instrumentalities, Mortgage Instruments (as defined herein), mortgage-backed and asset-backed securities, corporate obligations, and preferred stock (the "Puerto Rico Securities"). The Fund may invest up to 33% of its total assets in taxable and tax-exempt securities issued by the U.S. Government, its agencies and instrumentalities, non-Puerto Rico Mortgage Instruments, non-Puerto Rico mortgage-backed and asset-backed securities, corporate obligations or preferred stock of non-Puerto Rico issuers, municipal securities of issuers within the U.S., and in other non-Puerto Rico Securities which the Investment Advisers may select, consistent with the Fund's investment objective and policies.

At least 80% of the Fund's total assets will be invested in (i) "Mortgage Instruments" which are comprised of whole residential non-conforming mortgage loans ("Mortgage Loans"), securities issued by grantor trusts in connection with pooled Mortgage Loans (the "Units") and participation certificates in pools of Mortgage Loans (the "Participation Certificates"); (ii) securities issued or guaranteed by the Government National Mortgage Association ("GNMA"), Federal National Mortgage Association ("FNMA"), Federal Home Loan Mortgage Corporation ("FHLMC"), and/or other mortgage-backed securities and collateralized mortgage obligations ("CMOs") collateralized with securities issued or guaranteed by GNMA, FNMA or FHLMC; and (iii) securities issued or guaranteed by the U.S. Government, its agents and/or instrumentalities.

Up to 45% of the Fund's total assets will be invested in Mortgage Instruments whose timely payment of principal and interest is guaranteed by R&G Financial Corporation ("R&G Financial") pursuant to a corporate guarantee of the obligations of R&G Mortgage Corporation ("R&G Mortgage") or its affiliates under the corresponding servicing agreement for the Mortgage Loans. The Mortgage Loans will be originated or acquired by R-G Premier or any of its affiliates and will be serviced by R&G Mortgage or any of its affiliates.

At least 95% of the Fund's total assets will be invested in securities and assets, including Mortgage Instruments, that at the time of purchase are rated investment grade by a nationally recognized statistical rating organization, or, if not so rated, that the Fund's Investment Advisers determine to be of comparable credit quality.

The average maturity of the Fund's portfolio securities will vary based upon the Investment Advisers' assessment of economic and market conditions. The net asset value of the common shares of a closed-end investment company, such as the Fund, which invests primarily in fixed-income securities, changes as the general levels of interest rates fluctuate. When interest rates decline, the value of fixed-income securities can be expected to rise. Conversely, when interest rates rise, the value of fixed-income securities can be expected to decline. The prices of longer-term securities generally fluctuate more in response to interest rate changes than do short-term or medium-term securities.

These changes in net asset value might be greater in the case of an investment company having a leveraged capital structure, as the one proposed for the Fund. See “SPECIAL LEVERAGE CONSIDERATIONS.”

The Fund’s investment objective and fundamental policies may not be changed unless authorized by a supermajority (or in some cases, a simple majority) of investors in the Fund’s outstanding Shares and by the OCFI. All other investment policies and limitations, however, subject to applicable Puerto Rico law, may be changed by the Fund’s board of directors (the “Board of Directors”) without the approval of either the Shareholders or the OCFI. See “INVESTMENT RESTRICTIONS.”

Set forth below is a description of the various types of securities and assets in which the Fund may invest.

*Mortgage Instruments.* The Units, Participation Certificates and Mortgage Loans described above.

*Mortgage-Backed Securities.* Mortgage-Backed Securities, represent direct or indirect participations in, or are secured by and are payable from, mortgage loans secured by real property (“Mortgage-Backed Securities”). Investors in Mortgage-Backed Securities typically receive interest and principal on the underlying mortgage loans (and/or any related credit support). The Fund’s investments in Mortgage-Backed Securities will be considered as Puerto Rico Securities when the underlying assets are substantially comprised of mortgages over real property located within Puerto Rico (“Puerto Rico Mortgage-Backed Securities”).

Investments in Mortgage-Backed Securities will include those issued or guaranteed by GNMA, FNMA or FHLMC, as well as Mortgage-Backed Securities which are not guaranteed or issued by GNMA, FNMA, FHLMC, or any other government agency (“Private Label Mortgage-Backed Securities”), and in either case may include Units, Participation Certificates and CMOs. Private Label Mortgage-Backed Securities are issued in connection with a securitization and represent a beneficial interest in a privately sponsored trust or other entity, the assets of which are mortgage loans or GNMA, FNMA, FHLMC, or other Mortgage-Backed Securities, including CMOs. See “RISK FACTORS AND SPECIAL CONSIDERATIONS” and “TAXATION.”

GNMA Mortgage-Backed Securities include securities which are backed by mortgage loans insured by the Federal Housing Administration or guaranteed by the Veterans Administration, and which consist of mortgage-backed certificates with respect to pools of such mortgages guaranteed as to the timely payment of principal and interest by GNMA. That guaranty is backed by the full faith and credit of the United States.

FNMA Mortgage-Backed Securities represent a beneficial ownership interest in one or more pools of mortgage loans, which may be insured by the Federal Housing Administration or the Veterans Administration, or which may not be insured or guaranteed by any governmental agency. FHLMC Mortgage-Backed Securities represent direct or indirect participations in, and are payable from, conforming conventional residential mortgage loans. FNMA’s and FHLMC’s obligations with respect to their Mortgage-Backed Securities are not backed by the full faith and credit of the United States. CMOs are multiple-class Mortgage-Backed Securities. Some CMOs are directly supported by other CMOs, which in turn are supported by pools of mortgage loans. Investors in such securities typically receive payments out of the interest and principal on the underlying mortgage loans. The portions of these payments that investors receive, as well as the priority of their rights to receive payments, are determined by the specific terms of the CMO class. CMOs involve special risks. See “RISK FACTORS AND SPECIAL CONSIDERATIONS — Mortgage-Backed Securities, – Risks Related to CMOs.” The type of GNMA, FNMA, FHLMC and certain other Mortgage-Backed Securities in which the Fund may invest are described in more detail in “Appendix B — Mortgage-Backed Securities.” Not all types of Mortgage-Backed Securities are currently available in Puerto Rico.

*U.S. Government Securities.* The Fund may invest in U.S. Government securities. These include securities that are issued or guaranteed by the U.S. Government, such as Treasury bills, Treasury notes, and Treasury bonds, or that are issued or guaranteed by its agencies or instrumentalities, such as obligations of the Federal Home Loan Banks, which are supported by the right of the issuer to borrow from the U.S. Treasury, and obligations of the Federal Intermediate Credit Banks, which are supported only by the credit of the issuer. The Fund may also invest in repurchase agreements secured by such securities.

*Municipal Obligations.* Municipal Obligations are debt obligations or similar securities issued by or on behalf of Puerto Rico, a State of the U.S., or any of their respective political subdivisions, organizations, agencies or

instrumentalities, or by multi-state agencies or authorities. Municipal Obligations are issued for various public purposes, including construction of public or privately-operated facilities, such as airports, bridges, hospitals, housing, mass transportation, schools, streets and water and sewer works. Other public purposes for which Municipal Obligations may be issued include refinancing outstanding obligations and obtaining funds for general operating expenses and for loans to other public institutions and facilities. The types of Municipal Obligations in which the Fund may invest, and certain of the risks attached thereto, are described in the Appendix C to this Prospectus. Not all of such types of Municipal Obligations are currently available in Puerto Rico.

*Asset-Backed Securities.* The Fund may invest in various types of asset-backed securities (“Asset-Backed Securities”). The securitization techniques used in the context of Asset-Backed Securities are similar to those used for Mortgage-Backed Securities. The receivables supporting Asset-Backed Securities presently are primarily home equity mortgage loans and automobile and credit card receivables, but may also consist of other types of obligations. Asset-Backed Securities and the underlying receivables are not generally insured or guaranteed by any government agency. However, in certain cases, such securities are collateralized by loans guaranteed by the U.S. Small Business Administration (“SBA”). The SBA is an independent agency of the United States.

The SBA guarantees the payment of principal and interest on portions of loans made by private lenders to certain small businesses. The loans are generally commercial loans such as working capital loans and equipment loans. The SBA is authorized to issue from time to time, through its fiscal and transfer agent, SBA-guaranteed participation certificates evidencing fractional undivided interests in pools of these SBA-guaranteed portions of loans made by private lenders. The SBA’s guaranty of such certificates, and its guaranty of a portion of the underlying loan, is backed by the full faith and credit of the United States.

Asset-Backed Securities will be considered Puerto Rico Asset-Backed Securities when the securitization vehicle is organized under the laws of Puerto Rico, or regardless of where organized, when a majority of the underlying assets are obligations of Puerto Rico Residents.

*Corporate Obligations.* Corporate obligations are debt obligations or similar securities issued by or on behalf of a corporation that desires to raise money for particular corporate purposes, such as for working capital or capital or other expenditures, or for repayment of outstanding debt. See “Appendix E – Ratings of Securities” and “Appendix F – Certain Other Types of Investments.”

*Preferred Stock.* Preferred stock generally has priority over common stock with respect to payment of dividends and upon liquidation, but does not have the seniority of a debt instrument in an issuer’s capital structure in terms of claims to corporate income and liquidation payments. Preferred stock may have a fixed dividend rate and may not participate in any profits in the issuer above such dividend rate, in which case it is referred to as “non-participating,” or it may participate in some or all of the profits of the issuer, in which case it is referred to as “participating.” Preferred stock may be perpetual, with no mandatory redemption date, or issued with a mandatory redemption date. It may also be callable or redeemable at the option of the issuer after a certain period of time. Issuers of preferred stock are not required to pay dividends on the preferred stock, even if they have sufficient funds to pay dividends, although they are usually prohibited from paying dividends on their common stock unless all or some preferred dividends have been paid. Preferred dividends may be “cumulative” or “non-cumulative.” If dividends are cumulative and they are not declared and paid at their regularly scheduled time, such dividends must generally be paid when the issuer is liquidated, before any assets may be distributed to holders of the issuer’s common stock. If dividends are non-cumulative, they never have to be paid if they are not declared. (However, as mentioned above, the issuer may be prohibited from paying dividends on its common stock unless all or some preferred dividends have been paid.) Holders of preferred stock do not have the right to precipitate bankruptcy filings or collection activities in the event of missed dividend payments. Preferred stock may be convertible into common stock of the issuer or into some other security, or it may be non-convertible. Holders of preferred stock usually have no voting rights, except in cases where preferred dividends have been unpaid for a certain period, in which case holders of preferred stock usually have the right to elect certain representatives to the board of directors of the issuer. Most of the preferred stock of Puerto Rico issuers currently available in the market is non-cumulative, non-voting, non-convertible, and non-participating, and pays dividends at a fixed dividend rate on a monthly basis. Most of the preferred stock of Puerto Rico issuers currently available in the market is issued by bank holding companies.

## **OTHER INVESTMENT PRACTICES**

Certain of the other investment practices in which the Fund may engage are described below. If, as the Fund currently intends, the Fund issues preferred stock, debt securities, and other forms of leverage and seeks to obtain a rating of such preferred stock, debt securities, and other forms of leverage, any rating organization issuing such rating may, as a condition thereof, impose additional asset coverage or other requirements, which may restrict the Fund's ability to engage in these investment practices.

### **When-Issued Securities and Delayed Delivery Transactions**

The purchase of securities on a when-issued or delayed delivery basis involves the risk that, as a result of an increase in yields available in the marketplace, the value of the securities purchased will decline prior to the settlement date. The sale of securities for delayed delivery involves the risk that the prices available in the market on the delivery date may be greater than those obtained in the sale transaction. At the time the Fund enters into a transaction on a when-issued or delayed delivery basis, it will segregate with the Custodian (as defined herein) cash or liquid instruments with a value not less than the value of the when-issued or delayed delivery securities. The value of these assets will be monitored daily to ensure that their marked-to-market value will at all times exceed the corresponding obligations of the Fund. There is always a risk that the securities may not be delivered, and the Fund may incur a loss.

### **Short-Term Temporary Investments**

If, in the opinion of the Investment Advisers, no suitable Puerto Rico Securities, other municipal obligations, or long-term U.S. Government securities are available, or if the Investment Advisers believe unusual circumstances warrant a defensive posture, the Fund may temporarily commit all or any portion of its assets to taxable or tax-exempt short-term instruments. Such instruments may include securities issued or guaranteed by the U.S. Government, its agencies or instrumentalities, commercial paper rated at least A-1 by Standard & Poor's ("S&P"), P-1 by Moody's Investors Service, Inc.'s ("Moody's") or F1 by Fitch Ratings ("Fitch"), bank certificates of deposit, bankers' acceptances and Repurchase Agreements (as defined herein) secured by any of the foregoing. See "Appendix E – Ratings of Securities."

### **Dollar Rolls and Reverse Repurchase Agreements**

The Fund may enter into dollar rolls, in which the Fund sells mortgage-backed or other securities for delivery in the current month and simultaneously contracts to purchase substantially similar securities on a specified future date. In the case of dollar rolls involving mortgage-backed securities, the mortgage-backed securities that are purchased will be of the same type and will have the same interest rate as those sold, but will be supported by different pools of mortgages. The Fund forgoes principal and interest paid during the roll period on the securities sold in a dollar roll, but the Fund is compensated by the difference between the current sales price and the lower price for the future purchase as well as by any interest earned on the proceeds of the securities sold. The Fund could also be compensated through the receipt of fee income equivalent to a lower forward price. The Fund may also enter into reverse repurchase agreements with respect to its portfolio investments in which a member bank of the Federal Reserve System or a securities dealer who is a member of a national securities exchange or is a market-maker in U.S. Government Securities purchases portfolio securities from the Fund, coupled with an agreement to resell them to the Fund at a specific date, price and interest payment (a "Reverse Repurchase Agreement").

Dollar rolls and Reverse Repurchase Agreements will generally be considered to be leverage and accordingly, will be subject to the Fund's limitations on leverage, which will restrict the aggregate of such transactions, together with the issuance of preferred stock, debt securities, and other forms of leverage, to 50% of the Fund's total assets. See "SPECIAL LEVERAGE CONSIDERATIONS." However, dollar rolls and Reverse Repurchase Agreements will not be subject to such limitation if a separate account is established and maintained with respect to the value of the Fund's commitments thereunder. In addition, certain of the dollar rolls and Reverse Repurchase Agreements entered into by the Fund will be arbitrage transactions in which the Fund will maintain an offsetting position in securities or Repurchase Agreements (as defined herein) that mature on or before the settlement date on the related dollar roll or Reverse Repurchase Agreement. The Investment Advisers believe that such arbitrage transactions do not present the risks to the Fund that are associated with other types of leverage.



Reverse Repurchase Agreements involve the risk that the market value of the securities acquired in connection with the Reverse Repurchase Agreement may decline below the price the securities the Fund has sold but it is obligated to repurchase. Reverse Repurchase Agreements involve the risk that the buyer of the securities sold by the Fund might be unable to deliver them when the Fund seeks to repurchase such securities. In the event the buyer of securities under a Reverse Repurchase Agreement files for bankruptcy or becomes insolvent, such buyer or its trustee or receiver may receive an extension of time to determine whether to enforce the Fund's obligation to repurchase the securities, and the Fund's use of the proceeds of the Reverse Repurchase Agreement may effectively be restricted pending such decision. Also, the Fund would bear the risk of loss to the extent that the proceeds of the Reverse Repurchase Agreement are less than the value of the securities subject to such agreement.

## **Repurchase Agreements**

The Fund may use Repurchase Agreements. Repurchase Agreements consist of transactions in which the Fund purchases securities from a member bank of the Federal Reserve System or a securities dealer who is a member of a national securities exchange or is a market-maker in U.S. Government Securities and simultaneously commits to resell the securities to such original seller at an agreed-upon date and price reflecting a market rate of interest unrelated to the coupon rate or maturity of the purchased securities. Although Repurchase Agreements carry certain risks not associated with direct investments in securities, including possible declines in the market value of the underlying securities and delays and costs to the Fund if the other party to the Repurchase Agreement becomes bankrupt, the Fund intends to enter into Repurchase Agreements only with banks and dealers in transactions believed by the Investment Advisers to present minimum credit risks. In addition, each Repurchase Agreement must be collateralized at least at 102% with U.S. Government or other appropriate liquid high grade securities, held at a third party custodian, and marked-to-market daily.

## **Other Practices**

*Call Rights.* The Fund may purchase a Puerto Rico Security or other municipal obligation issuer's right to call all or a portion of such obligation for mandatory tender for purchase (a "Call Right"). A holder of a Call Right may exercise such right to require a mandatory tender for the purchase of related obligations, subject to certain conditions. A Call Right that is not exercised during the maturity of the related obligation will expire without value. The economic effect of holding both a Call Right and the related obligation is identical to holding an obligation as a non-callable security.

*Options and Futures.* The Fund may use securities options (both exchange-traded and over-the-counter) to attempt to enhance income and may also attempt to reduce the overall risk of its investments (i.e., hedge) by using securities options, financial futures contracts and other interest rate protection transactions such as swap agreements. However, the Fund will not enter into financial futures contracts or options thereon unless the Fund and the Investment Advisers qualify for an exclusion or exemption or comparable relief from applicable registration requirements contained in the regulations administered by the U.S. Commodity Futures Trading Commission. See Appendix G to this Prospectus, for a more complete discussion of the Fund's types of derivative and related income strategies and the risks thereof.

*Short Sales.* The Fund may engage in short sales of securities "against the box" to defer realization of gains or losses for tax or other purposes. A short sale "against the box" occurs when the Fund owns an equal amount of the securities sold short or owns securities convertible into or exchangeable, without payment of any further consideration, for securities of the same issue as, and equal amount to, the securities sold short.

*Securities Lending.* The Fund may also lend securities from its portfolio to broker-dealers, banks, financial institutions, and institutional borrowers of securities and receive collateral in the form of cash or U.S. Government obligations, subject to procedures adopted by the Board of Directors.

## **SPECIAL LEVERAGE CONSIDERATIONS**

### **Issuance of Preferred Stock and Debt Securities**

The Fund may raise additional cash to invest through the issuance of preferred stock, debt securities (i.e., debt instruments of varying maturities, including commercial paper, short-term and medium-term notes, and long-term securities; such securities are collectively referred to herein as the “debt securities”), or other forms of leverage to Puerto Rico Residents, in an aggregate amount representing not more than 50% of the value of the Fund’s total assets immediately after such issuance. Subject to these percentage limitations, the Fund may also engage in certain additional borrowings from banks or other financial institutions through Reverse Repurchase Agreements. In addition, the Fund may also borrow for temporary or emergency purposes in an amount of up to an additional 5% of its total assets.

The Fund presently anticipates that it will engage in borrowings from, and other forms of leverage with, UBS Puerto Rico or its affiliates and R&G Financial or its affiliates through Reverse Repurchase Agreements, dollar rolls, and other transactions. The Fund’s leveraging activities will be carried out in accordance with procedures established by the Board of Directors in an effort to address potential conflicts of interest including, among other things, the potential conflicts of interest in setting interest or dividend rates. There is no assurance that these procedures will be effective. The OCFI has restricted the Fund’s leveraging activities. See “RULING OF THE COMMISSIONER.” There can be no assurance that any of the above securities will be issued.

The Fund intends to begin structuring its leverage program after the completion of the initial offering of the Shares. UBS Puerto Rico and R-G Investments may act as dealers or placement agents in connection with any offering of debt securities by the Fund.

Although the terms of any shares of preferred stock or debt securities issued by the Fund, and of other forms of leverage used by the Fund, will be determined by the Board of Directors, it is anticipated that such shares of preferred stock, debt securities, and other forms of leverage will pay dividends or interest at rates that are adjusted over relatively short periods of time and will reflect prevailing short-term interest rates. The proceeds of any offering of preferred stock, debt securities, and other form of leverage may be invested in longer-term fixed income Puerto Rico Securities (or other debt securities), which typically bear interest at rates that are higher than short-term interest rates (although such higher rates cannot be assured).

Use of leverage through the issuance of preferred stock, debt securities, and other forms of leverage is a speculative investment technique and involves increased risk for Shareholders to a greater extent than in a non-leveraged fund. These include the possibility of higher volatility of the Fund’s yield and net asset value and in the market value of the Shares. In addition, changes in short-term, medium-term and long-term interest rates and the relationship with each other could negatively impact the Fund’s yield, net asset value and the market price of the Shares. The effects of leverage may cause a Shareholder to lose any or all of the amount invested in the Fund. So long as the Fund is able to realize a higher net return on the assets purchased with the proceeds of the leverage than the then current dividend or interest rate, as the case may be, on any preferred stock, debt securities, or other forms of leverage together with other related expenses, the effect of the leverage will be to cause the Shareholders to realize higher current net investment income than if the Fund were not so leveraged. There can be no assurance, however, that the Fund will be able to realize such a net return. Short-term, medium-term, and long-term interest rates change from time to time, as does their relationship to each other (i.e., the slope of the yield curve), depending upon such factors as supply and demand forces, monetary and tax policies, and investor expectations. Changes in any or all of such factors could cause the relationship between short-term, medium-term, and long-term rates to change (i.e., to flatten or to invert the slope of the yield curve) so that short-term and medium-term rates may substantially increase relative to the long-term obligations in which the Fund may be invested. To the extent that the then current dividend or interest rate, as the case may be, paid on any preferred stock, debt securities, and other forms of leverage approaches the net return on that portion of the Fund’s assets purchased with the proceeds of the leverage, the benefit of leverage to the Shareholders will be reduced. Should the then current dividend or interest rate, as the case may be, paid on any preferred stock, debt securities, and other forms of leverage exceed the yield or return on the Fund’s assets purchased with the proceeds of the leverage, the Fund’s leveraged capital structure would result in a lower yield or return to the Shareholders than if the Fund were not so leveraged and therefore, the amount available for distribution to Shareholders will be reduced. Because market interest rates are currently near their lowest levels in many years, there is a greater risk that interest rates will rise, and that the interest rate paid by the Fund on any short-term or medium-term debt securities or other forms of leverage will exceed

the yield or return on any long-term assets previously purchased by the Fund with the proceeds of leverage. Nevertheless, the Investment Advisers may determine to maintain the Fund's leveraged position if it deems such action to be appropriate under the circumstances. The investment advisory fee payable to the Investment Advisers during periods in which the Fund is utilizing leverage will be higher than when it is not doing so because the fee is calculated as a percentage of average weekly gross assets, including assets purchased with leverage. Because the asset base used for calculating the investment advisory fee is not reduced by aggregate indebtedness incurred in leveraging the Fund, the Investment Advisers may have a conflict of interest in formulating a recommendation to the Fund as to whether and to what extent to use leverage.

In addition, payments on preferred stock, debt securities, and other forms of leverage issued by the Fund for investment may be indexed to equity or other indices unrelated to the assets held by the Fund. While the Fund will attempt to enter into hedging transactions to minimize the risks inherent in those transactions, there is no assurance that those transactions will be available or successful. Moreover, any decline in the value of the Fund's assets will be borne entirely by the Shareholders. Accordingly, the effect of leverage in a declining market would be a greater decrease in the net asset value of the Shares than if the Fund were not leveraged and could adversely affect the Fund's ability to make dividend payments and other distributions on both the Shares and preferred stock. Any such decrease may be reflected in a greater decline in the market price of the Shares and preferred stock. If the current investment income of the Fund were not sufficient to meet dividend or interest requirements on the preferred stock, debt securities, and other forms of leverage, it could become necessary for the Fund to liquidate certain of its investments, thereby reducing net assets and therefore, the net asset value of the Shares. Such liquidations would also cause the Fund to incur transaction costs. Moreover, while dividends on preferred stock or interest on debt securities, or other forms of leverage are unpaid, no dividends or other distributions would be permitted to be paid on the Shares until the Fund resumes its payments of dividends on preferred stock or of interest on the debt securities, or other forms of leverage, as the case may be.

The Fund may use a variety of derivative instruments to attempt to hedge its portfolio of assets against interest rate risk. Successful use of most derivative instruments depends upon the Investment Advisers' ability to predict movements of the overall securities and interest rate markets. There can be no assurance that any particular hedging strategy will succeed, or that the Fund will employ such strategies with respect to all or any portion of its portfolio. See "Appendix G – Hedging and Related Income Strategies."

The Fund may issue preferred stock, debt securities, and other forms of leverage to the extent that immediately after their issuance, (i) the value of the Fund's total assets (ii) less all the Fund's liabilities and indebtedness which are not represented by preferred stock, debt securities, or other forms of leverage being issued or already outstanding, (iii) is equal to or greater than 200% of the aggregate par value of all outstanding preferred stock (not including any accumulated dividends or other distributions attributable to such preferred stock) and the total amount outstanding of debt securities and other forms of leverage. This asset coverage requirement must also be met any time the Fund pays a dividend or makes any other distribution on the issued and outstanding Shares or any shares of the Fund's preferred stock (other than a dividend or other distribution payable in Shares) as well as any time the Fund repurchases any Shares, in each case after giving effect to such repurchase of Shares or issuance of preferred stock, debt securities, or other forms of leverage in order to maintain asset coverage at the required 200% level. To the extent necessary, the Fund may purchase or redeem preferred stock, debt securities, or other forms of leverage in order to maintain asset coverage at the required 200% level. In such circumstances, the Fund may have to liquidate portfolio securities in order to meet redemption requirements and might also have to pay a premium. Any necessary liquidations could have the effect of reducing future net income of the Fund. Such liquidations could cause the Fund to incur related transactional costs.

Assuming the utilization of leverage by borrowings in the amount of approximately 50% of the Fund's total assets, and an annual interest rate (including dividends on preferred stock) of 2% payable on such leverage based on market rates as of the date of this Prospectus, the annual return on the assets that the Fund's portfolio must experience (net of expenses) in order to cover such interest payments would be 2%. The following table is designed to illustrate the effect on investment return with leverage obtained by the issuance of preferred stock, debt securities, and other forms of leverage representing approximately 50% of the Fund's total assets, assuming hypothetical annual returns of minus 10% to plus 10%. As the table shows, leverage generally increases the return when portfolio return is positive and decreases the return when the portfolio return is negative. The figures appearing in the table are hypothetical and actual returns may be greater or less than those appearing in the table.

Assumed Return (net of expenses)	(10%)	(5%)	0%	5%	10%
Corresponding Share Return	(22%)	(12%)	(2%)	8%	18%

Leveraging of the Fund cannot be fully achieved until preferred stock, debt securities, and other forms of leverage are issued and the proceeds have been invested by the Fund.

The Fund will seek to obtain an investment grade credit rating from S&P, Moody's, Fitch, or any other nationally recognized rating organization (collectively a "Rating Organization") on any preferred stock or debt securities which it may issue. The Fund believes that obtaining such ratings may enhance the marketability of the preferred stock, debt securities, and other forms of leverage and thereby reduce the dividend or interest rate on the preferred stock or debt securities which the Fund would be required to pay if the preferred stock, debt securities, and other forms of leverage were not so rated. There can be no assurance that the Fund will be able to obtain such ratings, and such ratings would not eliminate or mitigate any risks of investing in the Fund's securities. The Rating Organization rating the preferred stock, debt securities, and other forms of leverage may require asset coverage maintenance ratios that are in addition to, and more stringent than, those discussed above. In addition, restrictions may be imposed on certain investment practices in which the Fund may otherwise engage. The Rating Organization requirements are also expected to impose certain minimum issue size, diversification and other requirements for determining portfolio assets that are eligible for computing compliance with their asset coverage requirements. The ability of the Fund to comply with such asset coverage maintenance ratios may be subject to circumstances, which are beyond the control of the Fund, such as market conditions for its portfolio securities. The terms of any preferred stock, debt securities, or other forms of leverage might prohibit the payment of dividends or other distributions on the Shares and any other preferred stock of the Fund in the event the Fund fails to meet such asset coverage maintenance ratios and in such circumstances, might also provide for mandatory redemption of the preferred stock (if redeemable), with the potential adverse effects discussed above.

The issuance of any preferred stock, debt securities, and other forms of leverage entails certain costs and expenses, such as underwriting discounts, rating agency fees, legal and accounting fees, printing costs, and certain other ongoing expenses, such as administrative and accounting fees. These costs and expenses are borne by the Fund. Ongoing expenses associated with the issuance of any preferred stock, debt securities, and other forms of leverage are reflected as a reduction in the investment income that otherwise would be available for distribution to Shareholders.

## **Borrowings**

In addition, the Fund may also borrow from banks or other financial institutions for temporary or emergency purposes (including, among others, financing repurchases of the Shares and tender offers), in an amount of up to an additional 5% of its total assets. Such borrowings by the Fund would also create leverage and would entail speculative factors similar to those applicable to the issuance of preferred stock, debt securities, and other forms of leverage. If borrowings are made on a secured basis, the Custodian will segregate the pledged assets for the benefit of the lender or arrangements will be made with a suitable sub-custodian, which may include the lender.

## **INVESTMENT RESTRICTIONS**

The Fund may not change its investment objective or fundamental policy without the approval of the holders of (i) a majority of the outstanding Shares, if the proposed change has previously been recommended by the Board of Directors, or (ii) 75% of the outstanding Shares, upon the failure of the Board of Directors to approve a proposal submitted by a Shareholder or a group of Shareholders that hold in the aggregate at least 20% of the Shares. Under current law, the OCFI must also approve any change in such investment objective or fundamental policy.

As its fundamental policy, the Fund may not issue debt securities or borrow money from banks or other entities (including borrowings through dollar rolls and Reverse Repurchase Agreements) in excess of 50% of the Fund's total assets (including the amount of borrowings and debt securities issued). Notwithstanding this restriction, the Fund may borrow from banks or other financial institutions for temporary or emergency purposes (including, among others, financing repurchases of the Shares and tender offers) in an amount of up to an additional 5% of its total assets.

In addition, the Commissioner's Ruling contains certain conditions with respect to the Fund's investment of 67% of its total assets in Puerto Rico Securities (the "67% Investment Requirement") that restrict the Fund's investments. See "RULING OF THE COMMISSIONER."

The Fund may not change the following investment limitations without the approval of a majority of the members of the Board of Directors, and provided that prior written notice is given to its Shareholders:

(a) purchase the securities of any one issuer, if after such purchase it would own more than 75% of the voting securities of such issuer, provided that securities issued or guaranteed by the U.S. Government, its agencies or instrumentalities are not subject to this limitation;

(b) make an investment in any one industry if, at the time of purchase, the investment would cause the aggregate value of all the Fund's investments in such industry to equal 25% or more of the Fund's total assets; provided that this limitation shall not apply to: (i) investments in securities issued or guaranteed by the U.S. Government, its agencies or instrumentalities; (ii) Municipal Obligations, including Puerto Rico Municipal Obligations, other than those backed only by the assets or revenues of a non-governmental entity; (iii) investments in mortgage-backed securities (whether or not issued or guaranteed by an agency or instrumentality of the U.S. Government); and (iv) investments in the Mortgage Instruments. For purposes of this restriction, the intended or designated use of real estate shall determine its industry;

(c) purchase securities on margin, except for short term credits necessary for clearance of portfolio transactions, and except that the Fund may make margin deposits in connection with its use of options or future contracts. See "Appendix F – Certain Other Types of Investments;"

(d) engage in the business of underwriting securities of other issuers, except to the extent that, in connection with the disposition of portfolio securities, the Fund may be deemed an underwriter under U.S. securities laws and except that the Fund may write options;

(e) make short sales of securities or maintain a short position, except that the Fund may sell short "against the box." A short sale "against the box" occurs when the Fund owns an equal amount of the securities sold or owns securities convertible into or exchangeable for, without payment of any further consideration, securities of the same issue as, and equal in amount to, the securities sold short;

(f) purchase or sell real estate (including real estate limited partnership interests), provided that the Fund may invest in securities secured by real estate or interests therein or issued by entities that invest in real estate or interests therein (including mortgage-backed securities), and provided further that the Fund may exercise rights under agreements relating to such securities, including the right to enforce security interests and to liquidate real estate acquired as a result of such enforcement; provided, however, that such securities and any such real estate securing a security acquired by the Fund shall not be a "U.S. real property interest" within the meaning of Section 897 of the U.S. Internal Revenue Code of 1986, as amended (the "Code");

(g) purchase or sell commodities or commodity contracts, except that the Fund may enter into swap agreements, options, futures contracts, see "Appendix F – Certain Other Types of Investments," and options on futures contracts subject to certain restrictions. See "OTHER INVESTMENT PRACTICES — Other Practices — Options and Futures"; or

(h) make loans, except through Repurchase Agreements, provided that for purposes of this restriction the acquisition of Mortgage Instruments, bonds, debentures or other debt instruments or interests therein and investment in government obligations, shall not be deemed to be the making of a loan;

(i) purchase securities of other investment companies, unless immediately thereafter not more than (i) 3% of the total outstanding voting stock of such investment company is owned by the Fund, (ii) 5% of the Fund's total assets, valued at market value, would be invested in any one such investment company, (iii) 10% of the Fund's total assets, valued at market value, would be invested in such securities, and (iv) the Fund, together with other investment companies having the same investment adviser and companies controlled by such companies, owns not more than 10% of the total outstanding stock of any one closed-end investment company;

(j) make investments for the purpose of effecting control of management; or

(k) lend portfolio securities, except to the extent that such loans, if and when made, do not exceed 33⅓% of the total assets of the Fund valued at market value.

## THE MORTGAGES AND THE POOLING OF MORTGAGES

The Fund will initially acquire Units from a trust comprised of nonconforming mortgage loans originated by R-G Premier or its affiliates. The estimated balance of this pool of mortgages is \$65 million. Initially R-G Premier will pool Mortgage Loans secured by properties located in Puerto Rico through the creation of a “grantor trust” organized under the laws of Puerto Rico (the “Initial Trust”) whereby R-G Premier as settlor would transfer the Mortgage Loans to said Initial Trust. The Initial Trust in turn would issue Units representing an interest in the Mortgage Loans owned by the Initial Trust. UBS TCPR would serve as “Trustee” of the Initial Trust and the trust division of R-G Premier as custodian of the Mortgage Loans for the Initial Trust. R&G Mortgage will serve as servicer of these Mortgage Loans. The Fund will receive upon the sale and acquisition of the Units a “True Sale” opinion from Quiñones & Sánchez, PSC, counsel to R-G Premier.

Due to the nature of the Initial Trust as a “grantor trust” the principal balance of assets of the Initial Trust will decrease over time principally because of prepayments and foreclosures on the Mortgage Loans. In addition to that, the principal balance of assets of the Initial Trust will decrease over time because the aggregate outstanding principal amount of the Mortgage Loans in the Initial Trust will decrease as Mortgage Loans in the Initial Trust that become conforming mortgage loans are distributed to the Fund as owner of the Units. The Initial Trust will include a mechanism whereby Mortgage Loans owned by the Trust that become conforming loans are distributed to the Fund in order for the Fund to sell or otherwise transfer them to FNMA or FHLMC and maximize their value for the Fund.

In order for the Fund to comply with its investment policy of investing up to forty-five percent (45%) in Mortgage Instruments the Fund will continue to acquire Mortgage Instruments. In order to do this the Fund may: (i) purchase Mortgage Loans directly from R-G Premier, from its affiliates or from third parties (as long as these Mortgage Loans are serviced by R&G Mortgage or any of its affiliates); (ii) purchase Participation Certificates from R-G Premier; and (iii) purchase Units from subsequent “grantor trusts” organized in the same fashion as the Initial Trust. R-G Premier Bank may pool Mortgage Loans pursuant to a Master Pooling, Sale and Servicing Agreement (the “Master Servicing Agreement”) whereby R-G Premier sells participations in pools of Mortgage Loans to the Fund. The Mortgage Loans underlying the Participation Certificates will be serviced by R&G Mortgage and be held in custody on behalf of the Fund by a third party unaffiliated custodian.

The Mortgage Loans underlying the Units are conventional, fixed rate, monthly pay, residential mortgage nonconforming loans. Nonconforming loans are loans that may not be sold to FNMA or FHLMC in order for them to securitize, package, and sell these loans to investors in the secondary market. For a more detailed description of the nonconforming loans originated and acquired by R-G Premier and R-G Crown please refer to “Appendix H – Type of Mortgage Loans.”

The Units represent a *pro rata* interest in the Trust. The Fund as holder of the Units will be entitled to receive monthly distributions of principal and interest of the nonconforming mortgage loans underlying the Units. The Participation Certificates will each represent a *pro rata* interest in the related pool of the mortgages pooled by R&G Mortgage pursuant to the Master Servicing Agreement. The Fund as holder of the Participation Certificates will be entitled to receive monthly distributions of principal and interest of the mortgage loans underlying the Participation Certificates.

### Master Servicing Agreement

Pursuant to the Master Servicing Agreement, R&G Mortgage will serve as servicer to the Mortgage Loans underlying the Units and the Participation Certificates, and other Mortgage Loans the Fund may acquire directly. Pursuant to the Master Servicing Agreement, R&G Mortgage will act as initial servicer and will service and administer the mortgage loans underlying the Units and the Participation Certificates and shall be entitled to receive a servicing fee as compensation, which fee shall be consistent with market practices in Puerto Rico. The Fund, as holder of the Mortgage Instruments, will grant R&G Mortgage full power and authority, acting alone, to do any and all things in

connection with such servicing and administration which R&G Mortgage may deem necessary or desirable as servicer for the benefit of the Fund.

R&G Mortgage as servicer shall make reasonable efforts to collect all payments required under the Mortgage Loans and shall service such Mortgage Loans consistent with prudent mortgage loan servicing standards and procedures and to the extent consistent with such standards and procedures follow such collection procedures as it follows with respect to mortgage loans comparable to the Mortgage Loans held in its own portfolio; provided that at all times R&G Mortgage shall comply with applicable law and regulations and the terms of the mortgage loans.

As servicer, R&G Mortgage shall be obligated to make the following advances with respect to the Mortgage Loans, notwithstanding R&G Mortgage's failure to receive or collect any of such amounts: (i) delinquent mortgage payments on the Mortgage Loans, with respect to principal and interest, (ii) real estate taxes, assessments and insurance premiums, and (iii) other costs and expenses necessary to preserve the priority of the related Mortgage Loan or to maintain the related mortgaged property. If R&G Mortgage is not able to make the full payment by making an advance, it shall submit a timely notice to R&G Financial, before payment to the Fund is due, requesting R&G Financial to advance funds pursuant to the Guaranty sufficient to make the full monthly payment in a timely manner.

R&G Mortgage shall not resign from its obligations and duties as servicer hereunder unless it determines that such obligations and duties are no longer permissible under applicable law. No such resignation shall become effective until a successor shall have assumed R&G Mortgage's responsibilities and obligations as servicer hereunder, including R&G Mortgage's obligation to make advances pursuant to the Master Servicing Agreement. R&G Mortgage may be removed as servicer in the event it has defaulted its obligations under the Master Servicing Agreement. The Fund may also remove R&G Mortgage under certain circumstances and substitute it with another servicer. However, no such substitution shall become effective until a successor shall have assumed R&G Mortgage's responsibilities and obligations as servicer thereunder, including R&G Mortgage's obligation to make advances pursuant to the Master Servicing Agreement.

#### **Assignment of the Mortgage Loans**

R-G Premier will sell Mortgage Loans to the Initial Trust pursuant to a purchase agreement by and between R-G Premier and the Trustee (the "Purchase Agreement"). R-G Premier (as the initial seller) or any of its affiliates (together, the "Seller"), which may sell Mortgage Loans to the Fund will make certain representations, warranties and covenants as to the ownership and other characteristics of the Mortgage Loans and the underlying collateral. Subject to the limitations described below, the Seller will be obligated, as described herein, to purchase or substitute any mortgage loan which has deficient documentation or for which there has been an uncured breach of any such representation or warranty made in the Initial Trust and relating to the characteristics of the Mortgage Loan, which may, in turn, materially and adversely affect its value (a "Defective Mortgage Loan").

The Trustee or its custodian will review each mortgage file within the time period specified in the Purchase Agreement or promptly after the Trustee's receipt of any document permitted to be delivered after the closing date. The Trustee will hold such mortgage files in trust for the benefit of the holder of the Units and the Participation Certificates. If at the end of such specified period, any document in a mortgage file is found to be missing or not in compliance with the review requirements set forth in the Purchase Agreement and the Seller does not cure such omission or noncompliance within the time period required under the Purchase Agreement and such omission or noncompliance is deemed to have a material and adverse affect on the value of that Mortgage Loan, then the Seller pursuant to the Purchase Agreement is obligated to purchase the related Defective Mortgage Loan from the Initial Trust or the pool of Mortgage Loans represented by the applicable Participation Certificate at a price equal to the sum of (a) 100% of the stated principal balance thereof and (b) unpaid accrued interest thereon from the due date to which interest was last paid by the mortgagor to the due date immediately preceding the repurchase. Rather than purchase the Defective Mortgage Loan as provided above the Seller may remove such Mortgage Loan (a "Deleted Mortgage Loan") from the applicable pool of Mortgage Loans and substitute in its place one or more Mortgage Loans of like kind (such loan a "Replacement Mortgage Loan"); provided, however, that such substitution is permitted only within six months after the closing date and may not be made unless an opinion of counsel is provided to the effect that such substitution would not disqualify the Initial Trust or subsequent Trust, as the case may be, as a "grantor trust" or result in a prohibited transaction tax under the Puerto Rico Internal Revenue Code of 1994, as amended (the "Puerto Rico Code").

Any Replacement Mortgage Loan generally will, on the date of substitution, among other characteristics set forth in the Master Servicing Agreement, (i) have an outstanding principal balance, after deduction of all scheduled payments due in the month of substitution, not in excess of the stated principal balance of the Deleted Mortgage Loan (a “Substitution Adjustment Amount”), (ii) have a maximum mortgage rate not less than (and not more than two percentage points greater than) the maximum mortgage rate of the Deleted Mortgage Loan, (iii) have a loan-to-value ratio equal to or less than that of the Deleted Mortgage Loan, (iv) have a remaining term to maturity not greater than (and not more than one year less than) that of the Deleted Mortgage Loan, (v) is otherwise acceptable to the Seller, (vi) have the same adjustment date as that of the Deleted Mortgage Loan, (vii) have a minimum mortgage rate not less than that of the Deleted Mortgage Loan, (viii) have the same mortgage index as that of the Deleted Mortgage Loan and (ix) comply with all of the representations and warranties set forth in the Purchase Agreement. This cure, repurchase or substitution obligation constitutes the sole remedy available to the holders of the Units and the Participation Certificates or the Trustee for omission of, or a material defect in a mortgage file.

### **Guaranty Agreement**

As further credit enhancement, R&G Financial will guarantee the timely payment of principal and the pass-through interest rates due on the Units and Participation Certificates by issuing its corporate guaranty for the obligations of R&G Mortgage or its affiliates under the corresponding servicing agreement for the Mortgage Loans (the “Guaranty”). The Guaranty guarantees the timely payment of principal and interests of the Mortgage Loans owned by the Fund as long as the Mortgage Loans are serviced by R&G Mortgage or any of its affiliates.

In the event a debtor(s) fails to make a mortgage payment on time, R&G Mortgage, as servicer, shall advance such payments. However, in the event R&G Mortgage is unable to advance the above referenced payment, then R&G Financial, pursuant to the Guaranty, shall make guaranty payments of principal and interest due to R&G Mortgage, as servicer, in order for the Fund, as holder of the Mortgage Instruments, to receive payments of principal and interests in a timely fashion. For more information regarding R&G Financial please see “Appendix A –R&G Financial Corporation.”

### **Valuation Agent and Compliance**

The Fund has engaged the services of a nationally recognized firm to serve as an independent valuation agent (the “Valuation Agent”). Their services will consist of a weekly mark-to-market valuation analysis of the portfolio of residential mortgage loans underlying the Mortgage Instruments (the “Portfolio”). These mark-to-market valuation analysis reports will assist UBS TCPR as the Fund’s administrator (the “Administrator”) in assessing the Fund’s net asset value.

The Valuation Agent’s fee for performing the valuations described herein will be an amount equal to one-twelfth of five (5) basis points of the aggregate principal balance of the Portfolio as of the final weekly valuation performed in any month. This fee will be paid monthly.

The Fund has also engaged the services of another nationally recognized independent firm with an expertise in performing compliance review of mortgage loan portfolios. This firm will perform a compliance review of a randomly selected sample of Mortgage Loans underlying the Mortgage Instruments.

## **MANAGEMENT OF THE FUND**

The overall management of the business and affairs of the Fund is vested with the Board of Directors. The Board of Directors approves all significant agreements between the Fund and persons or companies furnishing services to it, including the Fund’s agreements with its Investment Advisers, Administrator, Custodian, and Transfer Agent (all terms as defined herein). The day-to-day operations of the Fund are delegated to its officers and to the Administrator, subject to the Fund’s investment objective and policies and to the general supervision of the Board of Directors.

**The Board of Directors.** As of the date of this Prospectus, the Board of Directors of the Fund is composed of eight members. Five of these are “Independent Fund Directors,” as defined in the Fund’s Code of Ethics, and three are affiliates of UBS TCPR. It is anticipated that the Board of Directors of the Fund will be increased to ten members to include as directors a representative from R-G Premier, and one additional “Independent Fund Director” proposed by R-



G Premier. Said appointments are subject to the discretion of the current members of the Board of Directors of the Fund and to the applicable provisions of the Fund's Articles of Incorporation and By-Laws.

The five Independent Fund Directors will be:

Victor J. Salgado Arroyo  
Gabriel Dolagaray Balado  
Mario S. Belaval  
Luis M. Pellot-González  
Agustín Cabrer-Roig

The three directors who are affiliates of UBS TCPR will be:

Miguel A. Ferrer  
Thomas F. Streiff  
Carlos V. Ubiñas

The Board of Directors will have two standing committees: an Audit Committee and a Dividend Committee. According to its charter, the role of the Audit Committee is to oversee the Fund's accounting and financial reporting policies and practices and to recommend to the Board of Directors any action to ensure that the Fund's accounting and financial reporting are consistent with accepted accounting standards applicable to the mutual fund industry. The Audit Committee is expected to consist initially of three members that are Independent Fund Directors, and one member that is an affiliate of UBS TCPR. According to its charter, the role of the Dividend Committee is to determine the amount, form, and record date of any dividends to be declared and paid by the Fund. The Dividend Committee is expected to consist initially of three members. Neither the Audit Committee nor the Dividend Committee has held any meetings since the Fund was organized.

***Independent Fund Directors.*** Certain biographical and other information relating to the directors of the Fund who are expected to be the "Independent Fund Directors" is set forth below, including their ages and their principal occupations for at least the last five years. Messrs. Salgado, Dolagaray and Belaval are also members of the boards or directors of all the other investment companies that have engaged UBS AMPR, a division of UBS TCPR as their investment adviser (the "UBS Advised Funds") or as their co-investment adviser (the "UBS Co-Advised Funds" and, together with the UBS Advised Funds, the "Affiliated Funds"). Messrs. Pellot-González and Cabrer-Roig are also members of the boards of directors of the UBS Advised Funds and of the Puerto Rico GNMA & U.S. Government Target Maturity Fund, Inc., which is also a UBS Co-Advised Fund.

<b>Name, Address, and Age</b>	<b>Positions Held with the Fund</b>	<b>Term of Office and Length of Time Served</b>	<b>Principal Occupations During Past Five Years</b>	<b>Number of Affiliated Funds Overseen</b>	<b>Public Directorships</b>
Víctor J. Salgado Arroyo (78) c/o UBS Trust Company of Puerto Rico, American International Plaza-Tenth Floor, 250 Muñoz Rivera Avenue, San Juan, Puerto Rico 00918	Director	Director since 2004	Chairman of the Board of Directors, President, and Chief Executive Officer of INTEGRAND Assurance Company.	22 funds consisting of 38 portfolios	None
Gabriel Dolagaray Balado (69) c/o UBS Trust Company of Puerto Rico, American International Plaza-Tenth Floor, 250 Muñoz Rivera Avenue, San Juan, Puerto Rico 00918	Director	Director since 2004	Former President of the Cooperativa de Seguros de Vida; former President of the Association of Insurance Companies of Puerto Rico, Inc.; former member of the Executive Committee of the North American Association of the International Cooperative Insurance Federation; Member, Advisory Board to the Commissioner of Insurance of Puerto Rico; and former President of the Puerto Rico Chamber of Commerce.	22 funds consisting of 38 portfolios	None
Mario S. Belaval (66) c/o UBS Trust Company of Puerto Rico, American International Plaza-Tenth Floor, 250 Muñoz Rivera Avenue, San Juan, Puerto Rico 00918	Director	Director since 2004	Special Advisor of Miradero Capital Partners, Inc.; Member of the Board of Directors of Triple S Management, Corp. and Triple S, Inc.	22 funds consisting of 38 portfolios	None

<b>Name, Address, and Age</b>	<b>Positions Held with the Fund</b>	<b>Term of Office and Length of Time Served</b>	<b>Principal Occupations During Past Five Years</b>	<b>Number of Affiliated Funds Overseen</b>	<b>Public Directorships</b>
Luis M. Pellot - González (56) c/o UBS Trust Company of Puerto Rico, American International Plaza-Tenth Floor, 250 Muñoz Rivera Avenue, San Juan, Puerto Rico 00918	Director	Director since 2004	Tax attorney at Pellot-González, PSC since 1989; Member of the Board of Directors of Empresas Santana; Secretary of AA-10,000 Corp.; Member of the Board of Directors and Secretary of Financiadora de Primas; 98% Partner and Manager of Lepanto, S.E.; Tax Professor, University of Puerto Rico Business School, 1981-1993; President of Tax Committee, Puerto Rico Chamber of Commerce, 1996-1997; Member, P.R. Bar Association; P.R. Manufacturers Association; P.R. Chamber of Commerce; P.R. General Contractors Association; P.R. Hotel and Tourism Association.	13 funds consisting of 28 portfolios	None
Agustín Cabrer - Roig (55) c/o UBS Trust Company of Puerto Rico, American International Plaza-Tenth Floor, 250 Muñoz Rivera Avenue, San Juan, Puerto Rico 00918	Director	Director since 2004	President of Starlight Development Group, Inc. since 1994; President of Antonio Roig Sucesores since 1995; Chairman of Marvel Specialties since 1998; Chairman of Pennock Growers since 1998; Chairman of Candelero Point Partners since 1999; Director of V. Suárez & Co., V. Suárez Investment Corporation, V. Suárez International Banking Entity, Inc., BacPlas, Inc., and Candelero Holding; Partner of Desarrollos Roig S.E., Desarrollos Agrícolas del Este S.E., El Ejemplo, S.E., RODUNECA, S.E., NECANE, S.E., Los Pinos S.E., Costa Norte, S.E.; Starlight One, Inc. and Forest Cove Homes, Inc.	13 funds consisting of 28 portfolios	None

***Directors who are not Independent Fund Directors and Officers.*** Certain biographical and other information relating to the other members of the Board of Directors who are not Independent Fund Directors and to the officers of the Fund is set forth below, including their ages and their principal occupations for at least the last five years and the total number of Affiliated Funds overseen by them. These persons also serve as directors and officers of the UBS Advised Funds and, in some cases, of certain of the UBS Co-Advised Funds.

<b>Name, Address, and Age</b>	<b>Positions Held with the Fund</b>	<b>Term of Office and Length of Time Served</b>	<b>Principal Occupations During Past Five Years</b>	<b>Affiliated Funds Overseen</b>	<b>Public Directorships</b>
Miguel A. Ferrer (66), c/o UBS Trust Company of Puerto Rico American International Plaza- Tenth Floor, 250 Muñoz Rivera Avenue, San Juan, Puerto Rico 00918	Director (Chairman of the Board) and President	Director and President since 2004	President and CEO of UBS TCPR; Director of “Fundación para la Universidad de Puerto Rico” since 1996; Director of “Fundación Biblioteca Rafael Hernández Colón” since 1993; President of UBS Puerto Rico since 1980 (employee since 1965) and a Senior Vice President of UBS Financial Services, Inc.; former President and founder of the Puerto Rico Association of Financial Analysts; Member of the Board of the Securities Industry Association of Puerto Rico; and Associate Member of the New York Stock Exchange.	22 funds consisting of 38 portfolios	None
Thomas F. Streiff (46) c/o UBS Trust Company of Puerto Rico, American International Plaza-Tenth Floor, 250 Muñoz Rivera Avenue, San Juan, Puerto Rico 00918	Director	Director since 2004	Senior Vice President and Director of Investment Solutions at UBS Financial Services, Inc. since October 2002; Partner at NxStar Ventures, LLC, from January 2002 to October 2002; President, Financial Services of Ilona Financial Group; President and CEO of Talbot Financial Services, Inc. and Co- founder and Chairman of NFC Consulting Group from February 1986 to May 2000.	22 funds consisting of 38 portfolios	None

<b>Name, Address, and Age</b>	<b>Positions Held with the Fund</b>	<b>Term of Office and Length of Time Served</b>	<b>Principal Occupations During Past Five Years</b>	<b>Affiliated Funds Overseen</b>	<b>Public Directorships</b>
Carlos V. Ubiñas (50) c/o UBS Trust Company of Puerto Rico, American International Plaza-Tenth Floor, 250 Muñoz Rivera Avenue, San Juan, Puerto Rico 00918	Director (Co-Chairman of the Board), Treasurer and Secretary	Director, Treasurer and Secretary since 2004	Executive Vice President and Chief Operating Officer of UBS Puerto Rico since 1988; Executive Vice President of UBS Puerto Rico and Managing Director of Investment Banking since 1989.	22 funds consisting of 38 portfolios	None
Leslie Highley, Jr. (57) c/o UBS Trust Company of Puerto Rico, American International Plaza-Tenth Floor, 250 Muñoz Rivera Avenue, San Juan, Puerto Rico 00918	Senior Vice President	Senior Vice President since 2004	Senior Vice President of UBS TCPR (since May 2000), of UBS Puerto Rico (since 1994), and of the Affiliated Funds; President of Dean Witter Puerto Rico, Inc. and a senior officer responsible for corporate and public finance from 1985 to 1993; Executive Vice President of Government Development Bank for Puerto Rico from 1977 to 1985.	Not applicable	None
William Rivera (46) c/o UBS Trust Company of Puerto Rico, American International Plaza-Tenth Floor, 250 Muñoz Rivera Avenue, San Juan, Puerto Rico 00918	First Vice President	First Vice President since 2004	Assistant portfolio manager for UBS AMPR; First Vice President of Trading of UBS TCPR since January 2002 and of UBS Puerto Rico since 1987	Not applicable	None

<b>Name, Address, and Age</b>	<b>Positions Held with the Fund</b>	<b>Term of Office and Length of Time Served</b>	<b>Principal Occupations During Past Five Years</b>	<b>Affiliated Funds Overseen</b>	<b>Public Directorships</b>
Ricardo Ramos (47) c/o UBS Trust Company of Puerto Rico, American International Plaza-Tenth Floor, 250 Muñoz Rivera Avenue, San Juan, Puerto Rico 00918	Vice President, Assistant Treasurer and Assistant Secretary	Vice President, Assistant Treasurer and Assistant Secretary since 2004	Portfolio manager and Vice President of UBS AMPR since September 2002; Executive Vice President of FirstBank Puerto Rico from August 1999 to September 2002; Executive Vice President of Reliable Financial Services, Inc. from November 1998 to July 1999; Senior Vice President-Finance of Oriental Financial Group from August 1992 to September 1998.	Not applicable	None
Jorge R. Rodríguez Vega (47) c/o R-G Premier Bank of Puerto Rico 280 Jesus T. Piñero Avenue Third Floor San Juan, Puerto Rico 00918	Vice President	Vice President since 2004	Senior Vice President of Investments for R-G Premier since 2004; President, Chief Executive Officer, and Chief Financial Officer of The Bank & Trust of Puerto Rico from 2003 to 2004; Senior Vice President and Chief Financial Officer of The Bank & Trust of Puerto Rico from 1995 to 2003; Senior Vice President of First Bank Puerto Rico from 1986 to 1994; member of the Board of Directors of The Bank & Trust of Puerto Rico from 1999 to May 2004.	Not applicable	None

**Compensation of Independent Fund Directors.** Each Independent Fund Director receives a stipend from the Fund of up to \$1,000 plus expenses, for attendance at each meeting of the Board of Directors or any of its committees, and \$500 plus expenses, for attendance at each meeting of one of its committees. The Independent Fund Directors do not receive retirement or other benefits as part of their compensation.

<b><u>Name of Independent Fund Director</u></b>	<b><u>Aggregate Compensation from Fund<sup>(1)</sup></u></b>	<b><u>Retirement</u></b>	<b><u>Estimated Annual Benefit Upon Retirement</u></b>	<b><u>Total Compensation from the Affiliated Funds<sup>(2)</sup></u></b>
		<b><u>Benefits Accrued Part of Fund Expenses</u></b>		
Víctor J. Salgado Arroyo	\$6,000	None	None	\$45,500
Gabriel Dolagaray Balado	\$4,000	None	None	\$47,500
Mario S. Belaval	\$6,000	None	None	\$57,500
Luis M. Pellot-Gonzalez	\$6,000	None	None	\$33,500
Agustin Cabrer-Roig	\$6,000	None	None	\$19,000

- (1) Estimated for the fiscal year of the Fund, assuming that the Board of Directors holds four meetings during the fiscal year which were attended by all of the Independent Fund Directors, and four meetings of the Audit Committee attended by all the members of such committee.
- (2) Amount as of December 31, 2003, excluding amounts, if any, related to reimbursement for expenses related to attendance at such Board meetings or meetings of its committees. In addition to the Fund, the Independent Fund Directors also serve on the Boards of Directors of some or all of the Affiliated Funds.

### **Code of Ethics**

The Board of Directors of the Fund will adopt a Code of Ethics. The Code of Ethics will require directors and officers of the Fund who are officers or employees of UBS Puerto Rico, UBS TCPR, R-G Premier and R-G Investments to comply with various requirements in connection with securities transactions by such officers or employees, including obtaining pre-authorization for certain transactions. It will also impose on these directors and officers certain confidentiality obligations, limitations on outside business activities, and certain other obligations. The Code of Ethics will also require Independent Fund Directors to provide to the Fund's compliance officer duplicate copies of each confirmation relating to a purchase or sale of securities by such director, as well as periodic statements of all securities transactions by such director.

### **Principal Holders of the Fund's Securities**

UBS TCPR or one of its affiliates will purchase \$100,000 of common stock of the Fund prior to the closing of the public offering of the Shares offered through this Prospectus, in order to comply with applicable Puerto Rico law. These Shares will be repurchased from UBS TCPR or its affiliate at the time of the closing of such public offering at the same price paid by such entity for such Shares.

## **Investment Advisory Services and other Service Providers to the Fund**

Subject to the supervision of the Board of Directors, investment advisory services are anticipated to be provided to the Fund by UBS AMPR, a division of UBS TCPR, pursuant to an Investment Advisory Agreement (the “UBS TCPR Advisory Agreement”) to be entered into prior to the issuance of the Shares. UBS AMPR also serves as investment adviser to the Affiliated Funds. As of September 30, 2004, the Affiliated Funds have combined portfolio assets of approximately \$7.5 billion. UBS TCPR is a trust company organized under the laws of Puerto Rico and has its principal office and place of business at American International Plaza, Tenth Floor, 250 Muñoz Rivera Avenue, San Juan, Puerto Rico 00918. UBS TCPR is licensed with the OCFI as a trust company organized under the Puerto Rico Trust Company Act, as amended, and is not registered as an investment adviser under the U.S. Investment Advisers Act of 1940, as amended (the “US Advisers Act”). UBS AMPR is located at American International Plaza, Tenth Floor, 250 Muñoz Rivera Avenue, San Juan, Puerto Rico 00918.

Subject to the supervision of the Board of Directors, investment advisory services are also anticipated to be provided to the Fund by R-G Portfolio Management, a division of R-G Premier, an affiliate of R&G Financial and R-G Investments, pursuant to an investment advisory agreement (the “R&G Advisory Agreement”; together with the UBS TCPR Advisory Agreement, the “Advisory Agreements”). R-G Premier is a commercial bank organized under the laws of the Commonwealth of Puerto Rico and a member of the Federal Deposit Insurance Corporation. R-G Premier is not registered as an investment adviser under the U.S. Advisers Act. R-G Premier has not previously served as an investment adviser to an investment company, although it has substantial experience in local financial markets, specifically, in the mortgage loan market. R-G Premier’s principal office is located at R&G Financial Plaza, 280 Jesus T. Piñero Avenue, San Juan, Puerto Rico, 00918. Under the R&G Advisory Agreement, R-G Premier’s duties under said agreement may be assigned and transferred to an investment advisory firm duly exempt or duly licensed as an investment adviser that is an affiliate of R&G Financial. Said assignment and transfer is subject to the consent of the Fund and UBS TCPR.

UBS TCPR and R-G Premier will serve as co-investment advisers to the Fund and pursuant to the Advisory Agreements, they will provide a complete and continuous investment program for the Fund and make investment decisions and place orders to buy, sell or hold particular securities and other investments. As compensation for their investment advisory services related to the Fund, the Investment Advisers will receive an annual investment advisory fee (which is indirectly paid entirely by Shareholders) not to exceed an aggregate rate of 0.75% of the average weekly gross assets of the Fund, payable monthly.

In addition to the relationship created between UBS TCPR and R-G Premier with the Fund as co-investment advisers under the Advisory Agreements, it is anticipated that R&G Financial and UBS Puerto Rico will enter into an agreement whereby they agree to sponsor the Fund.

Unless earlier terminated as described below, the Advisory Agreements will continue in effect for a period of two years from the date of execution and will remain in effect from year to year thereafter if approved annually by a vote of a majority of the Independent Board. The Advisory Agreements are not assignable, except to affiliates of the respective Investment Adviser subject to certain conditions. An Advisory Agreement may be terminated, without penalty, (i) at any time by the vote of a majority of the Independent Fund Directors, (ii) on 60 days’ written notice by the Investment Advisers to the Fund or (iii) on 60 days’ written notice to the Investment Advisers by the vote of a majority of the outstanding voting securities of the Fund.

The Investment Advisers shall not be liable for any loss, expense, cost, or liability arising out of any error in judgment or any action or omission, including any instruction given to the Custodian unless (i) such action or omission involved an officer, director, employee, or agent of the Investment Advisers, and (ii) such loss, expense, cost, or liability arises out of the Investment Advisers’ gross negligence, malfeasance or bad faith. The Investment Advisers may rely on any notice or communication (written or oral) reasonably believed by them to be genuine. These limitations shall not relieve the Investment Advisers from any responsibility, obligation or duty that the Investment Advisers may have under state statutes, the laws of Puerto Rico or any federal securities law which is not waivable.



UBS TCPR will also serve as the Fund's administrator. Pursuant to the Administration Agreement to be entered into by the Fund and UBS TCPR prior to the issuance of the Shares, and subject to the overall supervision of the Board of Directors, the Administrator will be responsible for providing facilities and personnel to the Fund in the performance of certain services including the weekly determination of the Fund's net asset value and net income. As compensation for its administration services to the Fund, the Administrator will receive an annual administration fee (which is indirectly paid entirely by the Shareholders) not to exceed 0.15% of the Fund's average weekly gross assets, payable monthly. The Administrator may retain the services of a sub-administrator, which may be its affiliate.

The Advisory Agreements and the Administration Agreement were reviewed and approved by the Board of Directors of the Fund and by a majority of the Independent Fund Directors. In connection with such approval, the Board of Directors and the Independent Fund Directors reviewed the nature and quality of the services provided by UBS TCPR and R-G Premier, as the case may be, and their respective affiliates pursuant to these agreements, determined that the nature and quality of these services are at least equal to the nature and quality of the services provided by other entities offering the same or similar services, and that the fees charged by UBS TCPR and R-G Premier for such services are fair and reasonable in light of the usual and customary charges made by other entities for services of the same nature and quality, and concluded that these agreements are in the best interest of the Fund and its Shareholders.

The Fund's securities and cash will be held under a custody agreement to be entered into by the Fund and UBS TCPR prior to the issuance of the Shares, pursuant to which UBS TCPR will serve as custodian for the Fund's assets (in such capacity, the "Custodian"). As compensation for its custody services, the Custodian will receive a fee as agreed from time to time with the Fund; such fee will be at a rate customarily paid to other custodians for the provision of similar services. The Custodian may retain the services of a sub-custodian, which may be its affiliate. In such regard, the Fund intends to retain Citibank, N.A. to perform certain custody functions for the Fund.

Pursuant to the terms of the Transfer Agency, Registrar, and Shareholder Servicing Agreement to be entered into by the Fund and UBS TCPR prior to the issuance of the Shares, the latter will be responsible for maintaining a register of the Shares for holders of record and opening and maintaining Shareholder accounts (in such capacity, the "Transfer Agent"). As compensation for its transfer agency, registrar, dividend disbursing and shareholder services, the Transfer Agent will receive a fee as agreed from time to time with the Fund. Such fee will be at a rate customarily paid to other transfer agents for the provision of similar services. The Transfer Agent may retain the services of a sub-transfer agent, which may be its affiliate.

Certain fees may be voluntarily waived or reimbursed by UBS TCPR from time to time. There is no assurance, however, that any such waiver or reimbursement, if commenced, will be continued.

### **Conflicts of Interests**

In addition to the conflicts discussed above, the transactions between the Fund and affiliates of R-G Portfolio Management, a co-investment adviser, may give rise to additional conflicts between any such affiliated parties and the interests of the Fund. The Mortgage Instruments are comprised of mortgages originated or acquired by R-G Premier or any of its affiliates. The Fund will purchase Mortgage Instruments from R-G Premier and/or its affiliates. R-G Portfolio Management, a division of R-G Premier, will provide advice to the Fund regarding whether to purchase such Mortgage Instruments from R-G Premier and also will provide advice on the value of such Mortgage Instruments. Consequently, R-G Premier's obligation to the Fund may conflict with its potential objective to maximize the value that it receives for Mortgage Instruments. The nature of the market for Mortgage Instruments as well as the role of R-G Portfolio Management makes it more difficult for the Fund to independently value the Mortgage Instruments. To protect against any conflict which may arise in the sale of Mortgage Instruments to the Fund, a nationally recognized valuation firm has been engaged by the Fund to independently value the Mortgage Loans underlying the Mortgage Instruments that the Fund may acquire from R-G Premier and/or its affiliates.

Further, the market for Mortgage Instruments is less liquid than markets for other securities in which the Fund may invest. Affiliates of R-G Portfolio Management may, on their own or at the recommendation of R-G Portfolio Management, enter into mortgage sale transactions with other entities, including any of its affiliated entities, that would further decrease the size of the market for the Fund's investments in Mortgage Instruments and increase the Fund's difficulty to independently value the Mortgage Instruments.

R&G Mortgage, or any affiliate, will service the Mortgage Instruments in the Fund's portfolio pursuant to the Master Servicing Agreement. R&G Mortgage is also an affiliate to an underwriter of the Fund's Shares, R-G Investments.

These affiliations could cause a conflict with R&G Mortgage and its duties to the Fund under the Master Servicing Agreement. A similar conflict exists with R-G Premier acting as custodian of the whole Mortgage Loans underlying the Units and Participation Certificates. R-G Premier may also be engaged as a sub-custodian of other Mortgage Loans acquired by the Fund.

Additionally, R&G Financial, the financial holding company and parent company of R-G Premier, will guarantee the timely payment of principal and interest of the Mortgage Instruments pursuant to the Guaranty if R&G Mortgage is unable to make an advance with respect to the Mortgage Loans it is servicing as described in this prospectus. This affiliation could cause the conflict that R&G Mortgage, as servicer, may not determine a mortgage loan is delinquent in a timely manner in order to avoid triggering R&G Financial's responsibilities and obligations under the Guaranty.

## **VALUATION OF COMMON STOCK**

The net asset value of the Shares will be calculated at least weekly by the Administrator. The Fund intends to publish its net asset value weekly in a local newspaper of general circulation within Puerto Rico. The net asset value per Share will be computed by dividing the value of the securities held by the Fund plus any cash or other assets (including interest and dividends accrued but not yet received and earned discount) minus all liabilities (including accrued expenses) by the total number of Shares outstanding at such time.

The Fund's assets, including but not limited to the Mortgage Instruments, will be valued by the Administrator, with the assistance of the Investment Advisers, in good faith and under the supervision of the Board of Directors based upon market quotations when such quotations are available. In connection with the valuation of the Mortgage Instruments, the Administrator will rely principally on the valuation of the portfolio by the Valuation Agent. Primarily because it may be an administrative inconvenience for dealers other than UBS Puerto Rico, R-G Investments or their affiliates to provide the Administrator with market quotations, independent sources of valuation may be unavailable for a substantial majority of the Fund's assets. When market quotations for securities held by the Fund are not readily available from any such independent dealers, the Administrator will be responsible for obtaining quotations from UBS Puerto Rico, R-G Investments or their affiliates. When market quotations for the Fund's assets are not available from any sources, including UBS Puerto Rico, R-G Investments or their affiliates, they will be valued at fair value by or under the direction of the Board of Directors utilizing quotations and other information concerning similar securities derived from recognized dealers in those securities or information regarding the trading spreads quoted by recognized dealers between such securities and U.S. Treasury securities whose maturities are determined to be most closely matched to the average life of the Fund's securities for which fair value is to be determined. UBS Puerto Rico, R-G Investments or their affiliates might also be the sole or best source of this type of pricing information. Notwithstanding the above, assets with maturities of 60 days or less will generally be valued at amortized cost if their original term to maturity was 60 days or less, or by amortizing the difference between their fair value as of the 61<sup>st</sup> day prior to maturity and their maturity value if their original term to maturity exceeded 60 days, unless in either case the Board of Directors or an authorized committee thereof determines that this does not represent fair value for the valuation methodology for the Mortgage Instruments. See "THE MORTGAGE AND THE POOLING OF MORTGAGES – Valuation Agent and Compliance."

## **PORTFOLIO TRANSACTIONS**

Subject to policies established from time to time by the Board of Directors, the Investment Advisers will be responsible for the execution of the Fund's portfolio transactions. In executing portfolio transactions, the Investment Advisers will seek to obtain the best net price and most favorable execution for the Fund, taking into account such factors as the price (including the applicable dealer spread or brokerage commission), size of order, difficulty of execution, and operational facilities of the firm involved. Certain securities in which the Fund will invest are traded on a "net" basis without a stated commission through dealers acting for their own account and not as brokers. Prices paid to dealers in principal transactions of such securities generally include a "spread," which is the difference between the prices at which the dealer is willing to purchase and sell a specific security at that time.

In placing orders with dealers, the Investment Advisers will generally attempt to obtain the best net price and most favorable execution of their orders. The Investment Advisers may purchase and sell portfolio securities from and to dealers who provide the Fund with research analysis, statistical, or pricing advice or similar services. Portfolio transactions will not be directed by the Fund to dealers solely on the basis of research and advice provided. In selecting brokers and dealers, the Investment Advisers will consider the full range and quality of a broker's or dealer's services. Factors considered by the Investment Advisers in selecting brokers and dealers may include the following: price; the broker's or dealer's facilities; the broker's or dealer's reliability and financial responsibility; when relevant, the ability of the broker or

dealer to effect securities transactions, particularly with regard to such aspects as timing, order size, and execution of orders; and the research and other services provided by that broker or dealer to the Investment Advisers (and the Investment Advisers' arrangements relating thereto) that are expected to enhance the Investment Advisers' general portfolio management capabilities, notwithstanding that the Fund may not be the direct or exclusive beneficiary of those services. While the Investment Advisers generally seek the best net price in placing orders, the Fund may not necessarily be paying the lowest price available. Commission rates are one factor considered together with other factors. The Investment Advisers will not be obligated to seek in advance competitive bidding for the most favorable commission rate applicable to any particular transaction for the Fund or to select any broker-dealer on the basis of its purported "posted" commission rate. The Investment Advisers in their discretion, may cause the Fund to pay a commission in excess of the amount another broker or dealer would have been charged for effecting that transaction, provided the Investment Advisers have determined in good faith that such commission is reasonable in relation to the value of the brokerage and/or research provided by the broker to the Investment Advisers. Research services furnished by the brokers or dealers through which or with which the Fund effects securities transactions may be used by the Investment Advisers in advising its other accounts (including the Affiliated Parties, as defined below), and conversely, research services furnished to the Investment Advisers in connection with their other accounts or such other funds may be used in advising the Fund.

The Investment Advisers seek to allocate on a fair and equitable basis among advisory clients, including the Affiliated Funds and the Fund, the opportunity to purchase or sell a security or investment that may be both desirable and suitable for one or more of their clients, but for which there is a limited supply or demand, although there can be no assurance of equality of treatment according to any particular or predetermined standards or criteria. Where, because of prevailing market conditions, it is not possible to obtain the same price or time of execution for all of the securities or other investments purchased or sold for the Fund, transactions for the Fund may be reported with the average price of these transactions.

The Investment Advisers may, on an aggregated basis, purchase or sell the same security for more than one client to obtain a favorable price to the extent permitted by applicable law. These orders may be averaged as to price and allocated as to amount according to each client's daily purchase or sale orders or upon some other basis believed to be equitable in accordance with procedures adopted by the Board of Directors.

### **Transactions Involving Affiliates**

While the Fund is subject to the terms and conditions of the Commissioner's Ruling (including provisions regarding transactions with affiliates), it is not registered under the 1940 Act and therefore, is not subject to the restrictions regarding, among other things, transactions between the Fund and UBS Puerto Rico and its affiliates and between the Fund and R&G Financial and its affiliates (an "Affiliated Party," and each such transaction an "Affiliated Transaction") contained therein.

It is anticipated that the Fund will engage in Affiliated Transactions, such as securities purchase and sale transactions and repurchase agreement transactions, directly with UBS Puerto Rico or R-G Investments, and possibly other of their respective affiliates. R-G Investments and some of its affiliates are significant participants in the mortgage-backed securities market in Puerto Rico, particularly R&G Mortgage. It is anticipated that the Fund will invest a substantial amount of its assets in Mortgage Instruments in order to meet the Fund's investment objective and policies. For most securities purchased by the Fund, one of those entities may be the only dealer, or one of only a few dealers, in the securities being purchased or sold by the Fund. In that event, independent sources for valuation or liquidity of a security may be limited or nonexistent. In the case of Mortgage Instruments the Valuation Agent will provide a weekly mark-to-market valuation analysis of the portfolio of residential mortgage loans underlying the Mortgage Instruments. This valuation shall be taken into consideration in an Affiliated Transaction concerning Mortgage Investments and the Fund will have such valuation prior to the acquisition of Mortgage Instruments. The Fund is expected to invest a substantial portion of its assets in those securities. The Fund may also invest in securities issued by or make deposits with an Affiliated Party. As a result of such Affiliated Transactions and other dealings, the interests of affiliates of an Affiliated Party may conflict with those of the Fund as to the price and other terms of transactions that they engage in. Portfolio transactions between the Fund and an Affiliated Party will be executed pursuant to terms and conditions comparable to those with unrelated third parties in the ordinary course of its investment activities.

An Affiliated Party may also act as agent in connection with the placement of the Fund's preferred stock, debt securities, and other forms of leverage. Such activities will be carried out in accordance with procedures as established by the Board of Directors in an effort to address potential conflicts of interest including, among other things, the potential conflicts of interest in setting interest or dividend rates. There is no assurance that the procedures will be effective. In

addition, the investment advisory fee payable to the Investment Advisers (an Affiliated Party) during periods in which the Fund is utilizing leverage will be higher than when it is not doing so because the fee is calculated as a percentage of average weekly gross assets, including assets purchased with leverage. Because the asset base used for calculating the investment advisory fee is not reduced by aggregate indebtedness incurred in leveraging the Fund, the Investment Advisers may have a conflict of interest in formulating a recommendation to the Fund as to whether and to what extent to use leverage. Affiliated Parties may also directly provide some or all of such leverage.

Affiliated Parties may also engage, at the present or in the future, in business transactions with or related to any one of the issuers of the Fund's investment assets, including borrowers in mortgage loans underlying certain Mortgage Instruments, or with competitors of such issuers, as well as provide them with investment banking, asset management, trust, or advisory services, including merger and acquisition advisory services. These activities may present a conflict between an Affiliated Party and the interests of the Fund. Affiliated Parties may also publish or may have published research reports on one or more of such issuers and may have expressed opinions or provided recommendations inconsistent with the purchasing or holding of the securities of such issuers. Any of these activities may affect the market value of the securities issued by them and therefore, will affect the value of the Shares.

Other conflicts of interest may arise in the future, which will be addressed by the Board of Directors at such time.

## **DIVIDENDS AND OTHER DISTRIBUTIONS; DIVIDEND REINVESTMENT PLAN**

### **Dividends and Other Distributions**

The Fund intends to distribute monthly dividends of substantially all of its net investment income (which reflects amounts declared and paid as dividends on preferred stock, as well as interest paid on outstanding debt securities or other forms of leverage).

The net capital gains realized by the Fund, if any, may be retained by the Fund, unless the Board of Directors determines that the net capital gains will be distributed to the Shareholders. The Fund will not retain any net capital gains, unless such gains are offset by operating expenses of the Fund that are deductible for Puerto Rico income tax purposes. Substantially all of the Fund's net investment income for any fiscal year will be distributed to Shareholders during or after that year.

"Net capital gains" as used herein, means the excess of the net long-term capital gains over the net short-term capital losses. "Net investment income" as used herein, includes all interest (including accrued income on zero coupon Municipal Obligations) and other ordinary income earned by the Fund on its portfolio holdings and the net short-term capital gains, net of Fund expenses.

While any debt securities or other forms of leverage are outstanding, the Fund may not declare any cash dividend or other distribution on the Shares unless at the time of such declaration: (1) all accrued, due and payable interest payments have been paid; and (2) after giving effect to such dividend or distribution, the value of the Fund's total assets less all liabilities and indebtedness not represented by any outstanding debt securities, is at least equal to 200% of the aggregate principal amount of the outstanding debt securities and the aggregate par value of all outstanding preferred stock. For further information regarding the impact of the issuance of preferred stock, debt securities, and other forms of leverage on the payment of dividends and other distributions on the Shares, see "SPECIAL LEVERAGE CONSIDERATIONS."

### **Dividend Reinvestment Plan**

The Fund will establish a Dividend Reinvestment Plan (the "Plan") under which all Shareholders will have all dividends and other distributions on their Shares paid in cash, unless all Shareholders elect to have the dividends and distributions reinvested in additional Shares. Shareholders who do not affirmatively elect to do so, will receive all dividends and other distributions in cash paid by check mailed directly to the Shareholders by the Transfer Agent. Shareholders who decide to hold their Shares in the name of a broker or nominee other than UBS Puerto Rico, R-G Investments or their nominees should contact such broker or nominee to confirm that they participate in the Plan. There will be no charge to participants for reinvesting dividends or other distributions. The Transfer Agent's fees for handling the Plan will be paid by the Fund. The reinvestment of dividends and other distributions in Shares will not relieve participants of any income tax that may be payable on such distributions. See "TAXATION."

The Transfer Agent will serve as the Fund's agent in administering the Plan for the participating Shareholders. After the Fund declares a dividend or determines to make a capital gain distribution, the Shares will be acquired by the Transfer Agent for the participant's account through (i) receipt of additional unissued but authorized Shares from the Fund

or (ii) the acquisition of Shares in the open market or privately negotiated transactions, whichever option is economically more favorable to the participant. In the case of newly-issued shares, the number of Shares to be credited to the participant's account will be determined by dividing the dollar amount of the dividend by the net asset value per Share on the date the Shares are issued. In the case of Shares acquired in the open market or privately negotiated transactions, the amount of the dividend or other distribution on the Shares of the Shareholder would be applied (less the *pro rata* share of brokerage commissions incurred with respect to such open market or privately negotiated purchases, such commissions to be paid to parties which are unaffiliated to the Fund) to the purchase of the Shares for the Shareholder's account. If the full dividend amount in open-market or privately negotiated purchases during the purchase period was unable to be so invested, the uninvested portion of the amount of the dividend or other distribution would be invested in newly-issued Shares at the close of business on the last purchase date. It is possible that, due to changes in market conditions or the Fund's net asset value, the prices at which Shares are acquired in the open market exceed net asset value per Share at any given point in time. In acquiring Shares in the open market or through privately negotiated transactions, the Transfer Agent may acquire Shares from an Affiliated Party. The acquisition of such Shares will be subject to the procedures adopted by the Board of Directors to address potential conflicts of interest. See "PORTFOLIO TRANSACTIONS- Transactions Involving Affiliates."

The Transfer Agent will maintain all Shareholder accounts in the Plan, including information needed by the Shareholders for personal and tax records. Shares in the account of each Plan participant will be held by the Transfer Agent in non-certificated form in the name of the participant, and each Shareholder's proxy will include those Shares purchased pursuant to the Plan.

All registered Shareholders (other than brokers and nominees), upon request made to the Fund, to UBS Puerto Rico, to R-G Investments or to the Shareholder's financial advisor, will receive, via mail, information regarding the Plan, including a form in which they may elect to participate in the Plan. A Shareholder who has elected to participate in the Plan may terminate participation in the Plan at any time without penalty, and Shareholders who have previously terminated participation in the Plan may rejoin at any time. Changes in these elections must be made in writing to the Transfer Agent and should include the Shareholder's name and address as they appear on the share certificate or the Fund's shareholder records. An election to terminate participation in the Plan, until such election is changed, will be deemed to be an election by a Shareholder to take all subsequent distributions in cash. An election will be effective only for distributions declared and having a record date at least ten days after the date on which the election is received.

The Fund reserves the right to amend or terminate the Plan with respect to any dividend or other distribution if notice of the change is sent to Plan participants at least 30 days prior to the record date for the payment of such dividend or distribution. The Plan may also be amended or terminated by the Transfer Agent by written notice to all Plan participants at least 30 days prior to the record date for the payment of the dividend or distribution. All correspondence concerning the Plan should be directed to the Transfer Agent at American International Plaza Building, Tenth Floor, 250 Muñoz Rivera Avenue, San Juan, Puerto Rico 00918.

#### **REPURCHASE OF SHARES BY THE FUND**

Although Fund shareholders will not have the right to require the Fund to redeem their Shares and the shares of preferred stock of the Fund (the "Preferred Stock"), the Board of Directors of the Fund may, in its sole discretion, with the approval of a majority of the Independent Fund Directors, from time to time authorize the Fund to repurchase Shares in the open market at the market price or make tender offers for its Shares at their net asset value and repurchase Preferred Stock in the open market at the market price or make tender offers for its Preferred Stock at their net liquidation preference amount. These transactions may have the effect of reducing any market discount from net asset value. There is no assurance that any such repurchase or tender offer will result in trading of the Shares at a price which approximates their net asset value. Although such repurchases and tenders could have a favorable effect on the market price of the Shares, the acquisition of such Shares by the Fund will decrease the Fund's Total Assets and therefore have the effect of increasing the Fund's expense ratio. Moreover, the Fund may repurchase its Shares and its Preferred Stock from affiliated parties. The Board of Directors will establish procedures to address any conflicts of interest which may arise when effecting such repurchases with an affiliated party. See "PORTFOLIO TRANSACTIONS – Transactions Involving Affiliates."

## TAXATION

**THIS SECTION IS NOT TO BE CONSTRUED AS A SUBSTITUTE FOR CAREFUL TAX PLANNING. PROSPECTIVE INVESTORS ARE URGED TO CONSULT THEIR OWN TAX ADVISERS WITH SPECIFIC REFERENCE TO THEIR OWN TAX SITUATIONS, INCLUDING THE APPLICATION AND EFFECT OF OTHER TAX LAWS AND ANY POSSIBLE CHANGES IN THE TAX LAWS AFTER THE DATE OF THIS PROSPECTUS.**

The following discussion is a summary of the material Puerto Rico and U.S. federal tax considerations that may be relevant to prospective investors in the Fund. The discussion in connection with the Puerto Rico tax considerations is based on the current provisions of the Puerto Rico Code and the regulations promulgated or applicable thereunder (the “Puerto Rico Code Regulations”) issued by the Treasury Department of Puerto Rico (the “Treasury Department”), the Puerto Rico Municipal Property Tax Act of 1991, as amended (the “MPTA”) and the regulations promulgated thereunder, the Municipal License Tax Act, as amended (the “MLTA”) and the regulations promulgated thereunder, and the PR-ICA. The U.S. federal tax discussion is based on the current provisions of the United States Internal Revenue Code (the “Code”) and the regulations promulgated thereunder (the “Code Regulations”).

This discussion assumes that (i) the investors will be (a) individuals who for the entire taxable year are bona fide residents of Puerto Rico for purposes of Section 933 of the Code and residents of Puerto Rico for purposes of the Puerto Rico Code (the “Puerto Rico Individuals”), or (b) corporations and partnerships organized under the laws of Puerto Rico, excluding corporations and partnerships having in effect an election and qualifying as “corporations of individuals” or “special partnerships” under the Puerto Rico Code or subject to any other special tax regime under the Puerto Rico Code (the “Puerto Rico Entities,” and jointly with the Puerto Rico Individuals, the “Puerto Rico Investors”), (ii) the Puerto Rico Entities will not be subject at any time to any special tax regime under the Code including, without limitation, the provisions of the Code that apply to “controlled foreign corporations,” “passive foreign investment companies,” “personal holding companies,” or “foreign personal holding companies,” and (iii) that for each taxable year that dividends are distributed by the Fund, the Fund will meet the 90% Distribution Requirement, as defined herein.

This discussion does not purport to deal with all aspects of Puerto Rico and U.S. federal taxation that may be relevant to other types of investors, particular investors in light of their investment circumstances, or to certain types of investors subject to special treatment under the Puerto Rico Code or the Code (e.g., banks, insurance companies or tax-exempt organizations). Unless otherwise noted, the references in this discussion to the Puerto Rico regular income tax will include the alternative minimum tax imposed on Puerto Rico Entities by the Puerto Rico Code.

The existing provisions of the statutes, regulations, judicial decisions, and administrative pronouncements, on which this discussion is based, are subject to change (even with retroactive effect) and could affect the continued validity of this summary.

The statements herein have been opined on by Fiddler González & Rodríguez, P.S.C., counsel to the Fund. A prospective investor should be aware that an opinion of counsel represents only such counsel's best legal judgment and that it is not binding on the Treasury Department, the Municipal Revenue Collection Center, any other agency or municipality of Puerto Rico, the U.S. Internal Revenue Service (the “IRS”), or the courts. Accordingly, there can be no assurance that the opinions set forth herein, if challenged, would be sustained.

You should consult your tax advisor as to the application to your particular situation of the tax discussion described below.

## PUERTO RICO TAXATION

### Taxation of the Fund

*Income Taxes.* As a registered investment company under the PR-ICA, the Fund will be exempt from the income tax imposed by the Puerto Rico Code for each taxable year that it distributes as Taxable Dividends (as defined below) to its investors an amount equal to at least 90% of its net income for such year within the time period provided by the Puerto Rico Code (the “90% Distribution Requirement”). In determining its net income for purposes of the 90% Distribution Requirement, the Fund is not required to take into account capital gains and losses and net interest income that is exempt under the Puerto Rico Code. For each taxable year, the Fund intends to meet the 90% Distribution Requirement to be exempt from the income tax imposed by the Puerto Rico Code.

*Property Taxes.* The Fund's fixed income securities will be exempt from the personal property tax imposed by the MPTA.

*Municipal License Taxes.* Under the provisions of the MLTA, as modified by certain exemptions included in the Puerto Rico Investment Companies Act, the Fund will be subject to a municipal license tax of up to 1.5% imposed on its net taxable income that is not distributed to its Shareholders. Interest derived by the Fund on obligations issued by the Government of Puerto Rico, its instrumentalities or political subdivisions, or by the Government of the U.S., is exempt from municipal license tax.

### **Taxation of Puerto Rico Investors**

*Income Taxes.* The Fund may make distributions out of its current or accumulated earnings and profits attributable to (i) income that is included in the Fund's gross income for purposes of the Puerto Rico Code, other than gains from the sale or exchange of property (the "Taxable Dividends"), (ii) net gains derived from the sale or exchange of property (the "Capital Gain Dividends"), or (iii) income exempt from Puerto Rico income tax (the "Exempt Dividends," and jointly with the Taxable Dividends and the Capital Gains Dividends, the "Dividends").

*Taxable Dividends Distributed to Puerto Rico Individuals.* Taxable Dividends distributed to Puerto Rico Individuals are subject to a 10% tax withholding (the "10% Puerto Rico Tax Withholding"), if certain requirements are met. Otherwise, Taxable Dividends will be subject to the regular income tax.

The Puerto Rico Code Regulations state that to qualify for the 10% Puerto Rico Tax Withholding, the Taxable Dividends must be derived from current or accumulated earnings and profits of the Fund derived from investments (i) in Puerto Rico corporations or partnerships, or non-Puerto Rico corporations or partnerships whose gross income effectively connected with the conduct of a trade or business in Puerto Rico is at least 80% of its gross income for the preceding three taxable years ending with the close of its taxable year preceding the declaration of the dividend, (ii) the income of which constitutes Puerto Rico source income under the Puerto Rico Code, provided the proceeds thereof are used to finance or refinance real property located in Puerto Rico or used in the active conduct of a trade or business in Puerto Rico, or (iii) subject to U.S. federal income tax under the Code. Additionally, if the Fund derives income from sources within the U.S. that qualifies as "portfolio interest" under Section 881(c) of the Code, dividends distributed by the Fund from such earnings and profits will qualify for the 10% Puerto Rico Tax Withholding only if the "portfolio interest" derived by the Fund for any given taxable year represents less than 10% of the Fund's total gross income for such year. For purposes of determining whether less than 10% of the Fund's total gross income is "portfolio interest," gross income that is exempt from tax under Section 1022(b) of the Puerto Rico Code shall be excluded from the Fund's gross income.

If the 10% Puerto Rico Tax Withholding is applicable, it must be withheld by the Fund and paid to the Treasury Department. However, a Puerto Rico Individual may elect not to be subject to the 10% Puerto Rico Tax Withholding (the "Election"). If the Election is made, the Taxable Dividend distributed to such individual will be subject to the regular income tax. For an Election to be effective during a taxable year, the Fund must be notified in writing prior to the first distribution made by the Fund during such taxable year. The Election must be made on a yearly basis, and it must include (i) the name and address of the electing Puerto Rico Individual, (ii) his or her taxpayer identification number, (iii) a statement authorizing the Fund to abstain from withholding the 10% Puerto Rico Withholding Tax, (iv) the year of the distribution(s) with respect to which the Election is made, (v) the date on which the election is made, and (vi) the signature of the Puerto Rico Individual. Once an Election is made, such Election is final with respect to all subsequent distributions during such taxable year.

Absent an Election, the Fund will withhold the 10% Puerto Rico Tax Withholding from Taxable Dividends distributed to Puerto Rico Individuals. Upon filing his or her Puerto Rico income tax return, the Puerto Rico Individual that fails to make an Election will still have the option to include the Taxable Dividend as ordinary income subject to the regular income tax. If such option to include the Taxable Dividends as ordinary income is made, the 10% Puerto Rico Tax Withholding will be allowed as a credit against the Puerto Rico Individual's income tax liability for the particular taxable year.

Unless otherwise designated by the Fund, its distributions of dividends to Puerto Rico Individuals will consist of Taxable Dividends subject to the 10% Puerto Rico Tax Withholding.

*Taxable Dividends Distributed to Puerto Rico Entities.* Puerto Rico Entities receiving Taxable Dividends during a taxable year are entitled to claim an 85% dividend received deduction with respect to such distributions (the "Dividend

Received Deduction”). The Dividend Received Deduction may not exceed 85% of the Puerto Rico Entity's net taxable income for such taxable year.

Unless otherwise designated by the Fund, its distributions of dividends to Puerto Rico Entities will consist of Taxable Dividends subject to the Dividend Received Deduction.

*Capital Gain Dividends.* Capital Gain Dividends distributed to Puerto Rico Investors are treated as long-term capital gains in the hands of such investors.

The Puerto Rico Code provides for a 10% long term capital gains rate for Puerto Rico Individuals and a 12.5% long term capital gains tax rate for Puerto Rico Entities in connection with long term capital gains realized from the sale or exchange of “property located in Puerto Rico,” as defined in the Puerto Rico Code. Long-term capital gains realized by Puerto Rico Individuals and Puerto Rico Entities with respect to the sale or exchange of property that does not constitute “property located in Puerto Rico” will respectively qualify for a 20% and 25% capital gains tax rate. It is important to note that the Puerto Rico Code does not specify whether Capital Gain Dividends should be treated as a gain from the sale or exchange of “property located within Puerto Rico” or other property and, therefore, the applicable capital gains tax rate for such distributions is not currently determinable.

Pursuant to recently enacted legislation, long-term capital gains derived by Puerto Rico Individuals in transactions occurring between July 1, 2004 and June 30, 2005 which are reinvested in Puerto Rico are entitled to a 5% rate if the gain is realized in the sale or exchange of “property located in Puerto Rico” or 10% in the case of other property. Long-term capital gains derived by Puerto Rico Entities in transactions with capital assets effected between July 1, 2004 and June 30, 2005 are eligible for a 6.25% rate if the gain is realized in the sale or exchange of “property located in Puerto Rico” or 12.5% in the case of other property. It is not currently determinable whether these temporary special capital gains rates are applicable to Capital Gains Dividends.

*Exempt Dividends.* Exempt Dividends will be excluded from gross income and will not be subject to the regular income tax imposed by the Puerto Rico Code on the Puerto Rico Investors. Likewise, for purposes of the alternative minimum tax, the “adjusted net book income” of the Puerto Rico Entities will not include Exempt Dividends.

A Distribution by the Fund will qualify as an Exempt Dividend if (i) such dividend is designated as an Exempt Dividend by the Fund in a written notice submitted to the Puerto Rico Investors no later than 59 days after the close of the Fund's taxable year, and (ii) such dividend does not exceed the earnings and profits of the Fund attributable to income that is exempt under the Puerto Rico Code.

The Puerto Rico Code provides various rules that disallow a deduction for expenses that are directly or indirectly attributable to income that is exempt from Puerto Rico income tax.

*Treatment of Distributions.* For purposes of the Puerto Rico Code, all distributions made by the Fund, if any, during a taxable year, will be treated as dividends to the extent that for such year the Fund has current or accumulated earnings and profits, as determined under the Puerto Rico Code. Distributions in excess of current and accumulated earnings and profits will be treated as a tax-free return of capital to the Puerto Rico Investor to the extent of such investor's basis in the Shares. To the extent that such distributions exceed the Fund's current and accumulated earnings and profits and the Puerto Rico Investor's basis in the Shares, such excess will be treated as a gain derived from the sale, exchange or other disposition of such Shares. If the Shares have been held by the Puerto Rico Investor for more than six months and they constitute a capital asset in the hands of such investor, the gain will qualify as a long term capital gain. The Puerto Rico Code provides for a 10% long term capital gains rate for Puerto Rico Individuals and a 12.5% long term capital gains rate for Puerto Rico entities in connection with long term capital gains realized from the sale or exchange of “property located in Puerto Rico,” as defined in the Puerto Rico Code. Long term capital gains realized by Puerto Rico Individuals and Puerto Rico entities with respect to the sale or exchange of property that does not constitute “property located in Puerto Rico” will qualify, respectively, for a 20% and 25% capital gains rate. It is important to note that the Puerto Rico Code does not specify whether distributions in excess of current and accumulated earnings or profits should be treated as a gain from the sale or exchange of “property located in Puerto Rico” or other property and, therefore, the applicable capital gains rate for such distributions is not currently determinable.

Pursuant to recently enacted legislation, long-term capital gains derived by Puerto Rico Individuals in transactions occurring between July 1, 2004 and June 30, 2005 which are reinvested in Puerto Rico are entitled to a 5% rate if the gain is realized in the sale or exchange of “property located in Puerto Rico” or 10% in the case of other property. Long-term capital gains derived by Puerto Rico Entities in transactions with capital assets effected between July 1, 2004 and June 30,



2005 are eligible for a 6.25% rate if the gain is realized in the sale or exchange of “property located in Puerto Rico” or 12.5% in the case of other property. It is not currently determinable whether these temporary special capital gains rates are applicable to distributions in excess of current or accumulated earnings and profits.

*Sale, Exchange or Other Disposition of the Shares.* Gains from the sale, exchange or other disposition of Shares which have been held by Puerto Rico Individuals for more than six months and which constitute capital assets in the hands of such investors are subject to a 10% capital gains tax. Puerto Rico Individuals may elect to treat such gains as ordinary income and subject to the regular income tax provided by the Puerto Rico Code in lieu of the 10% tax rate indicated herein.

Pursuant to recently enacted legislation, Puerto Rico Individuals are eligible for a 5% tax rate, in lieu of the above-described 10% rate, with respect to gains from the sale, exchange or other disposition of Shares effected between July 1, 2004 and June 30, 2005 which are reinvested in Puerto Rico. We suggest consulting with your own tax advisor on the applicability requirements imposed by the recently enacted legislation, including, but not limited to, the amount, nature and term of the reinvestment in Puerto Rico.

Gains from the sale, exchange or other disposition of Shares which have been held by Puerto Rico Entities for more than six months and which constitute capital assets in the hands of such investors qualify for a 12.5% alternative capital gains tax.

Pursuant to recently enacted legislation, Puerto Rico Entities are eligible for a 6.25% tax rate, in lieu of the above-described 12.5% rate, with respect to gains from the sale, exchange or other disposition of Shares effected between July 1, 2004 and June 30, 2005. Since this recently enacted legislation is not entirely clear, we suggest consulting with your tax advisor on the scope of its requirements.

Losses from the sale, exchange or other disposition of Shares that constitute capital assets in the hands of Puerto Rico Investors are deductible only to the extent of gains from the sale, exchange or other disposition of capital assets; except that Puerto Rico Individuals may also deduct up to \$1,000 of such losses from ordinary income.

*Redemption of Shares.* The partial or total redemption of Shares is generally treated as a sale or exchange of such Shares, unless it is “essentially equivalent to a dividend.” If a redemption of Shares is treated as “essentially equivalent to a dividend,” then the redemption is treated as a Taxable Dividend to the extent of the Fund's current and accumulated earnings and profits. In distinguishing whether a stock redemption should be treated as such or “essentially equivalent to a dividend,” the Puerto Rico Code Regulations provide that (i) pro-rata redemptions of stock are generally treated as essentially equivalent to a dividend, and (ii) redemptions that terminate a shareholder's interest are not to be treated as essentially equivalent to a dividend. However, neither the Puerto Rico Code nor the Puerto Rico Code Regulations set forth guidelines to determine which other redemptions are not essentially equivalent to a dividend distribution. In the absence of Puerto Rico guidelines, the Treasury Department generally follows the principles established under the Code, the Code Regulations, and rulings and other administrative pronouncements of the IRS.

*Reinvested Dividends.* Taxable and capital gains dividends distributed by the Fund that are reinvested by shareholders in Shares of the Fund will be subject to Puerto Rico income taxes under the rules hereof.

*Dividends Distributed to Life Insurance Companies.* Taxable Dividends and Exempt Dividends distributed to insurance companies organized under the laws of the Commonwealth of Puerto Rico which are subject to the Puerto Rico income tax as “life insurance companies” under the provisions of Section 1201 of the Puerto Rico Code (the “Life Insurance Companies”) will not be subject to the regular income tax.

Capital Gain Dividends will be subject to income tax under the Puerto Rico Code and treated as long term capital gains. See “Taxation of Puerto Rico Investors – Capital Gain Dividends” above.

For purposes of the alternative minimum tax, the “adjusted net book income” of Life Insurance Companies does not include Exempt Dividends.

*Dividends Distributed to Mutual Insurance Companies.* Taxable Dividends received by insurance companies organized under the laws of the Commonwealth of Puerto Rico, other than Life Insurance Companies, which are subject to Puerto Rico income tax under the provisions of Section 1211 of the Puerto Rico Code (the “Mutual Insurance Companies”) are subject to income tax under the Puerto Rico Code. Mutual Insurance Companies are entitled to claim the 85% Dividend Received Deduction with respect to Taxable Dividends, subject to the limitations imposed by the Puerto Rico Code.

Capital Gain Dividends will be treated as long-term capital gains. See “Taxation of Puerto Rico Investors – Capital Gain Dividends” above.

Exempt Dividends distributed to Mutual Insurance Companies will not be subject to the regular income tax. The Puerto Rico Code provides various rules that disallow a deduction for expenses that are directly or indirectly attributable to income that is exempt from Puerto Rico income tax.

For purposes of the alternative minimum tax, the “adjusted net book income” of Mutual Insurance Companies does not include the Exempt Dividends.

*Dividends Distributed to Non-Mutual Insurance Companies.* Dividends received by Insurance Companies subject to Puerto Rico income tax under the provisions of Section 1207 of the Puerto Rico Code (the “Non-Mutual Insurance Companies”), will be included in gross income. Non-Mutual Insurance Companies are entitled to claim the 85% Dividend Received Deduction with respect to Taxable Dividends, subject to the limitations imposed by the Puerto Rico Code.

In computing their net income for purposes of the regular income tax, Non-Mutual Insurance Companies are entitled to deduct interest exempt from Puerto Rico income taxes under the provisions of Section 1022(b)(4) of the Puerto Rico Code. The Non-Mutual Insurance Companies are not, however, entitled to deduct expenses that are attributable to exempt interest as provided in Section 1207(e) of the Puerto Rico Code. Moreover, such Section 1207 does not address the treatment of Exempt Dividends distributed from earnings and profits attributable to interest described in Section 1022(b)(4) of the Puerto Rico Code. Under the general principles that apply to the tax treatment of distributions made by investment companies registered under the PR-ICA, Exempt Dividends should be treated as interest described in Section 1022(b)(4) of the Puerto Rico Code to the extent distributed out of such earnings and profits.

Capital Gain Dividends will be treated as long term capital gains. See “Taxation of Puerto Rico Investors – Capital Gain Dividends” above.

For purposes of the alternative minimum tax, the “adjusted net book income” of Non-Mutual Insurance Companies will not include Exempt Dividends.

*Estate and Gift Taxes.* The Shares will not be subject to Puerto Rico estate and gift taxes if held by a Puerto Rico Individual who is a citizen of the United States that acquired his or her citizenship solely by reason of birth or residence in Puerto Rico and was a resident of Puerto Rico, in the case of estate taxes, at the time of death, and in the case of gift taxes, at the time the gift was made.

*Municipal License Taxes.* Distributions made to Puerto Rico Entities may be subject to a municipal license tax of up to 1.5% in the case of investors engaged in a financial business, and up to 0.5% in the case of Puerto Rico Entities engaged in a non-financial business, as defined in the MLTA. Distributions to Puerto Rico Individuals will not be subject to municipal license tax.

*Property Taxes.* The Shares are exempt from Puerto Rico personal property taxes in the hands of the Puerto Rico Investors.

## UNITED STATES TAXATION

### Taxation of the Fund

In the opinion of Fiddler González & Rodríguez, P.S.C., counsel to the Fund, based on certain representations made by the Fund and the Investment Adviser, the Fund will be treated under the Code as a foreign corporation not engaged in a U.S. trade or business. As a foreign corporation not engaged in a U.S. trade or business, the Fund is not subject to U.S. federal income tax on gains derived from the sale or exchange of personal property (except for gains from the disposition of a “United States Real Property Interest,” as defined in Section 897 of the Code). The Fund is, however, subject to a U.S. federal income tax of 30% on certain other types of income from sources within the United States. An opinion of counsel is not binding on the IRS, however, and it is possible that the IRS or a court could disagree with counsel's conclusion. If the Fund were ultimately found to be engaged in a U.S. trade or business, it would be subject to U.S. federal corporate income tax on that part of its net income that was effectively connected with such trade or business and to a branch profits tax (which is generally imposed on a foreign corporation on the repatriation from the U.S. of earnings and profits attributable to a U.S. trade or business) at a 30% rate on its earnings and profits attributable to such effectively connected income, subject to a number of statutory adjustments.

The Code also imposes a “Personal Holding Company” tax on certain income derived from sources within the U.S. by foreign corporations that qualify as “Personal Holding Companies.” In general, a “Personal Holding Company” is any corporation that derives at least 60% of its gross income from certain sources and more than 50% of the value of its stock is owned directly or indirectly by five (5) individuals or less. The Fund's Certificate of Incorporation contains certain ownership limitations to ensure that five or fewer Puerto Rico residents never own directly or indirectly more than 50% of the stock of the Fund, measured by value or voting power. Furthermore, if the Fund qualifies as a “Foreign Personal Holding Company” or as a “PFIC” (as defined below), it will not be treated as a “Personal Holding Company.”

### Taxation of Puerto Rico Individuals and Puerto Rico Entities

*General.* Dividends on the Shares will constitute gross income from sources outside the United States if less than 25% of the gross income from all sources of the Fund for the three-year period ending with the close of the taxable year preceding the deduction of such dividends (or for such part of such period as the Fund has been in existence) was effectively connected with a trade or business within the United States. Since its incorporation, less than 25% of the fund's gross income has been effectively connected in the conduct of a trade or business in the United States, and the Fund expects to satisfy such gross income test on an ongoing basis. Accordingly, dividends on the Shares distributed by the Fund will constitute gross income from sources outside the United States so long as the Fund continues to meet such gross income test.

*Dividends.* Under Section 933 of the Code, Puerto Rico Individuals will generally not be subject to U.S. federal income tax on dividends distributed by the Fund (see “PFIC” discussion below).

Foreign corporations not engaged in a U.S. trade or business are generally not subject to U.S. federal income tax on amounts received from sources outside the U.S. Corporations incorporated in Puerto Rico are treated as foreign corporations under the Code. Because dividends distributed by the Fund will constitute income from sources within Puerto Rico, such Puerto Rico corporate investors not engaged in a U.S. trade or business will not be subject to U.S. taxation on dividends received from the Fund. Dividends paid to a Puerto Rico corporate investor that is engaged in a U.S. trade or business will be subject to U.S. federal income tax only if such dividends are effectively connected to the U.S. trade or business. The Code provides special rules for Puerto Rico Entities that are treated as partnerships for U.S. federal income tax purposes.

*Sales, Exchange or Disposition of Shares.* Gain, if any, from the sale, exchange or other disposition of the Shares by a Puerto Rico Individual that is not a resident of the United States, within the meaning of Section 865(g)(1) of the Code, is generally treated as Puerto Rico source income and therefore exempt from federal income taxation if such shares do not constitute inventory in the hands of such investor and the Puerto Rico Individual pays a Puerto Rico income tax at an effective rate of at least 10% on the gain. However, a Puerto Rico Individual who is not subject to a 10% Puerto Rico income tax on a gain realized from the sale of the Shares (that does not constitute inventory in the hands of such investor) may nevertheless treat the gain as Puerto Rico source income not subject to U.S. federal income tax if the requirements of Notice 89-40 are met. In Notice 89-40, the IRS announced that regulations will be issued to provide that gain from the sale of stock that does not constitute inventory, by an individual that is not a resident of the U.S. under Section 865(g)(1) of the Code and who has been a bona fide resident of Puerto Rico for the entire taxable year of the sale will be income from sources within Puerto Rico and therefore exempt from U.S. federal income taxation, whether or not the individual paid a

Puerto Rico income tax of at least 10% on the gain. Unless contrary authority is issued, a Puerto Rico Individual who meets the conditions described in the Notice may treat gain from the sale, exchange or other disposition of the Shares as Puerto Rico source income.

A Puerto Rico corporation that invests in the Fund will be subject to U.S. federal income tax on a gain from a disposition of Shares only if the gain is effectively connected to a U.S. trade or business carried on by the Puerto Rico corporation. The Code provides special rules for Puerto Rico Entities that are subject to federal income tax as partnerships.

*PFIC Rules.* Under the Code, the Fund will likely be treated as a passive foreign investment company (“PFIC”) for U.S. federal income tax purposes. Under the PFIC rules, a Shareholder that is a U.S. person — i.e., a citizen or resident of the U.S., a U.S. domestic corporation or partnership, or an estate or trust that is taxed as a resident of the U.S. — (such a Shareholder referred to as a “U.S. Shareholder”), that disposes of its PFIC stock at a gain is treated as receiving an “excess distribution” equal to such gain. In addition, if a U.S. Shareholder receives a distribution from a PFIC in excess of 125% of the average amount of distributions such Shareholder has received from the PFIC during the three preceding taxable years (or shorter period if the U.S. Shareholder has not held the stock for three years), the U.S. Shareholder is also treated as receiving an “excess distribution” equal to such excess. In general, an “excess distribution” is taxed as ordinary income, and to the extent it is attributed to earlier years in which the PFIC stock was held, is subject to an interest charge which the Code refers to as the “deferred tax amount.” Puerto Rico corporations are not U.S. Shareholders for purposes of the PFIC provisions. However, the PFIC rules may also give rise to tax consequences for a U.S. person that owns an interest in such entity. Citizens of the U.S. who are bona fide residents of Puerto Rico are U.S. Shareholders for purposes of the PFIC provisions.

Prop. Reg. Sec. 1.1291-1(f) states that a “deferred tax amount” will be determined under Section 1291 of the Code on amounts derived from sources within Puerto Rico by Puerto Rico Individuals only to the extent such amounts are allocated to a taxable year in the Shareholder's holding period during which the Shareholder was not entitled to the benefits of Section 933 thereof. Thus, under the proposed regulations, Puerto Rico Individuals will not be subject to the PFIC provisions if they are entitled to the benefits of Section 933 of the Code for each entire taxable year that they hold the Shares.

*Foreign Personal Holding Company Rules.* U.S. Shareholders of a “foreign personal holding company” are subject to U.S. federal income tax on their share of certain undistributed income of such entity, thereby preventing deferral of U.S. federal income taxes on such income. A “foreign personal holding company” generally includes a foreign corporation if such corporation meets certain income tests and more than 50% of its stock is owned directly or indirectly by five or fewer individuals who are U.S. citizens or residents. Puerto Rico Individuals, that are U.S. citizens, are not excepted from such status for these purposes. However, because the Code excludes Puerto Rico source income from the gross income of Puerto Rico Individuals, such an individual would not be subject to U.S. federal income tax on undistributed income of the Fund, even if the Fund were a foreign personal holding company. Furthermore, the Fund's Certificate of Incorporation contains certain ownership limitations to ensure that five or fewer Puerto Rico residents never own directly or indirectly more than 50% of the stock of the Fund, measured by value or voting power.

## **Estate and Gift Taxes**

Under the provisions of the Code, the Shares will not be subject to U.S. estate and gift taxes if held by a Puerto Rico Individual who is a citizen of the U.S. who acquired his or her citizenship solely by reason of birth or residence in Puerto Rico and was a resident of Puerto Rico, in the case of estate taxes, at the time of death, and in the case of gift taxes, at the time the gift was made.

Potential investors are advised to consult their own tax advisers as to the consequences of an investment in the Fund under the tax laws of Puerto Rico and the U.S., including the consequences of the sale or redemption of Shares in the Fund.

## **DESCRIPTION OF CAPITAL STOCK**

The Fund is authorized to issue 88 million shares of Common Stock, \$0.01 par value, and 12 million shares of Preferred Stock, \$25 par value. The Board of Directors is further authorized to classify and reclassify any unissued shares of capital stock from time to time by setting or changing the preferences, conversion or other rights, voting powers, restrictions, limitations as to dividends or terms and conditions of redemption of such shares by the Fund.

### **Common Stock**

The Certificate of Incorporation of the Fund specifies that the Shares have no preemptive, conversion, exchange or redemption rights. Each Share has equal voting, dividend, distribution, and liquidation rights. The outstanding Shares are, and those offered hereby, when issued, will be, fully paid and nonassessable. Shareholders are entitled to one vote per Share. All voting rights for the election of directors are noncumulative, which means that the holders of more than 50% of the Shares can elect 100% of the directors then nominated for election if they choose to do so, and in such event, the holders of the remaining Shares will not be able to elect any directors. The PR-ICA provides that not more than 50% of the Shares may be controlled by less than six Shareholders.

The Fund may in the future make additional offerings of its Shares. Any additional offerings, if made, will require approval of the Board of Directors. UBS Puerto Rico and R-G Investments may have to suspend any future purchase and sale transactions effected by them for a period of time prior to an offering and up to the date of completion of such additional offering of Shares conducted in the future.

### **Preferred Stock**

Under the Fund's Certificate of Incorporation, it is authorized to issue 12,000,000 shares of preferred stock. Each share of preferred stock has a par value of \$25, which is equal to its liquidation preference (the "Liquidation Preference").

The Fund's Certificate of Incorporation permits the Board of Directors to make the following determinations with respect to the shares of preferred stock:

- (a) The number of shares constituting that series and the distinctive designation of that series;
- (b) The dividend rate on the shares of that series, whether dividends shall be cumulative, and if so, from which date or dates, and the relative rights of priority, if any, of payment of dividends on shares of that series;
- (c) Whether that series shall have conversion privileges, and if so, the terms and conditions of such conversion, including provision for adjustment of the conversion rate in such events as the Board of Directors shall determine;
- (d) Whether or not the shares of that series shall be redeemable, and if so, the terms and conditions of such redemption, including the date or dates upon or after which they shall be redeemable, and the amount per share payable in case of redemption, which amount may vary under different conditions and at different redemption dates;
- (e) Whether that series shall have a sinking fund for the redemption or purchase of shares of that series, and if so, the terms and amount of such sinking fund;
- (f) The rights of the shares of that series in the event of voluntary or involuntary liquidation, dissolution or winding-up of the Fund, and the relative rights of priority, if any, of payment of shares of that series; and
- (g) Any other relative rights, voting rights, preferences, and limitations of that series.

Upon any voluntary or involuntary liquidation, dissolution, or winding-up of the Fund, as the case may be, the then holders of record of the shares of preferred stock will be entitled to receive out of the assets of the Fund available for distribution to all holders of the Shares as well as the shares of preferred stock, before any distribution is made to holders of the Shares, distributions upon liquidation in an amount equal to the Liquidation Preference of each share of preferred stock, without premium or penalty.

If upon any voluntary or involuntary liquidation, dissolution or winding-up of the Fund, as the case may be, the amounts payable with respect to the shares of the Fund's preferred stock, are not paid in full, the holders of such shares will share ratably in any such distribution of assets of the Fund in proportion to the full liquidation preferences to which each is entitled. After payment of the full amount of the liquidation preference to which they are entitled, the holders of such shares will not be entitled to any further participation in any distribution of assets of the Fund.

The Fund may not issue shares ranking, as to participation in profits or the assets of the Fund, senior or in priority to its preferred stock, unless approved by the preferred stockholders in accordance with the Board of Directors' resolution providing for their creation.

The specific terms and conditions of any preferred stock issuance by the Fund will be set forth in a Prospectus supplement to this Prospectus. Moreover, in accordance with the PR-ICA, the OCFI must also approve the issuance of such preferred stock.

## **RULING OF THE COMMISSIONER**

Pursuant to the Commissioner's Ruling, certain waivers from the provisions of the PR-ICA were granted. Terms not otherwise defined in this section shall have the meanings ascribed to them in the Commissioner's Ruling. It is available for inspection at the Fund's principal office. Among the waivers granted in the Commissioner's Ruling are the following:

1. For purposes of computing the number of persons holding securities of the Fund under the PR-ICA, the beneficial owners of such securities shall be considered as the holders, irrespective of whether such securities are held in "street name" or by a fiduciary.

2. The Fund is allowed to hold investments in Puerto Rico Securities (particularly the Mortgage Instruments) and U.S. Government securities in each case in excess of the 25% limitation on investments in a single issuer imposed by Section 2 of the PR-ICA. For all other securities, the Fund must comply with the 25% limitation on investment of a single issuer imposed by Section 2 of the PR-ICA.

3. The Fund may also purchase or otherwise acquire securities issued by UBS Puerto Rico or its affiliates and R&G Financial or its affiliates, subject to a limitation of 5% of the market value of the Fund's total assets and the approval of a majority of the Independent Fund Directors. For purposes of this particular ruling, mortgage-backed securities issued by R&G Financial or its affiliates (particularly, the Mortgage Instruments) shall not be considered as securities issued by R&G Financial or its affiliates.

4. The public notice requirement of Regulation 143 promulgated under the PR-ICA and the obligation to file Part 2 on Form 1 of the Application for Registration under the PR-ICA were waived.

5. The Fund has been exempted from the requirement of the PR-ICA that it have no less than 11 Shareholders during the period from its initial capitalization until the first closing of the Fund's initial public offering of securities.

6. The Fund shall comply with the 67% Investment Requirement on or before the first anniversary of its registration as an investment company with the OCFI, by investing at least 67% of the net proceeds received by the Fund from the sale of its securities invested in Puerto Rico Assets (as defined in the Commissioner's Ruling). Thereafter, the Fund shall comply with the 67% Investment Requirement by investing at all times 67% of its total assets in Puerto Rico Assets upon the sale, exchange, prepayment, maturity or any other voluntary or involuntary disposition of a Fund asset, provided that the amount required by the Fund to be invested in order to achieve compliance with the 67% Investment Requirement shall not exceed the amount of cash available for investment by the Fund as a result of the sale, exchange, prepayment, maturity, or any other voluntary or involuntary disposition of a Fund asset. In the event that the 67% Investment Requirement is not met, as verified on any valuation date, the Fund shall achieve compliance with such requirement by the end of the calendar month after the date of non-compliance, taking such actions as may be determined by the Investment Adviser to be in the best interests of the Fund's investors.

7. The 67% Investment Requirement shall not be applicable (i) during a maximum of 60 days per year, for defensive or strategic purposes, (ii) during a maximum of 30 days per year, upon the proven scarcity of Puerto Rico Assets or of market disruption, or (iii) otherwise, for such longer periods as approved by the OCFI.

8. The Fund will render quarterly reports as specified by the OCFI affirmatively certifying full compliance with the 67% Investment Requirement during the preceding quarter (if applicable), or if the Fund failed to comply with such requirement, specifying the extent of the breach, the reasons therefor, and a description of the actions taken or to be taken by the Fund to achieve compliance. In addition, the Fund shall submit annual reports and audited financial statements, as well as any report requested by the OCFI from time to time, and the OCFI in the Commissioner's Ruling.

In addition, the OCFI has restricted the Fund's ability to engage in certain leveraging activities. Presently, the Fund may conduct additional offerings of preferred stock, debt securities, and other forms of leverage subject to the 50% of total assets restriction after giving effect to previous borrowings and previously issued preferred stock, debt securities, and other forms of leverage. Such offerings would be made to Puerto Rico Residents. See "Appendix G — Hedging and Related Income Strategies" herein.

## UNDERWRITING

UBS Puerto Rico and R-G Investments, as the Underwriters of the Shares, will purchase from the Fund, subject to the terms and conditions of a certain underwriting agreement (the “Underwriting Agreement”), and the Fund will sell to the Underwriters, the totality of the Shares being offered hereby as set forth opposite its name below:

UBS Financial Services Incorporated of Puerto Rico.....	5,000,000
R-G Investments Corporation.....	<u>3,200,000</u>
Total:	8,200,000

The Underwriters will commit to purchase the number of Shares specified in the cover page of this Prospectus at several closings to be held in San Juan, Puerto Rico. It is anticipated that the Initial Closing will take place on or about November 4, 2004, and other closings may take place thereafter. The Fund may increase the number of Shares offered to the public. The Underwriters will offer and sell the Shares at a public offering price equal to the greater of (i) \$10.00 or (ii) the then current net asset value per Share plus the applicable sales load. The sales load on purchases of the Shares in this offering is \$0.475 per Share (4.75%). Subject to the terms and conditions of the Underwriting Agreement, the Underwriters will compensate certain brokers and dealers in connection with sales of the Shares in this offering at a rate of up to \$0.30 per Share. After the later of (i) the final closing of the initial public offering of the Shares or (ii) the date of closing for the purchase of any Shares to cover over-allotments, the public offering price and other selling terms may be changed by the Underwriters. Investors should consult their brokers concerning the manner and method of payment for the Shares. The minimum investment in the initial public offering is 100 Shares.

The Underwriters may reduce or waive in its entirety the sales load on sales of the Shares where investors (i) represent that the purchase of the Shares will be made with the proceeds from the redemption or sale of stock or units of any fixed income investment companies or portfolio thereof advised by UBS AMPR and R-G Portfolio Management; (ii) provide notice to the Underwriters prior to such redemption or sale; and (iii) execute their purchase of the Shares within 60 days of such redemption or sale. Pending such purchase, the redemption or sale proceeds must be held in cash or cash equivalents. For investors that satisfy such requirements, the Underwriters currently intend to reduce the sales load in an amount not to exceed \$0.275 per Share, which results in a sales load of \$0.20 per Share.

The Fund will grant to the Underwriters an option, exercisable for 30 days from the date of the final closing, to purchase up to 1,230,000 additional Shares. The Underwriters may exercise this option only to cover over-allotments. The maximum sales load paid to the Underwriters for this offering, based on a maximum sales load per Share of \$0.475, and assuming that the Fund issues only the number of Shares set forth on the cover page of this Prospectus, is set forth on the cover page of this Prospectus.

The Underwriters may take certain actions to discourage short-term trading of the Shares during a period of time following the initial offering date. Included in these actions is the withholding of any compensation to dealers in connection with Shares which were sold by such dealers and which were repurchased for the account of the Underwriters during such period.

The Underwriting Agreement will provide that the obligation of the Underwriters to purchase the Shares offered hereby will be subject to certain conditions. The Underwriters will commit to purchase, and the Fund will be obligated to sell, by means of a firm commitment underwriting, all of the Shares offered by this Prospectus, if any are purchased. The Underwriting Agreement will provide that it may be terminated at or prior to the closing date of the Initial Closing if, in the judgment of the Underwriters, payment for and delivery of the Shares is rendered impracticable or inadvisable.

The Underwriters may appoint other entities to distribute Shares of the Fund as selected dealers.

## LEGAL OPINIONS

The statements in the section “TAXATION” have been passed upon by Fiddler González & Rodríguez, P.S.C., San Juan, Puerto Rico. Fiddler González & Rodríguez, P.S.C. will render an opinion on the validity of the Shares on each closing date.

## **INDEPENDENT ACCOUNTANTS**

The independent accountants of the Fund are PricewaterhouseCoopers LLP. The address of such independent accountants is BBVA Tower, Ninth Floor, 254 Muñoz Rivera Avenue, San Juan, Puerto Rico 00918.

## **PRIVACY POLICY**

Attached as Appendix I is a copy of the Privacy Policy as to the information the Fund compiles and maintains on its investors.

## **GENERAL INFORMATION**

### **Reports to Shareholders**

The fiscal year of the Fund ends on September the 30<sup>th</sup> of each year. An annual report, containing financial statements audited by the Fund's independent auditors, will be sent to Shareholders each year. After the end of each year, Shareholders will receive Puerto Rico income tax information regarding dividends and capital gains distributions.

### **Additional Information**

Additional public information regarding the Fund is on file with the OCFI. You may contact the OCFI at Centro Europa Building, Suite 600, 1492 Ponce de León Avenue, San Juan PR 00910, telephone (787) 723-3131.



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***The information provided in this Appendix A has been provided by R&G Financial Corporation. Neither the Fund nor UBS Financial Services Incorporated of Puerto Rico or its affiliates are responsible for its accuracy.***

## **R&G FINANCIAL CORPORATION**

### ***Overview***

R&G Financial Corporation (“R&G Financial” or “Company”) is a Puerto Rico chartered diversified financial holding company that, through its wholly-owned subsidiaries, is engaged in banking, mortgage banking, securities and insurance brokerage activities. R&G Financial, currently in its 32nd year of operations, operates 32 bank branches mainly located in the northeastern section of Puerto Rico, 15 bank branches in the Orlando and Tampa/St. Petersburg Florida markets, 5 mortgage and 6 commercial lending offices in the continental United States, and 55 mortgage offices in Puerto Rico, including 26 facilities located within Premier Bank’s branches.

R&G Financial is engaged in providing a full range of banking services. R-G Premier Bank of Puerto Rico (“R-G Premier”) is R&G Financial’s Puerto Rico commercial bank. In June 2002, R&G Financial acquired R-G Crown Bank (“R-G Crown”), a federal savings bank which operates in the Tampa — St. Petersburg — Clearwater and Orlando metropolitan areas through 14 full-service offices at the time. Since the Orlando market is one of the fastest growing markets in Florida, both generally and for Hispanics in particular (mainly Puerto Rican), the Company believes that owning and operating R-G Crown is a cost effective way to access the Hispanic markets in the United States, while providing a strong platform for further expansion in Florida. Banking activities for R-G Premier and R-G Crown include commercial banking services, corporate and construction lending, consumer lending and credit cards, offering a variety of deposit products and, to a lesser extent, trust and investment services through private banking.

On October 11, 2004, R&G Financial and R-G Crown entered into a purchase and assumption agreement with SouthTrust Bank to acquire 18 SouthTrust branches located in three banking markets in Florida and one banking market in Georgia, with deposits and other liabilities totaling approximately \$600 million. The acquisition results from the proposed divestiture of certain SouthTrust branches, together with the assets, deposits and other liabilities of such branches in order to facilitate regulatory approval of Wachovia Corporation’s previously announced proposed acquisition of SouthTrust Corporation, the parent of SouthTrust Bank. Completion of the sale to R-G Crown is contingent on the completion of the proposed merger of SouthTrust Corporation and Wachovia Corporation. As part of the terms of the agreement, R-G Crown agreed to complete the closing and conversion of the accounts by March 3, 2005. R-G Crown will pay SouthTrust a fee of \$4.5 million if the closing and conversion does not occur by such date provided the inability to meet that deadline is caused solely by R-G Crown’s action or failure to act. The transaction is subject to final regulatory approvals.

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

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

R&G Financial is the second largest mortgage loan originator and servicer of mortgage loans on single family residences in Puerto Rico. R&G Financial’s mortgage servicing portfolio amounted to approximately \$10.9 billion as of June 30, 2004. While R&G Financial’s servicing portfolio continues to be affected by a high level of prepayments due to lower interest rates, R&G Financial continues to emphasize increasing the size of its mortgage servicing portfolio by relying principally on internal loan originations.

As part of its strategy to maximize net interest income, R&G Financial maintains a substantial portfolio of mortgage-backed and investment securities. At June 30, 2004, R&G Financial held securities available for sale with a fair market value of \$3.2 billion, which included \$2.5 billion of mortgage-backed securities, of which \$320.4 million consisted of Puerto Rico GNMA securities, the interest on which is tax-exempt to R&G Financial. These securities are generally held by R&G Financial for longer periods prior to sale in order to maximize the tax-exempt interest received thereon. R&G Financial's lower effective tax rate compared to the maximum statutory rate reflects the exemption under Puerto Rico law of the net interest income derived from such securities. In addition, R&G Financial invests in certain U.S. agency securities that are exempt from Puerto Rico taxation and are not subject to federal income taxation. Finally, through its international banking subsidiaries, R&G Financial may invest in various U.S. securities, the income on which is exempt from Puerto Rico income taxation and is not subject to federal income taxation.

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

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

## **Banking Operations**

*General.* R&G Financial provides a full range of banking services through its banking subsidiaries, including residential, commercial and personal loans and a diversified range of deposit products. R-G Premier also provides private banking, trust and other financial services to its customers.

R&G Financial's banking business consists principally of holding deposits from the general public and using them, together with funds obtained from other sources, to originate and purchase loans secured primarily by residential real estate, and to purchase mortgage-backed and other securities. To a lesser extent, but with increasing emphasis over the past few years, R&G Financial also originates construction loans and loans secured by commercial real estate, as well as consumer and personal loans and commercial business loans. Such loans offer higher yields, are generally for shorter terms and offer R&G Financial an opportunity to provide a greater range of financial services to its customers. R-G Premier also offers trust services through its trust department. To date, R-G Premier has engaged in business solely in Puerto Rico. R-G Crown conducts business from its Florida locations, and Continental Capital originates retail construction and commercial loans in New York, New Jersey, Connecticut and North Carolina.

*Residential Loans.* At June 30, 2004, R&G Financial's net loan receivables totaled \$4.5 billion, which represented 50.4% of R&G Financial's \$8.9 billion of total assets. At such date, all of R&G Financial's loan receivables were held by its banking subsidiaries. R&G Financial's loan portfolio historically has had a substantial amount of loans secured by first mortgage liens on existing single-family residences. At June 30, 2004, \$2.7 billion, or 55.1% of R&G Financial's total loans held for investment, consisted of such loans, of which all but \$1.4 million consisted of conventional loans.

*Construction Loans.* At June 30, 2004, retail construction loans and commercial construction and land acquisition loans amounted to \$861.5 million in the aggregate, or 17.9% of total loans held for investment. R&G Financial intends to continue to increase its involvement in single-family residential construction lending. Such loans afford R&G Financial the opportunity to increase the interest rate sensitivity of its loan portfolio.

*Commercial and Consumer Loans.* R&G Financial also originates mortgage loans secured by commercial real estate, primarily office buildings, retail stores, warehouses and general purpose industrial space. At June 30, 2004, \$844.1 million, or 17.5% of R&G Financial's total loans held for investment, consisted of such loans. Finally, R&G Financial also offers commercial business loans, including working capital lines of credit, inventory and accounts receivable loans, equipment financing (including equipment leases), term loans, insurance premium loans and loans guaranteed by the Small Business Administration and various consumer loans. At June 30, 2004, consumer loans, some

of which are secured by real estate and deposits, amounted to \$206.4 million, or 4.3% of total loans held for investment, and commercial business loans amounted to \$250.4 million, or 5.2% of total loans held for investment.

## **Mortgage Banking**

*Originations.* R&G Financial is the second largest mortgage loans originator and servicer of mortgage loans on single-family residences in Puerto Rico. R&G Mortgage is primarily engaged in the business of originating first and second mortgage loans on single-family residential properties secured by real estate. R&G Mortgage also originates residential mortgage loans through The Mortgage Store, its wholly-owned subsidiary. Pursuant to agreements entered into between R&G Mortgage and R-G Premier, non-conforming conventional single-family residential loans and consumer loans secured by real estate are also originated by R&G Mortgage for portfolio retention by R-G Premier. R-G Premier retains most of the non-conforming conventional single-family residential loans because these loans generally do not satisfy resale guidelines of purchasers in the secondary mortgage market, primarily because of size (in the case of “jumbo” loans) or other underwriting technicalities (mostly related to documentation requirements) at the time of origination. However, from time to time, R&G Financial may sell or securitize some of these loans should the need arise for asset/liability management or other considerations. Jumbo loans may be packaged and sold in the secondary market, while loans with underwriting technicalities may be cured through payment experience and subsequently sold. Management believes that these loans are essentially of the same credit quality as conforming loans. For the six-month period ended June 30, 2004 and 2003, R&G Financial originated a total of \$1.2 billion and \$1.4 billion of residential mortgage loans, respectively. These aggregate originations include loans originated by R&G Mortgage directly for R-G Premier of \$610.7 million and \$583.2 million during the six-month period ended June 30, 2004 and 2003, respectively, or 52% and 42%, respectively, of total originations. The loans originated by R&G Mortgage for R-G Premier are comprised primarily of conventional residential loans and, to a lesser extent, residential construction loans and consumer loans secured by real estate.

*Servicing.* R&G Financial’s servicing portfolio has grown significantly over the past several years. At June 30, 2004, R&G Financial’s servicing portfolio totaled \$10.9 billion and consisted of a total of 144,914 loans. These amounts include R&G Mortgage’s servicing portfolio, totaling \$8.1 billion and R-G Crown’s servicing portfolio, totaling \$2.8 billion. At June 30, 2004, R&G Financial’s servicing portfolio included \$2.1 billion of loans serviced for R-G Premier and \$387.2 million of loans serviced for R-G Crown, or 19.6% and 3.5%, respectively, of the total servicing portfolio. Substantially all of the mortgage loans in R&G Financial’s servicing portfolio are secured by single-family residences. R&G Financial generally retains the servicing function with respect to the loans that have been securitized and sold.

*Securitizations.* R&G Financial pools Federal Housing Administration, (the “FHA”), and Veterans Administration (the “VA”) loans into mortgage-backed securities that are guaranteed by the GNMA. These securities are sold to securities broker-dealers and other investors in Puerto Rico. Conventional loans may either be sold directly to agencies such as FNMA, and FHLMC, or to private investors, or may be pooled into FNMA or FHLMC mortgage-backed securities, that are generally sold to investors. During the six-month period ended June 30, 2004 and 2003, R&G Financial sold \$704.4 million and \$845.5 million of loans, respectively, as part of its mortgage banking activities, that includes loans securitized and sold but does not include loans originated for R-G Premier.

## **Regulation**

R&G Financial operates its businesses under a variety of federal, state and Puerto Rico laws and rules. As a financial holding company, it is subject to the rules of the Board of Governors of the Federal Reserve System and the Office of the Puerto Rico Commissioner of Financial Institutions (the “OCFI”). Among other things, R&G Financial is required to meet minimum capital requirements, and its activities are limited to those that are determined to be financial in nature or incidental or complimentary to a financial activity.

R-G Premier is subject to extensive regulation and examination by the Federal Deposit Insurance Corporation (the “FDIC”), and by the OCFI, and R-G Crown is subject to extensive regulation and supervision by the Office of Thrift Supervision (the “OTS”). This regulation and supervision establishes a comprehensive framework of activities in which R&G Financial’s banking subsidiaries can engage. In addition, the FDIC and the OTS are required to take “prompt corrective action” if a given bank does not meet its minimum capital requirements. The FDIC and the OTS have established five capital tiers to implement this requirement, from “well capitalized” to “critically undercapitalized.” A

bank's capital tier will depend on various capital measures and other qualitative factors and will subject it to specific requirements. As of June 30, 2004, R-G Premier and R-G Crown met the capital measures for being "well capitalized" under the regulations.

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

## SELECTED CONSOLIDATED FINANCIAL AND OTHER DATA

The reader should read the summary consolidated financial information presented below, together with our Consolidated Financial Statements and notes which are incorporated by reference herein. Historical results are not necessarily indicative of future results.

	At or for the Six-Months Ended June 30,		At or for the Year Ended December 31,				
	2004	2003	2003	2002	2001	2000	1999
<b>Balance Sheet Data:</b>							
Total assets	\$8,944,575	\$7,256,132	\$8,198,880	\$6,277,246	\$4,664,394	\$3,539,444	\$2,911,993
Stockholders' equity	779,827	700,732	750,353	662,218	459,121	308,836	269,535
Common stockholders' equity	566,827	487,732	537,353	449,218	315,121	233,836	194,535
Common stockholders' equity per share <sup>(1)</sup>	11.09	9.55	10.52	8.81	6.71	5.44	4.53
<b>Income Statement Data:</b>							
Net income (income before cumulative effect from change in accounting principle in 2001, net of taxes)	79,287	60,591	131,023	96,342	66,294	43,633	41,335
Net income available to common stockholders	71,345	52,649	115,139	81,387	56,051	37,995	37,581
Diluted earnings per common share (before cumulative effect of change in accounting principle in 2001) <sup>(1)</sup>	1.39	1.03	2.25	1.66	1.22	0.86	0.85
<b>Operating Data:</b>							
Loan production	2,066,618	2,113,077	4,464,099	2,942,684	2,473,168	1,729,373	1,977,322
Loan servicing portfolio	10,947,458	11,318,506	10,942,821	10,991,944	7,224,571	6,634,059	6,177,511
<b>Performance Ratios<sup>(2)</sup>:</b>							
Return on average assets	1.85%	1.78%	1.80%	1.76%	1.63%	1.34%	1.72%
Return on average common equity	25.58	22.48	23.45	21.77	20.77	18.00	20.23
Net interest margin <sup>(3)</sup>	2.79	2.76	2.78	2.98	2.59	2.16	2.60
<b>Asset Quality Ratios<sup>(4)</sup>:</b>							
Non-performing assets to total assets at end of period	1.23	1.49	1.29	1.50	1.78	2.96	2.26
Non-performing loans to total loans at end of period	1.83	2.50	1.98	2.66	3.79	5.52	3.66
Allowance for loan losses to total loans at end of period	0.97	0.98	0.92	1.11	0.91	0.67	0.55
Allowance for loan losses to total non-performing loans at end of period	53.07	39.19	46.38	41.79	24.05	12.21	15.11
Net charge-offs to average loans outstanding	0.25	0.43	0.32	0.41	0.32	0.17	0.25

(1) Per share information presented takes into consideration a 3 for 2 stock split paid in January 2004.

(2) The return on average assets ratio is computed by dividing net income by average total assets for the period. The return on average common equity ratio is computed by dividing net income less preferred stock dividends by average common stockholders' equity for the period. With the exception of end of period ratios, all ratios for mortgage subsidiaries are based on the average of month end balances while all ratios for banking subsidiaries are based on average daily balances.

(3) Net interest margin represents net interest income as a percent of average interest earning assets.

(4) Non-performing loans consist of our non-accrual loans and non-performing assets consist of our non-performing loans and real estate acquired by foreclosure or deed-in-lieu thereof.

## RECENT DEVELOPMENTS

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 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.

The Company's return on equity during the third quarter of 2004 was 25.08%, while its return on assets was 1.80%, compared to 24.26% and 1.82%, respectively, during the third quarter of 2003.

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.

Total loan production during the first nine months of 2004 was \$3.4 billion. Total loan production during the third quarter was \$1.3 billion, surpassing the amount for the second quarter this year. In both periods, almost 90% of the Company's total loan production continues to be internally generated.

The increase in earnings during the first nine months and third quarter of 2004 also reflects a reduction in servicing-related impairment charges (including in operating expenses) of \$2.7 million and \$24.3 million, respectively. These reductions stem from decreases in mortgages prepayment rates in the Company's loan servicing portfolio during the periods.

Total assets of R-G Crown Bank at the end of the third quarter of 2004 were \$1.6 billion, contributing \$18.3 million in profits during the first nine months of 2004. Total banking assets increased 21%, compared to the third quarter of 2003 to \$8.5 billion, which represented 92% of the Company's consolidated assets at September 30, 2004.

The accompanying unaudited financial information has been prepared pursuant to accounting principles generally accepted in the United States of America. In the opinion of R&G Financial's Management, the following unaudited consolidated statements of financial condition information and the related unaudited consolidated statement of income information include all adjustments (consisting only of normal recurring accruals) necessary for a fair statement of the Company's financial position at September 30, 2004, and the results of operations for the nine-month periods ended on September 30, 2004 and 2003. All significant intercompany balances and transactions have been eliminated in consolidation. Certain amounts in the 2003 financial information have been reclassified to conform with the 2004 presentation.

The following tables show the Company's unaudited statements of financial condition and statements of income for the quarter and nine-month period ended September 30, 2004:

# **SELECTED BALANCE SHEET DATA (Unaudited)**

(Dollars in Thousands, except for per share data)

	<u>At Sept. 30, 2004</u>	<u>At June 30, 2004</u>	<u>At Dec. 31, 2003</u>	<u>At Sept. 30, 2003</u>
Total assets	\$9, 184, 640	\$8,944,575	\$8,198,880	\$7,835,001
Loans receivable, net	4,827,955	4,506,621	4,048,507	3,754,039
Mortgage loans held for sale	240,963	277,025	315,691	240,535
Mortgage-backed and investment securities held for trading	26,995	30,637	38,355	40,949
Mortgage-backed and investment securities available for sale	3,188,550	3,195,176	3,020,647	3,068,444
FHLB Stock	94,408	111,092	100,461	107,157
Mortgage-backed and investment securities held to maturity	80,723	73,086	78,200	71,320
Servicing asset	118,569	117,740	119,610	124,149
Cash and cash equivalents	326,044	344,434	234,318	176,778
Deposits	4,143,938	3,822,998	3,555,764	3,431,976
Securities sold under agreements to repurchase	2,539,620	2,488,536	2,220,795	2,112,382
Notes payable	98,800	136,813	192,259	194,632
Other borrowings	1,390,828	1,543,881	1,308,270	1,191,464
Stockholder's equity	823,187	779,827	750,353	725,132
Common stockholder's equity	610,187	566,827	537,353	512,132
Total # of common shares outstanding	51,120,774	51,102,420	51,066,299	51,065,916
Common Stockholders equity per share	\$11.94	\$11.09	\$10.52	\$10.03
Servicing portfolio	11,115,069	10,947,458	10,942,821	10,924,263
Book value of servicing portfolio	1.07%	1.08%	1.09%	1.14%
Allowance for loan losses (ALL)	49,209	46,799	39,615	35,729
Non-performing loans (NPL's)	101,046	88,187	85,414	87,803
NPL's / Total loans	1.93%	1.83%	1.98%	2.21%
All / Total loans	0.94%	0.97%	0.92%	0.90%
All / Total Non-performing loans	48.70%	53.07%	46.38%	40.69%



## SELECTED INCOME STATEMENT DATA

(Dollars in Thousands, except for per share data)

	For the three months ended September 30, (Unaudited)		For the nine months Ended September 30, (Unaudited)		Three months Ended June 30, (Unaudited)
	<u>2004</u>	<u>2003</u>	<u>2004</u>	<u>2003</u>	<u>2004</u>
<b>REVENUES</b>					
Net interest income	\$ 61,371	\$ 47,743	\$ 173,091	\$ 134,533	\$ 56,066
Provisions for loans losses	(6,265)	(4,292)	(19,000)	(12,956)	(6,265)
Net interest income after provision for loan losses	55,106	43,451	154,091	121,577	49,741
Net gain on sales of loans	54,546	29,554	136,917	108,057	40,323
Trading gains (losses)	(23,978)	613	(25,017)	(87)	1,116
Loan administration and other fee income	17,006	20,530	53,120	59,879	17,885
Total Revenue	\$ 102,680	\$ 94,148	\$ 319,111	\$ 289,426	\$ 109,065
<b>OPERATING EXPENSES</b>					
Employee compensation and benefits	18,086	15,377	53,625	45,030	18,839
Office occupancy and equipment	7,336	6,489	20,622	18,265	6,906
Other administrative and general	22,825	26,638	83,462	99,887	29,394
Total expenses	\$ 48,247	\$ 48,504	\$ 157,709	\$ 163,182	\$ 55,139
Income before income taxes	54,433	45,644	161,402	126,244	53,926
Income taxes	(13,563)	(11,352)	(41,245)	(31,361)	(13,179)
Net income	\$ 40,870	\$ 34,292	\$ 120,157	\$ 94,883	\$ 40,747
Less: Preferred stock dividends	(3,971)	(3,971)	(11,913)	(11,913)	(3,971)
Net income available to common stockholders	36,899	30,321	108,244	82,970	36,776
Net income per common share – Basic	\$ 0.72	\$ 0.59	\$ 2.12	\$ 1.63	\$ 0.72
Net income per common share – Diluted	\$ 0.72	\$ 0.59	\$ 2.11	\$ 1.62	\$ 0.72
Average shares outstanding - Basic	51,107,120	51,065,462	51,099,356	51,054,845	51,101,380
Average shares outstanding – Diluted	51,377,508	51,290,912	51,360,408	51,277,991	51,377,157
Return on common equity	25.08%	24.26%	25.28%	23.08%	25.89%
Return on assets	1.80%	1.82%	1.84%	1.79%	1.86%
Total loan production	\$1,293,138	\$1,271,046	\$3,359,756	\$3,384,123	\$1,136,808

## INCORPORATION OF CERTAIN DOCUMENTS BY REFERENCE

R&G Financial files periodic reports, proxy statements and other information with the Securities and Exchange Commission. R&G Financial's filings are available to the public over the Internet at the Securities and Exchange Commission's website at <http://www.sec.gov>. You may also inspect and copy these materials at the public reference facilities of the Securities and Exchange Commission at 450 Fifth Street, N.W., Room 1024, Washington, D.C. 20549. Copies of such material can be obtained at prescribed rates from the Public Reference Section of the Securities and Exchange Commission at 450 Fifth Street, N.W., Washington, D.C. 20549. Please call the Securities and Exchange Commission at 1-800-SEC-0330 for further information.

R&G Financial incorporates by reference the documents listed below and any filings R&G Financial makes with the Securities and Exchange Commission under Sections 13(a), 13(c), 14, or 15(d) of the Exchange Act:

1. The Annual Report on Form 10-K for the fiscal year ended December 31, 2003 dated March 15, 2004.
2. The Quarterly Report on Form 10-Q filed as of November 14, 2003 (with respect to the quarterly period ending September 30, 2003), the Quarterly Report on Form 10-Q filed as of May 5, 2004 (with respect to the quarter ending March 31, 2004) and the Quarterly Report on Form 10-Q filed as of August 9, 2004 (with respect to the quarterly period ending June 30, 2004).
3. The Current Reports on Form 8-K filed as of July 29, 2004, August 16, 2004, October 12, 2004 and October 22, 2004.

The Securities and Exchange Commission file number for each of these documents is 001-31381. You may request a copy of these filings (other than an exhibit to a filing unless that exhibit is specifically incorporated by reference into that filing) at no cost, by writing to or telephoning us at the following address: 280 Jesus T. Pinero, San Juan, Puerto Rico 00918 (787) 758-2424.

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## MORTGAGE-BACKED SECURITIES

### General

Mortgage-backed securities were introduced in the 1970s when the first pool of mortgage loans was converted into a mortgage pass-through security. Since the 1970s, the mortgage-backed securities market in general has vastly expanded and a variety of structures have been developed to meet investor needs.

New types of mortgage-backed securities are developed and marketed from time to time, and consistent with its investment limitations, the Fund expects to invest in those new types of mortgage-backed securities that the Investment Adviser believes may assist the Fund in achieving its investment objective. The Fund may invest in various types of Mortgage-Backed Securities, as described in herein. Not all of the types of securities described below are available in Puerto Rico.

### Government National Mortgage Association Securities

GNMA is a wholly-owned corporate instrumentality of the U.S. within the Department of Housing and Urban Development. The National Housing Act of 1934, as amended (the “Housing Act”), authorizes GNMA to guarantee the timely payment of the principal of and interest on securities that are based on and backed by a pool of specified mortgage loans. To qualify such securities for a GNMA guaranty, the underlying mortgages must be insured by the Federal Housing Administration under the Housing Act, or Title V of the Housing Act of 1949 (“FHA Loans”), or be guaranteed by the Veterans' Administration under the Servicemen's Readjustment Act of 1944, as amended (“VA Loans”), or be pools of other eligible mortgage loans. The Housing Act provides that the full faith and credit of the U.S. Government is pledged to the payment of all amounts that may be required to be paid under any guaranty. In order to meet its obligations under such guaranty, GNMA is authorized to borrow from the U.S. Treasury with no limitations as to amount.

GNMA pass-through mortgage-backed securities may represent a *pro rata* interest in one or more pools of the following types of mortgage loans: (i) fixed rate level payment mortgage loans; (ii) fixed rate graduated payment mortgage loans; (iii) fixed rate growing equity mortgage loans; (iv) fixed rate mortgage loans secured by manufactured (mobile) homes; (v) mortgage loans on multifamily residential properties under construction; (vi) mortgage loans on completed multifamily projects; (vii) fixed rate mortgage loans as to which escrowed funds are used to reduce the borrower's monthly payments during the early years of the mortgage loans (“buydown” mortgage loans); (viii) mortgage loans that provide for adjustments in payments based on periodic changes in interest rates or in other payment terms of the mortgage loans; and (ix) mortgage-backed serial notes.

### Federal National Mortgage Association Securities

FNMA is a federally chartered and privately owned corporation established under the Federal National Association Charter Act. FNMA was originally organized in 1938 as a U.S. Government agency to add greater liquidity to the mortgage market. FNMA was transformed into a private sector corporation by legislation enacted in 1968. FNMA provides funds to the mortgage market primarily by purchasing home mortgage loans from local lenders, thereby providing them with funds for additional lending. FNMA acquires funds to purchase such loans from investors that may not ordinarily invest in mortgage loans directly, thereby expanding the total amount of funds available for housing.

Each FNMA pass-through mortgage-backed security represents a *pro rata* interest in one or more pool of FHA Loans, VA Loans or conventional mortgage loans (i.e., mortgage loans that are not insured or guaranteed by any governmental agency). The loans contained in those pools consist of: (i) fixed rate level payment mortgage loans; (ii) fixed rate growing equity mortgage loans; (iii) fixed rate graduated payment mortgage loans; (iv) variable rate mortgage loans; (v) other adjustable rate mortgage loans; and (vi) fixed rate mortgage loans secured by multifamily projects. FNMA guarantees timely payment of principal and interest on FNMA mortgage-backed securities. However, the obligations of FNMA are not backed by the full faith and credit of the U.S. Nevertheless, because of the relationship between FNMA and the U.S., it is widely believed that FNMA mortgage-backed securities present minimal credit risks.

### Federal Home Loan Mortgage Corporation Securities

FHLMC is a corporate instrumentality of the U.S. established by the Emergency Home Finance Act of 1970, as amended (the “FHLMC Act”). FHLMC was organized primarily for the purpose of increasing the availability of mortgage credit to finance needed housing. The operations of FHLMC currently consist primarily of the purchase of

first lien, conventional, residential mortgage loans and participation interests in such mortgage loans and the resale of the mortgage loans so purchased in the form of mortgage-backed securities.

The mortgage loans underlying the FHLMC mortgage-backed securities typically consist of fixed rate or adjustable rate mortgage loans with original terms to maturity of between ten and 30 years, substantially all of which are secured by first liens on one-to four-family residential properties or multifamily projects. Each mortgage loan must meet the applicable standards set forth in the FHLMC Act. Mortgage loans underlying FHLMC mortgage-backed securities may include whole loans, participation interests in whole loans and undivided interests in whole loans and participations in another FHLMC mortgage-backed securities.

FHLMC guarantees: (i) the timely payment of interest on all FHLMC mortgage-backed securities; (ii) the ultimate collection of principal with respect to some FHLMC mortgage-backed securities; and (iii) the timely payment of principal with respect to other FHLMC mortgage-backed securities. However, the obligations of FHLMC are not backed by the full faith and credit of the U.S.

### **Collateralized Mortgage Obligations**

Collateralized Mortgage Obligations (“CMOs”) are multiple-class Mortgage-Backed Securities. Some CMOs are directly supported by other CMOs, which in turn are supported by pools of mortgage loans. Investors in such securities typically receive payments out of the interest and principal on the underlying mortgage loans. The portions of these payments that investors receive, as well as the priority of their rights to receive payments, are determined by the specific terms of the CMO class acquired. CMOs involve special risks. The following are classes of CMOs:

*Accretion Directed:* A class that receives principal payments from the accreted interest from specified accrual classes. An accretion directed class also may receive principal payments from principal paid on the underlying Mortgage Assets or other assets of the trust fund for the related series.

*Companion Class:* A class that receives principal payments on any distribution date only if scheduled payments have been made on specified planned principal classes, targeted principal classes or scheduled principal classes.

*Component Certificates:* A class consisting of “components.” The components of a class of component certificates may have different principal and interest payment characteristics but together constitute a single class. Each component of a class of component certificates may be identified as falling into one or more of the categories in this chart.

*Non-Accelerated Senior or NAS:* A class that, for the period of time specified in the related prospectus supplement, generally will not receive (in other words, is locked out of) (1) principal prepayments on the underlying Mortgage Assets that are allocated disproportionately to the senior certificates because of the shifting interest structure of the certificates in the trust and/or (2) scheduled principal payments on the underlying Mortgage Assets, as specified in the related prospectus supplement. During the lock-out period, the portion of the principal distributions on the underlying Mortgage Assets that the NAS class is locked out of will be distributed to the other classes of senior certificates.

*Notional Amount Certificates:* A class having no principal balance and bearing interest on the related notional amount. The notional amount is used for purposes of the determination of interest distributions.

*Planned Principal Class or PACs:* A class that is designed to receive principal payments using a predetermined principal balance schedule derived by assuming two constant prepayment rates for the underlying Mortgage Assets. These two rates are the endpoints for the “structuring range” for the planned principal class. The planned principal classes in any series of certificates may be subdivided into different categories (e.g., primary planned principal classes, secondary planned principal classes and so forth) having different effective structuring ranges and different principal payment priorities. The structuring range for the secondary planned principal class of a series of certificates will be narrower than that for the primary planned principal class of the series

*Scheduled Principal Class:* A class that is designed to receive principal payments using a predetermined principal balance schedule but is not designated as a planned principal class or targeted principal class. In many cases, the schedule is derived by assuming two constant prepayment rates for the underlying Mortgage Assets. These two rates are the endpoints for the “structuring range” for the scheduled principal class.

*Sequential Pay:* Classes that receive principal payments in a prescribed sequence, that do not have predetermined principal balance schedules and that under all circumstances receive payments of principal continuously from the first distribution date on which they receive principal until they are retired. A single class that receives principal payments before or after all other classes in the same series of certificates may be identified as a sequential pay class.

*Strip:* A class that receives a constant proportion, or “strip”, of the principal payments on the underlying Mortgage Assets or other assets of the trust fund.

*Super Senior:* A class that will not bear its proportionate share of realized losses (other than excess losses) as its share is directed to another class, referred to as the “support class” until the class certificate balance of the support class is reduced to zero.

*Support Class:* A class that absorbs the realized losses other than excess losses that would otherwise be allocated to a Super Senior class after the related classes of subordinated certificates are no longer outstanding.

*Targeted Principal Class or TACs:* A class that is designed to receive principal payments using a predetermined principal balance schedule derived by assuming a single constant prepayment rate for the underlying mortgage assets.

The following are other classes of interest type mortgage-backed securities:

*Fixed Rate:* A class with an interest rate that is fixed throughout the life of the class.

*Floating Rate:* A class with an interest rate that resets periodically based upon a designated index and that varies directly with changes in the index.

*Inverse Floating Rate:* A class with an interest rate that resets periodically based upon a designated index and that varies inversely with changes in the index.

*Variable Rate:* A class with an interest rate that resets periodically and is calculated by reference to the rate or rates of interest applicable to specified assets or instruments (e.g., the mortgage rates borne by the underlying mortgage loans).

*Interest Only:* A class that receives some or all of the interest payments made on the underlying Mortgage Assets or other assets of the trust fund and little or no principal. Interest only classes have either a nominal principal balance or a notional amount. A nominal principal balance represents actual principal that will be paid on the class. It is referred to as nominal since it is extremely small compared to other classes. A notional amount is the amount used as a reference to calculate the amount of interest due on an interest only class that is not entitled to any distributions of principal.

*Principal Only:* A class that does not bear interest and is entitled to receive only distributions of principal.

*Partial Accrual:* A class that accretes a portion of the amount of accrued interest on it, which amount will be added to the principal balance of the class on each applicable distribution date, with the remainder of the accrued interest to be distributed currently as interest on the class. The accretion may continue until a specified event has occurred or until the partial accrual class is retired.

*Accrual:* A class that accretes the amount of accrued interest otherwise distributable on the class, which amount will be added as principal to the principal balance of the class on each applicable distribution date. The accretion may continue until some specified event has occurred or until the accrual class is retired.

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## MUNICIPAL OBLIGATIONS

The Fund may invest in the following types of Municipal Obligations, subject to their availability in Puerto Rico, and in other types of Municipal Obligations as become available on the Puerto Rico market from time to time. Not all of the described Municipal Obligations are presently available in Puerto Rico.

### **Municipal Bonds, Industrial Development Bonds and Private Activity Bonds**

Municipal bonds are debt obligations issued to obtain funds for various public purposes. The two principal classifications of municipal bonds are “general obligation” and “revenue” bonds. General obligation bonds are secured by the issuer's pledge of its full faith, credit and taxing power for the payment of principal and interest. Revenue bonds are payable only from the revenues derived from a particular facility or class of facilities or, in some cases, from the proceeds of a special excise tax or from another specific source, such as the user of the facility being financed. Certain municipal bonds are “moral obligation” issues, which normally are issued by special purpose public authorities. In the case of such issues, an express or implied “moral obligation” of a related government unit is pledged to the payment of the debt service but is usually subject to annual budget appropriations.

The Fund may invest in industrial development bonds (“IDBs”) and private activity bonds (“PABs”), which are municipal bonds issued by or on behalf of public authorities to finance various privately operated facilities, such as airports or pollution control facilities. IDBs and PABs are generally revenue bonds and thus are not payable from the unrestricted revenue of the issuer. The credit quality of IDBs and PABs is usually directly related to the credit standing of the user of the facilities being financed.

As generally described in this Prospectus, the Fund may not presently concentrate its investments, e.g., invest a relatively high percentage of its assets in Municipal Obligations (e.g., revenue bonds) issued by entities which may pay their debt service obligations from the revenues derived from similar projects such as hospitals, multifamily housing, nursing homes, continuing care facilities, commercial facilities (including hotels), electric utility systems or industrial companies. That limitation may in the future be changed by the Board of Directors. Any future determination to allow concentration of the Fund's investments may make the Fund more susceptible to similar economic, political, or regulatory occurrences. As the similarity in issuers increases, the potential for fluctuation of the net asset value of Shares of the Fund also increases. Also, it is anticipated that a significant percentage of the Municipal Obligations (e.g., revenue bonds) in the Fund's portfolio may be issued by entities or secured by facilities with a relatively short operating history. Therefore, investors should also be aware of the risks which these investments might entail, as discussed below.

*Health Care Revenue Bonds.* These securities include Municipal Obligations (i.e., revenue bonds) issued to finance hospitals, nursing homes and continuing care facilities and which are generally secured by the revenues of particular facilities. The ability of the issuers of such securities to meet their obligations is dependent upon, among other things, the revenues, costs and occupancy levels of the subject facilities and the competitive nature of these industries. In addition, a major portion of hospital and nursing home revenues typically is derived from Federal or state programs such as Medicare and Medicaid and from various insurers. Changes in such programs or in the rates paid by insurers may reduce revenues available for the payment of principal of or interest on such bonds. New governmental legislation or regulations and other factors, such as the inability to obtain sufficient malpractice insurance, may also adversely affect the revenues or costs of these issuers. Moreover, in the case of life care facilities, since a portion of the services provided may be financed by an initial lump-sum deposit paid by occupants of the facility, there may be risk if the facility does not maintain adequate financial resources to secure estimated actuarial liabilities.

A number of legislative proposals concerning health care have been introduced in U.S. Congress in recent years or have been reported to be under consideration. These proposals include or may lead to a wide range of topics, including cost controls, national health insurance, incentives for competition in the provision of health care services, tax incentives and penalties related to health care insurance premiums and promotion of prepaid health care plans. The Fund is unable to predict the effect of any of these proposals, if enacted.

*Single Family Housing Bonds and Multifamily Housing Bonds.* Single family housing bonds and multifamily housing bonds are obligations of state and local housing authorities that have been issued in connection with a variety of single and multifamily housing projects. Economic developments, including fluctuations in interest rates, increasing construction and operating costs, increasing real estate taxes and declining occupancy rates, and real estate investment risks may have an adverse effect upon the revenues of such projects and such housing authorities. Multifamily housing bonds may be subject to mandatory redemption prior to maturity, including redemption upon a non-completion of the project or upon receipt of Federal Housing Administration or certain other insurance proceeds. Housing bonds may also be subject to changes in creditworthiness due to potential weaknesses of mortgage insurance



companies providing various policies; fluctuations in the valuation of invested funds and the strengths of banks and other entities which may provide investment agreements; and smaller than expected mortgage portfolios due to the inability to originate mortgages.

*Public Power Revenue Bonds.* Risks that may arise with respect to the electric utility industry include difficulty in financing large construction programs during an inflationary period; restrictions on operations and increased costs attributable to environmental considerations; the difficulty of the capital markets in absorbing utility securities; the availability of fuel for electric generation at reasonable prices, including among other considerations the potential rise in fuel costs and the costs associated with conversion to alternate fuel sources; technical cost factors and other problems associated with construction, licensing, regulation and operation of nuclear facilities for electric generation, including among other considerations the problems associated with the use of radioactive materials and the disposal of radioactive waste; and the effects of energy conservation. Certain of the issuers of these bonds may own or operate nuclear generating facilities. Federal, state, and municipal governmental authorities may from time to time review and revise existing requirements and impose additional requirements on such facilities. Problems of the type referred to above could adversely affect the ability of the issuer of public power revenue bonds to make payments of principal and/or interest on such bonds. Certain municipal utilities or agencies may have entered into contractual arrangements with investor-owned utilities and large industrial users and consequently may be dependent in varying degrees on the performance of such contracts for payment of bond debt service. Also, the enforceability against municipalities of “take-and-pay” and “take-or-pay” contracts which secure bonds issued by other municipal issuers has been successfully challenged in recent years.

*Transportation Revenue Bonds.* Bonds in this category include bonds issued for airport facilities, bridges, turnpikes, port facilities, railroad systems, or mass transit systems. Generally, airport facility revenue bonds are payable from and secured by the revenues derived from the ownership and operation of a particular airport. Payment on other transportation bonds is often dependent primarily or solely on revenues from financed facilities, including user fees, charges, tolls and rents. Such revenues may be adversely affected by increased construction and maintenance costs or taxes, decreased use, competition from alternative facilities, scarcity of fuel, reduction or loss of rents, or the impact of environmental considerations. Other transportation bonds may be dependent primarily or solely on Federal, state or local assistance including motor fuel and motor vehicle taxes, fees and licenses and therefore, may be subject to fluctuations in such assistance.

*Water and Sewage Revenue Bonds.* Bonds in this category include securities issued to finance public water supply treatment and distribution facilities, and sewage collection, treatment and disposal facilities. Repayment of these bonds is dependent primarily on revenues derived from the billing of customers for water and sewer services, as well as, in some instances, connection fees and hook-up charges. Such revenue bonds may be adversely affected by the lack of availability of Federal and state grants and by decisions of Federal and state regulatory bodies and courts.

*Solid Waste and Resource Recovery Revenue Bonds.* Bonds in this category include securities issued to finance facilities for removal and disposal of solid waste. Repayment of these bonds is dependent on factors which may include revenues from appropriations from a governmental entity, the financial condition of the private project corporation and revenues derived from the collection of charges for disposal of solid waste. In addition, construction and operation of such facilities may be subject to cost overruns. Repayment of resource recovery bonds may also be dependent to various degrees on revenues from the sale of electric energy or steam. Bonds in this category may be subject to mandatory redemption in the event of project non-completion, if the project is rendered uneconomical, if the project fails to meet certain performance criteria, or if it is considered an environmental hazard.

*Pollution Control Facility Revenue Bonds.* Bonds in the pollution control facilities category include securities issued on behalf of private corporations, including utilities, to provide facilities for the treatment of air, water and solid waste pollution. Repayment of these bonds is dependent upon income from and/or the financial condition of the project corporation. In addition, governmental entities may from time to time impose additional restrictions or regulations which could adversely affect the cost or operation of the facility.

*Educational Facility Revenue Bonds.* Educational facility revenue bonds include debt of state and private colleges, universities and systems, and parental and student loan obligations. The ability of universities and colleges to meet their obligations is dependent on various factors, including the revenues, costs and enrollment levels of the institutions. In addition, their ability may be affected by declines in Federal, state, and alumni financial support, fluctuations in interest rates and construction costs, increased maintenance and energy costs, failure or inability to raise tuition or room charges and adverse results of endowment fund investments.

*Tax Increment Bonds.* Tax increment bonds are issued to finance various public improvements and redevelopment projects in blighted areas. Interest on such bonds is payable from increases in real property taxes attributable to increases in assessed value resulting from the redevelopment of the blighted project area. Repayment risks include, among other things, a reduction in taxable value in the project areas, reduction in tax rates, delinquencies in tax payments or a general shortfall in forecasted tax revenues.

*Commercial Facility Revenue Bonds.* The Fund may also invest in bonds for other commercial facilities (including hotels) and industrial enterprises. The viability of such facilities depends on, among other things, general economic factors affecting those industries and affecting those geographic areas in which such facilities are situated, as well as the ability of the individual management of those facilities to maximize earnings and to remain competitive within its service area.

### **Municipal Lease Obligations**

Municipal lease obligations are Municipal Obligations that may take the form of leases, installment purchase contracts or conditional sales contracts, or participation certificates with respect to such contracts or leases. Municipal lease obligations are issued by state and local governments and authorities to purchase land or various types of equipment and facilities. Although municipal lease obligations do not constitute general obligations of the municipality for which the municipality's taxing power is pledged, they ordinarily are backed by the municipality's covenant to budget for, appropriate and make the payments due under the lease obligation. The leases underlying certain Municipal Obligations, however, provide that lease payments are subject to partial or full abatement if, because of material damage or destruction of the leased property, there is substantial interference with the lessee's use or occupancy of such property. This "abatement risk" may be reduced by the existence of insurance covering the leased property, the maintenance by the lessee of reserve funds or the provision of credit enhancements such as letters of credit.

The liquidity of municipal lease obligations varies. Certain municipal lease obligations contain "non-appropriation" clauses which provide that the municipality has no obligation to make lease or installment purchase payments in future years unless money is appropriated for such purpose on a yearly basis. Some municipal lease obligations of this type are insured as to timely payment of principal and interest, even in the event of a failure by the municipality to appropriate sufficient funds to make payments under the lease. However, in the case of an uninsured municipal lease obligation, the Fund's ability to recover under the lease in the event of non-appropriation or default will be limited solely to the repossession of the leased property, without recourse to the general credit of the lessee, and disposition of the property in the event of foreclosure might prove difficult. The Fund does not intend to invest a significant portion of its assets in such uninsured "non-appropriation" municipal lease obligations. There is no limitation on the Fund's ability to invest in other municipal lease obligations.

### **Zero Coupon Obligations**

The Fund may invest in zero coupon Municipal Obligations. Such obligations include "pure zero" obligations, which pay no interest for their entire life (either because they bear no stated rate of interest or because their stated rate of interest is not payable until maturity), and "zero/fixed" obligations, which pay no interest for an initial period and thereafter pay interest currently. Zero coupon obligations also include derivative instruments representing the principal-only components of Municipal Obligations from which the interest components have been stripped and sold separately by the holders of the underlying Municipal Obligations. Zero coupon securities usually trade at a deep discount from their face or par value and will be subject to greater fluctuations in market value in response to changing interest rates than obligations of comparable maturities that make current distributions of interest.

### **Floating and Variable Rate Obligations**

The Fund may also purchase floating and variable rate municipal notes and bonds, which frequently permit the holder to demand payment of principal at any time, or at specified intervals, and permit the issuer to prepay principal, plus accrued interest, at its discretion after a specified notice period. The issuer's obligations under the demand feature of such notes and bonds generally are secured by bank letters of credit or other credit support arrangements. There frequently will be no secondary market for variable and floating rate obligations held by the Fund, although the Fund may be able to obtain payment of principal at face value by exercising the demand feature of the obligation.

## **Participation Interests**

The Fund may invest in participation interests in municipal bonds, including IDBs, PABs, and floating and variable rate securities. A participation interest gives the Fund an undivided interest in a municipal bond owned by a bank. The Fund has the right to sell the instrument back to the bank. Such right is generally backed by the bank's irrevocable letter of credit or guaranty and permits the Fund to draw on the letter of credit on demand, after specified notice, for all or any part of the principal amount of the Fund's participation interest plus accrued interest. Generally, the Fund intends to exercise the demand under the letters of credit or other guarantees only upon a default under the terms of the underlying bond, or to maintain compliance with the investment objective and policies of the Fund. The ability of a bank to fulfill its obligations under a letter of credit or guaranty might be affected by possible financial difficulties of its borrowers, adverse interest rate or economic conditions, regulatory limitations or other factors. The Administrator will be responsible for the Fund being provided the services of monitoring the pricing, quality and liquidity of the participation interests held by the Fund, and the credit standing of banks issuing letters of credit or guarantees supporting such participation interests on the basis of published financial information reports of rating services and bank analytical services.

## **Put Bonds**

Put bonds are municipal bonds which give the holder an unconditional right to sell the bond back to the issuer or a remarketing agent at a specified price and exercise date, which is typically well in advance of the bond's maturity date. If the put is a "one time only" put, the Fund ordinarily will sell the bond or put the bond, depending on the more favorable price. If the bond has a series of puts after the first put, the bond will be held as long as, in the opinion of the Investment Adviser, it is in the best interests of the Fund to do so. The obligation to purchase the bond on the exercise date of the put may be supported by a letter of credit or other credit support agreement from a bank, insurance company or other financial institution, the credit standing of which affects the credit standing of the obligation. There is no assurance that an issuer or remarketing agent for a put bond will be able to repurchase the bond on the put exercise date if the Fund chooses to exercise its right to put the bond back to the issuer or remarketing agent.

## **Tender Option Bonds**

Tender option bonds are long-term municipal securities sold by a bank subject to a "tender option" that gives the purchaser the right to tender them to the bank at par plus accrued interest at designated times (the "tender option"). The tender option may be exercisable at intervals ranging from bi-weekly to semi-annually, and the interest rate on the bonds is typically reset at the end of the applicable interval in order to cause the bonds to have a market value that approximates their par value. The tender option generally would not be exercisable in the event of a default on, or significant downgrading of, the underlying municipal securities. Therefore, the Fund's ability to exercise the tender option will be affected by the credit standing of both the bank involved and the issuer of the underlying securities.

**FORM OF PUERTO RICO RESIDENCY REPRESENTATION LETTER  
(FOR INDIVIDUALS)**

[Date]

TO: UBS Financial Services Incorporated of Puerto Rico  
San Juan, Puerto Rico

R-G Investments Corporation  
San Juan, Puerto Rico

RE: Puerto Rico Mortgage-Backed & U.S. Government Securities Fund, Inc.

Dear Sirs:

I am the owner of, or propose to purchase, shares of common stock, shares of preferred stock, units or debt securities (collectively, "Securities") of the Puerto Rico Mortgage-Backed & U.S. Government Securities Fund, Inc. (the "Fund").

The Fund has represented in its Prospectus that the Securities are exempt from registration under the Securities Act of 1933 and that the Fund is exempt from registration under the U.S. Investment Company Act of 1940, based in part on the requirements that: Securities may only be sold in accordance with the Prospectus of the Fund, and then only to individuals who have their principal residence in Puerto Rico or to corporations or other business organizations that have their principal office and principal place of business within Puerto Rico ("Puerto Rico Residents"), who in each case have executed a Puerto Rico residency representation letter in the form provided by the Fund.

I hereby represent to you that:

1. I have acquired or propose to acquire the Securities for my own account and will be the sole beneficial owner thereof.
2. At the time the Securities were offered to me, and as of the date of this letter, I was and am an individual whose principal residence is in Puerto Rico.
3. If I cease to be a Puerto Rico Resident, I will (i) notify you or the Fund within 30 days of ceasing to be a Puerto Rico Resident, (ii) liquidate my investment in the Fund when such liquidation becomes economically feasible, and (iii) not acquire additional Securities.
4. I acknowledge having received and read a copy of the Prospectus and Prospectus Supplements, if any, relating to the offering of the Shares by the Fund. I further acknowledge that (i) an investment in the Shares may not be suitable to all investors as they are designed primarily for long-term investors, (ii) investors in the Shares should not view the Fund as a vehicle for trading purposes, and (iii) an investment in the Fund is not equivalent to an investment in the underlying securities of the Fund.
5. I hereby acknowledge that the Fund may issue debt securities and/or preferred stock or otherwise engage in activities that may constitute leverage. In that regard, I fully understand the risks to the Fund and my investment in the Fund resulting from leverage including, but not limited to, the risks described in the Prospectus of the Fund under "Special Leverage Considerations" and "Appendix G — Hedging and Related Income Strategies."
6. I hereby acknowledge that the Shares are not deposits or obligations of, or guaranteed or endorsed by any bank or other insured depository institution and are not insured by the Federal Deposit Insurance Corporation, the Federal Reserve Board or any other government agency.

Very truly yours,

**FORM OF PUERTO RICO RESIDENCY REPRESENTATION LETTER  
(FOR BUSINESS ORGANIZATIONS)**

[Date]

TO: UBS Financial Services Incorporated of Puerto Rico  
San Juan, Puerto Rico

R-G Investments Corporation  
San Juan, Puerto Rico

RE: Puerto Rico Mortgage-Backed & U.S. Government Securities Fund, Inc.

Dear Sirs:

We are the owner of, or propose to purchase, shares of common stock, shares of preferred stock, units or debt securities (collectively, "Securities") of the Puerto Rico Mortgage-Backed & U.S. Government Securities Fund, Inc.(the "Fund").

The Fund has represented in its Prospectus that the Securities are exempt from registration under the Securities Act of 1933 and that the Fund is exempt from registration under the U.S. Investment Company Act of 1940, based in part on the requirements that: Securities may only be sold in accordance with the Prospectus of the Fund, and then only to individuals who have their principal residence in Puerto Rico or to corporations or other business organizations that have their principal office and principal place of business within Puerto Rico ("Puerto Rico Residents"), who in each case have executed a Puerto Rico residency representation letter in the form provided by the Fund.

We hereby represent to you that:

1. We have acquired or propose to acquire the Securities for our own account and will be the sole beneficial owner thereof.
2. At the time the Securities were offered to us, and as of the date of this letter, we were and are a corporation, partnership, trust or other form of business organization that has its principal office and principal place of business within Puerto Rico, and that has not been organized for the purpose of acquiring the Securities.
3. If we cease to be a Puerto Rico Resident, we will (i) notify you or the Fund within 30 days of ceasing to be a Puerto Rico Resident, (ii) liquidate our investment in the Fund when such liquidation becomes economically feasible, and (iii) not acquire additional Securities.
4. We acknowledge having received and read a copy of the Prospectus and Prospectus Supplements, if any, relating to the offering of the Shares by the Fund. We further acknowledge that (i) an investment in the Shares may not be suitable to all investors as they are designed primarily for long-term investors, (ii) investors in the Shares should not view the Fund as a vehicle for trading purposes, and (iii) an investment in the Fund is not equivalent to an investment in the underlying securities of the Fund.
5. We hereby acknowledge that the Fund may issue debt securities and/or preferred stock or otherwise engage in activities that may constitute leverage. In that regard, we fully understand the risks to the Fund and our investment in the Fund resulting from leverage including, but not limited to, the risks described in the Prospectus of the Fund under "Special Leverage Considerations" and "Appendix G — Hedging and Related Income Strategies."
6. We are not an employee benefit plan subject to Section 406 of the Employee Retirement Income Security Act of 1974, as amended, or to Section 4975 of the Internal Revenue Code of 1986, as amended (or comparable provisions of any subsequent enactments), or a trustee of any such plan

7. We hereby acknowledge that the Shares are not deposits or obligations of, or guaranteed or endorsed by any bank or other insured depository institution and are not insured by the Federal Deposit Insurance Corporation, the Federal Reserve Board or any other government agency.

Very truly yours,

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## RATINGS OF SECURITIES

### Description of Moody's Investors Service, Inc.'s ("Moody's") Long-Term Ratings

The purpose of Moody's ratings is to provide investors with a simple system of gradation by which the relative creditworthiness of securities may be noted. Gradations of creditworthiness are indicated by rating symbols, with each symbol representing a group in which the credit characteristics are broadly the same. There are nine symbols as shown below, from that used to designate least credit risk to that denoting greatest credit risk.

Moody's long-term obligation ratings are opinions of the relative credit risk of fixed-income obligations with an original maturity of one year or more. They address the possibility that a financial obligation will not be honored as promised. Such ratings reflect both the likelihood of default and any financial loss suffered in the event of default.

**Aaa** — Obligations rated Aaa are judged to be of the highest quality, with minimal credit risk.

**Aa** — Obligations rated Aa are judged to be of high quality and are subject to very low credit risk.

**A** — Obligations rated A are considered upper-medium grade and are subject to low credit risk.

**Baa** — Obligations rated Baa are subject to moderate credit risk. They are considered medium grade and as such may possess certain speculative characteristics.

**Ba** — Obligations rated Ba are judged to have speculative elements and are subject to substantial credit risk.

**B** — Obligations rated B are considered speculative and are subject to high credit risk.

**Caa** — Obligations rated Caa are judged to be of poor standing and are subject to very high credit risk.

**Ca** — Obligations rated Ca are highly speculative and are likely in, or very near, default, with some prospect of recovery of principal and interest.

**C** — Obligations rated C are the lowest rated class of bonds and are typically in default, with little prospect for recovery of principal or interest.

**Note:** Moody's appends numerical modifiers 1, 2, and 3 to each generic rating classification from Aa through Caa. The modifier 1 indicates that the obligation ranks in the higher end of its generic rating category; the modifier 2 indicates a mid-range category; and the modifier 3 indicates a ranking in the lower end of that generic rating category.

### Description of Moody's Short-Term Ratings

Moody's short-term issuer ratings are opinions of the ability of issuers to honor short-term financial obligations. Ratings may be assigned to issuers, short-term programs or to individual short term debt instruments. Such obligations generally have an original maturity not exceeding thirteen months, unless explicitly noted. Moody's employs the following designations to indicate the relative repayment ability of rated issuers:

**P-1.** Issuers (or supporting institutions) rated P-1 have a superior ability to repay short-term debt obligations.

**P-2.** Issuers (or supporting institutions) rated P-2 have a strong ability to repay short-term debt obligations.

**P-3.** Issuers (or supporting institutions) rated P-3 have an acceptable ability to repay short-term debt obligations.

**NP.** Issuers (or supporting institutions) rated Not Prime do not fall within any of the Prime rating categories.



## **Description of Moody's U.S. Municipal Short-Term Debt and Variable Rate Demand Obligations (VRDOs) Ratings**

There are three rating categories for short-term municipal obligations that are considered investment grade. These ratings are designated as Moody's Investment Grade (MIG) and are divided into three levels — MIG 1 through MIG 3. In addition, those short-term obligations that are of speculative quality are designated SG, or speculative grade. MIG ratings expire at note maturity.

**MIG1.** This designation denotes superior credit quality. Excellent protection is afforded by established cash flows, highly reliable liquidity support, or demonstrated broad-based access to the market for refinancing.

**MIG2.** This designation denotes strong credit quality. Margins of protection are ample, although not so large as in the preceding group.

**MIG3.** This designation denotes acceptable credit quality. Liquidity and cash flow protection may be narrow and market access for refinancing is likely to be less well established.

**SG.** This designation denotes speculative-grade credit quality. Debt instruments in this category may lack sufficient margins of protection. In the case of variable rate demand obligations (VRDOs), a two-component rating is assigned; a long or short-term debt rating and a demand obligation rating. The first element represents Moody's evaluation of the degree of risk associated with scheduled principal and interest payments. The second element represents Moody's evaluation of the degree of risk associated with the ability to receive purchase price upon demand ("demand feature"), using a variation of the MIG rating scale, the variable Municipal Investment Grade or VMIG rating. The short-term rating assigned to the demand feature of VRDOs is designated as VMIG. When either the long- or short-term aspect of a VRDO is not rated, that piece is designated NR, e.g., Aaa/NR or NR/VMIG 1. VMIG rating expirations are a function of each issue's specific structural or credit features.

**VMIG1.** This designation denotes superior credit quality. Excellent protection is afforded by the superior short-term credit strength of the liquidity provider and structural and legal protections that ensure the timely payment of purchase price upon demand.

**VMIG 2.** This designation denotes strong credit quality. Good protection is afforded by the strong short-term credit strength of the liquidity provider and structural and legal protections that ensure the timely payment of purchase price upon demand.

**VMIG 3.** This designation denotes acceptable credit quality. Adequate protection is afforded by the satisfactory short-term credit strength of the liquidity provider and structural and legal protections that ensure the timely payment of purchase price upon demand.

**SG.** This designation denotes speculative-grade credit quality. Demand features rated in this category may be supported by a liquidity provider that does not have an investment grade short-term rating or may lack the structural and/or legal protections necessary to ensure the timely payment of purchase price upon demand.

## **Description of Issue Credit Rating Definitions of Standard & Poor's, a Division of the McGraw-Hill Companies, Inc. ("S&P")**

An S&P issue credit rating is a current opinion of the creditworthiness of an obligor with respect to a specific financial obligation, a specific class of financial obligations, or a specific financial program (such as medium-term note programs and commercial paper programs). The rating takes into consideration the creditworthiness of guarantors, insurers, or other forms of credit enhancement on the obligation, as well as the currency in which the obligation is denominated. The issue credit rating is not a recommendation to purchase, sell, or hold a financial obligation, inasmuch as it does not comment as to market price or suitability for a particular investor.

Issue credit ratings are based on information furnished by the obligors or obtained by S&P from other sources it considers reliable. S&P does not perform an audit in connection with any credit rating and may, on occasion, rely on unaudited financial information. Credit ratings may be changed, suspended, or withdrawn as a result of changes in, or unavailability of, such information.

Issue credit ratings can be either long-term or short-term. Short-term ratings are generally assigned to those obligations considered short-term in the relevant market. In the U.S., for example, that means obligations with an original maturity of no more

than 365 days - including commercial paper. Short-term ratings are also used to indicate the creditworthiness of an obligor with respect to put features on long-term obligations. The result is a dual rating, in which the short-term rating addresses the put feature, in addition to the usual long-term rating. Medium-term notes are assigned long-term ratings.

### ***Long-Term Issue Credit Ratings***

Issue credit ratings are based, in varying degrees, on the following considerations:

- I. Likelihood of payment capacity and willingness of the obligor to meet its financial commitment on an obligation in accordance with the terms of the obligation;
  - II. Nature of and provisions of the obligations; and
  - III. Protection afforded by, and relative position of, the obligation in the event of bankruptcy, reorganization, or other arrangement under the laws of bankruptcy and other laws affecting creditors' rights.
- The issue rating definitions are expressed in terms of default risk. As such, they pertain to senior obligations of an entity.

Junior obligations are typically rated lower than senior obligations, to reflect the lower priority in bankruptcy, as noted above. (Such differentiation applies when an entity has both senior and subordinated obligations, secured and unsecured obligations, or operating company and holding company obligations.) Accordingly, in the case of junior debt, the rating may not conform exactly with the category definition.

**AAA** — An obligation rated “AAA” has the highest rating assigned by S&P. The obligor’s capacity to meet its financial commitments on the obligation is extremely strong.

**AA** — An obligation rated “AA” differs from the highest rated obligors only in small degree. The obligor’s capacity to meet its financial commitments on the obligation is very strong.

**A** — An obligation rated “A” is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligors in higher-rated categories. However, the obligor’s capacity to meet its financial commitments on the obligation is still strong.

**BBB** — An obligation rated “BBB” exhibits adequate protection parameters. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligor to meet its financial commitments on the obligation.

**BB, B, CCC, CC, C** — Obligations rated “BB,” “B,” “CCC,” and “CC” are regarded as having significant speculative characteristics. “BB” indicates the least degree of speculation and “CC” the highest. While such obligors will likely have some quality and protective characteristics, these may be outweighed by large uncertainties or major exposures to adverse conditions.

**BB** — An obligation rated “BB” is less vulnerable to nonpayment than other speculative issues. However, it faces major ongoing uncertainties or exposure to adverse business, financial, or economic conditions which could lead to the obligor’s inadequate capacity to meet its financial commitments on the obligation.

**B** — An obligation rated “B” is more vulnerable to nonpayment than obligations rated “BB,” but the obligor currently has the capacity to meet its financial commitment on the obligation. Adverse business, financial, or economic conditions will likely impair the obligor’s capacity or willingness to meet its financial commitment on the obligation.

**CCC** — An obligation rated “CCC” is currently vulnerable to nonpayment and is dependent upon favorable business, financial, and economic conditions for the obligor to meet its financial commitments on the obligation. In the event of adverse business, financial, or economic conditions, the obligor is not likely to have the capacity to meet its financial commitments on the obligation.

**CC** — An obligation rated “CC” is currently highly vulnerable to nonpayment.

**C** — A “C” rating may be used to cover a situation where a bankruptcy petition has been filed or similar action taken, but payments on this obligation are being continued. A “C” also will be assigned to a preferred stock issue in arrears on dividends or sinking fund payments, but that is currently paying.

**SD and D** — An obligor rated “SD” (Selective Default) or “D” has failed to pay one or more of its financial obligations (rated or unrated) when it came due. A “D” rating is assigned when S&P believes that the default will be a general default and that the obligor will fail to pay all or substantially all of its obligations as they come due. An “SD” rating is assigned when S&P believes that the obligor has selectively defaulted on a specific issue or class of obligations but it will continue to meet its payment obligations on other issues or classes of obligations in a timely manner. Please see S&P’s issue credit ratings, for a more detailed description of the effects of a default on specific issues or classes of obligations.

**N.R.** — An issuer designated N.R. is not rated.

Plus (+) or minus (-). The ratings from “AA” to “CCC” may be modified by the addition of a plus or minus sign to show relative standing within the major rating categories.

**Public Information Ratings** — Ratings with a “pi” subscript are based on an analysis of an issuer’s published financial information, as well as additional information in the public domain. They do not, however, reflect in-depth meetings with an issuer’s management and are therefore based on less comprehensive information than ratings without a “pi” subscript. Ratings with a “pi” subscript are reviewed annually based on a new year’s financial statements, but may be reviewed on an interim basis if a major event occurs that may affect the issuer’s credit quality.

Outlooks are not provided for ratings with a “pi” subscript, nor are they subject to potential CreditWatch listings. Ratings with a “pi” subscript generally are not modified with “+” or “-” designations. However, such designations may be assigned when the issuer’s credit rating is constrained by sovereign risk or the credit quality of a parent company or affiliated group.

### ***Short-Term Issue Credit Ratings***

**A-1** — This designation indicates that the degree of safety regarding timely payment is strong. Those issues determined to possess extremely strong safety characteristics are denoted with a plus sign (+) designation.

**A-2** — Capacity for timely payment on issues with this designation is satisfactory. However, the relative degree of safety is not as high as for issues designated “A-1.”

**A-3** — Issues carrying this designation have an adequate capacity for timely payment. They are, however, more vulnerable to the adverse effects of changes in circumstances than obligations carrying the higher designations.

**B** — Issuers rated “B” are regarded as having only speculative capacity for timely payment.

**C** — This rating is assigned to short term debt obligations with a doubtful capacity for payment.

**SD and D** — An obligor rated “SD” (Selective Default) or “D” has failed to pay one or more of its financial obligations (rated or unrated) when it came due. A “D” rating is assigned when S&P believes that the default will be a general default and that the obligor will fail to pay all or substantially all of its obligations as they come due. An “SD” rating is assigned when S&P believes that the obligor has selectively defaulted on a specific issue or class of obligations but it will continue to meet its payment obligations on other issues or classes of obligations in a timely manner. Please see S&P’s issue credit ratings, for a more detailed description of the effects of a default on specific issues or classes of obligations.

**N.R.** — An issuer designated N.R. is not rated.

### **Description of Fitch Ratings’ (“Fitch”) Credit Ratings**

Fitch credit ratings are an opinion on the ability of an entity or of a securities issue to meet financial commitments, such as interest, preferred dividends, or repayment of principal, on a timely basis.

Credit ratings are used by investors as indications of the likelihood of repayment in accordance with the terms on which they invested. Thus, the use of credit ratings defines their function: “investmentgrade” ratings (international long-term “AAA” —

“BBB” categories; short-term “F-1” — “F-3”) indicate a relatively low probability of default, while those in the “speculative” or “non-investment grade” categories (international long-term “BB” — “D”; short-term “B” — “D”) may signal a higher probability of default or that a default has already occurred. Ratings imply no specific prediction of default probability.

Entities or issues carrying the same rating are of similar but not necessarily identical credit quality since the rating categories do not fully reflect small differences in the degrees of credit risk.

Fitch credit and other ratings are not recommendations to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of any payments of any security. The ratings are based on information obtained from issuers, other obligors, underwriters, their experts, and other sources Fitch believes to be reliable. Fitch does not audit or verify the truth or accuracy of such information. Ratings may be changed or withdrawn as a result of changes in, or the unavailability of, information or for other reasons.

### ***Analytical Considerations***

When assigning ratings, the agency considers the historical and prospective financial condition, quality of management, and operating performance of the issuer and of any guarantor, any special features of a specific issue or guarantee, the issue’s relationship to other obligations of the issuer, as well as developments in the economic and political environment that might affect the issuer’s financial strength and credit quality.

Investment-grade ratings reflect expectations of timeliness of payment. However, ratings of different classes of obligations of the same issuer may vary based on expectations of recoveries in the event of a default or liquidation. Recovery expectations, which are the amounts expected to be received by investors after a security defaults, are a relatively minor consideration in investment-grade ratings, but Fitch does “notching” of particular issues to reflect their degree of preference in a winding up, liquidation, or reorganization as well as other factors. Recoveries do, however, gain in importance at lower rating levels, because of the greater likelihood of default, and become the major consideration at the “DDD” category. Factors that affect recovery expectations include collateral and seniority relative to other obligations in the capital structure.

Fitch Ratings bases the differential between preferred/preference stock and senior and subordinated debt on the issuer’s senior debt rating, the specific terms and conditions of the preferred instrument, the amount of preferred stock and of subordinated debt in the capital structure, coverage ratios, the use of proceeds from a preferred issue, the issuer’s rating outlook, and the influence of regulators on the issuer’s ability to pay preferred dividends. For rating purposes, Fitch generally treats preferred stock in a manner similar to that it adopts for deeply subordinated debt. The degree of “notching”, or number of rating grades below senior debt, will be narrower for investment-grade entities and wider for those in the speculative grades.

Variable rate demand obligations and other securities which contain a demand feature will have a dual rating, such as “AAA/F1+.” The first rating denotes long-term ability to make principal and interest payments. The second rating denotes ability to meet a demand feature in full and on time.

The following ratings scale applies to foreign currency and local currency ratings.

### ***International Long-Term Credit Ratings***

International credit ratings assess the capacity to meet foreign or local currency commitments. Both foreign and local currency ratings are internationally comparable assessments. The local currency rating measures the probability of payment only within the sovereign state’s currency and jurisdiction.

#### **Investment Grade**

**AAA — Highest credit quality.** “AAA” ratings denote the lowest expectation of credit risk. They are assigned only in case of exceptionally strong capacity for timely payment of financial commitments. This capacity is highly unlikely to be adversely affected by foreseeable events.

**AA — Very high credit quality.** “AA” ratings denote a very low expectation of credit risk. They indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.

**A — High credit quality.** “A” ratings denote a low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be more vulnerable to changes in circumstances or in economic conditions than is the case for higher ratings.

**BBB — Good credit quality.** “BBB” ratings indicate that there is currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity. This is the lowest investment-grade category.

#### Speculative Grade

**BB — Speculative.** “BB” ratings indicate that there is a possibility of credit risk developing, particularly as the result of adverse economic change over time; however, business or financial alternatives may be available to allow financial commitments to be met. Securities rated in this category are not investment grade.

**B — Highly speculative.** “B” ratings indicate that significant credit risk is present, but a limited margin of safety remains. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.

**CCC, CC, C — High default risk.** Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. A “CC” rating indicates that default of some kind appears probable. “C” ratings signal imminent default.

**DDD, DD, D — Default.** The ratings of obligations in this category are based on their prospects for achieving partial or full recovery in a reorganization or liquidation of the obligor. While expected recovery values are highly speculative and cannot be estimated with any precision, the following serve as general guidelines. “DDD” obligations have the highest potential for recovery, around 90% - 100% of outstanding amounts and accrued interest. “DD” indicates potential recoveries in the range of 50% - 90% and “D” the lowest recovery potential, i.e., below 50%.

Entities rated in this category have defaulted on some or all of their obligations. Entities rated “DDD” have the highest prospect for resumption of performance or continued operation with or without a formal reorganization process. Entities rated “DD” and “D” are generally undergoing a formal reorganization or liquidation process; those rated “DD” are likely to satisfy a higher portion of their outstanding obligations, while entities rated “D” have a poor prospect of repaying all obligations.

#### ***International Short-Term Credit Ratings***

A short-term rating has a time horizon of less than 12 months for most obligations, or up to three years for U.S. public finance securities, and thus places greater emphasis on the liquidity necessary to meet financial commitments in a timely manner.

**F1 — Highest credit quality.** Indicates the strongest capacity for timely payment of financial commitments; may have an added “+” to denote any exceptionally strong credit feature.

**F2 — Good credit quality.** A satisfactory capacity for timely payment of financial commitments, but the margin of safety is not as great as in the case of the higher ratings.

**F3 — Fair credit quality.** The capacity for timely payment of financial commitments is adequate; however, near-term adverse changes could result in a reduction to non-investment grade.

**B — Speculative.** Minimal capacity for timely payment of financial commitments, plus vulnerability to near-term adverse changes in financial and economic conditions.

**C — High default risk.** Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon a sustained, favorable business and economic environment.

**D — Default.** Denotes actual or imminent payment default.

#### **Notes to Long-term and Short-term ratings:**

“+” or “-” may be appended to a rating to denote relative status within major rating categories. Such suffixes are not added to the “AAA” long-term rating category, to long-term rating categories below “CCC,” or to short-term ratings other than “F1.”

“NR” — Indicates that Fitch does not rate the issuer or issue in question.

“Withdrawn” — A rating is withdrawn when Fitch deems the amount of information available to be inadequate for rating purposes, or when an obligation matures, is called, or refinanced.

“Rating Watch” — Ratings are placed on Rating Watch to notify investors that there is a reasonable probability of a rating change and the likely direction of such change. These are designated as “Positive,” indicating a potential upgrade, “Negative,” for a potential downgrade, or “Evolving,” if ratings may be raised, lowered or maintained. Rating Watch is typically resolved over a relatively short period.

A Rating Outlook indicates the direction a rating is likely to move over a one to two-year period. Outlooks may be positive, stable or negative. A positive or negative Rating Outlook does not imply a rating change is inevitable. Similarly, companies whose outlooks are “stable” could be upgraded or downgraded before an outlook moves to positive or negative if circumstances warrant such an action. Occasionally, Fitch may be unable to identify the fundamental trend. In these cases, the Rating Outlook may be described as “evolving.”

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## CERTAIN OTHER TYPES OF INVESTMENTS

*American Depositary Receipts.* The Fund may invest in sponsored and un-sponsored American Depositary Receipts representing interests in securities issued by foreign issuers (collectively, “ADRs”). ADRs are receipts typically issued by a U.S. bank or trust company evidencing ownership of the underlying securities of foreign issuers. Generally, ADRs, in registered form, are denominated in U.S. dollars and are designed for use in the U.S. securities markets. Thus, these securities are not denominated in the same currency as the securities into which they may be converted. ADRs are subject to many of the risks inherent in investing in foreign securities, including confiscatory taxation or nationalization, and less comprehensive disclosure requirements for the underlying security. See “Securities of Foreign Issuers” below. In addition, the issuers of the securities underlying un-sponsored ADRs are not obligated to disclose material information in the United States and therefore, there may be less information available regarding such issuers and there may not be a correlation between such information and the market value of the ADRs.

*Bankers' Acceptances.* The Fund may invest in bankers' acceptances, which are short-term credit instruments used to finance commercial transactions. Generally, an acceptance is a time draft drawn on a bank by an exporter or an importer to obtain a stated amount of Funds to pay for specific merchandise. The draft is then “accepted” by a bank that, in effect unconditionally guarantees to pay the face value of the instrument on its maturity date. The acceptance may then be held by the accepting bank as an asset, or it may be sold in the secondary market at the going rate of interest for a specified maturity. Although maturities for acceptances can be as long as 270 days, most acceptances have maturities of six months or less.

*Certificates of Deposit.* The Fund may invest in bank certificates of deposit (“CDs”). The Federal Deposit Insurance Corporation is an agency of the U.S. Government that insures the deposits of certain banks and savings and loan associations up to \$100,000 per deposit. The interest on such deposits may not be insured if this limit is exceeded. Current federal regulations also permit such institutions to issue insured negotiable CDs in amounts of \$100,000 or more, without regard to the interest rate ceilings on other deposits. To remain fully insured, these investments currently must be limited to \$100,000 per insured bank or savings and loan association. Investments in CDs are made only with domestic institutions with assets in excess of \$1 billion.

*Commercial Paper.* The Fund may invest in commercial paper that is limited to obligations rated Prime-1 or Prime-2 by Moody's, or A-1 or A-2 by S&P and F-1 or F-2 by Fitch. Commercial paper includes notes, drafts or similar instruments payable on demand or having a maturity at the time of issuance not exceeding nine months, exclusive of days of grace or any renewal thereof. See Appendix C for a description of commercial paper ratings.

*Convertible Securities.* The Fund may invest in convertible securities that are rated as investment grade or, if not so rated, are deemed to be of comparable quality by the Investment Adviser. Investment grade securities rated in the lowest investment grade category are considered to have some speculative characteristics, and changes in economic conditions are more likely to lead to a weakened capacity to pay interest and repay principal than is the case with higher grade securities. While no securities investment is without some risk, investments in convertible securities generally entail less risk than the issuer's common stock, although the extent to which such risk is reduced depends in large measure upon the degree to which the convertible security sells above its value as a fixed income security. The Investment Adviser will decide to invest in convertible securities based upon a fundamental analysis of the long-term attractiveness of the issuer and the underlying common stock, the evaluation of the relative attractiveness of the current price of the underlying common stock, and the judgment of the value of the convertible security relative to the common stock at current prices. Convertible securities in which the Fund may invest include corporate bonds, notes and preferred stock that can be converted into common stock. Convertible securities combine the fixed-income characteristics of bonds and preferred stock with the potential for capital appreciation. As with all debt securities, the market value of convertible securities tends to decline as interest rates increase and conversely, to increase as interest rates decline. While convertible securities generally offer lower interest or dividend yields than nonconvertible debt securities of similar quality, they do enable the investor to benefit from increases in the market price of the underlying common stock.

*Debt Securities.* The Fund may invest in debt securities. The market value of debt securities is influenced primarily by changes in the level of interest rates. Generally, as interest rates rise, the market value of debt securities decreases. Conversely, as interest rates fall; the market value of debt securities increases. Factors that could result in a rise in interest rates, and a decrease in the market value of debt securities, include an increase in inflation or inflation expectations, an increase in the rate of Puerto Rico or U.S. economic growth, an increase in the Federal budget deficit or an increase in the price of commodities such as oil.

*Floating and Variable Rate Obligations.* The Fund may also purchase certain types of floating and variable rate securities. The interest payable on a variable rate obligation is adjusted at predesignated periodic intervals and on floating rate obligations, whenever there is a change in the market rate of interest on which the interest rate payable is based. There is a risk that the current interest rate on such obligations may not accurately reflect existing market interest rates. These obligations frequently permit the holder to demand payment of principal at any time, or at specified intervals, and permit the issuer to prepay,



at its discretion, principal plus accrued interest, in each case after a specified notice period. The issuer's obligations under the demand feature of such notes and bonds generally are secured by bank letters of credit or other credit support arrangements.

*Money Market Funds.* The Fund may invest in money market funds. These funds attempt to provide the highest current income possible through investment in a portfolio of short-term money market securities, consistent with the preservation of capital. While these funds typically invest in high quality investments, the value of an investment in these funds, among other things, remains subject to credit risk on the underlying instruments and volatility due to interest rate changes.

*Securities of Foreign Issuers.* There are certain risks connected with investing in foreign securities. These include risks of adverse political and economic developments (including possible governmental seizure or nationalization of assets), the possible imposition of exchange controls or other governmental restrictions, less uniformity in accounting and reporting requirements, the possibility that there will be less information on such securities and their issuers available to the public, the difficulty of obtaining or enforcing court judgments abroad, restrictions on foreign investments in other jurisdictions, difficulties in affecting repatriation of capital invested abroad, and difficulties in transaction settlements and the effect of delay on shareholder equity. Foreign securities may be subject to foreign taxes, and may be less marketable than comparable U.S. securities.

*Preferred Stock.* The Fund may invest in preferred stock. A preferred stock has a blend of the characteristics of a bond and common stock. It can offer the higher yield of a bond and have priority over common stock in equity ownership, but does not have the seniority of a bond and its participation in the issuer's growth may be limited. Preferred stock has preference over common stock in the receipt of dividends and in any residual assets after payment to creditors should the issuer be dissolved. Although the dividend is usually set at a fixed annual rate, in some circumstances it can be changed or omitted by the issuer.

*Real Estate Investment Trusts ("REITs").* REITs are entities that invest primarily in commercial real estate or real estate-related loans. A REIT is not taxed on income distributed to its shareholders if it complies with regulatory requirements relating to its organization, ownership, assets and income, and with the regulatory requirement that it distribute to its shareholders at least 95% of its taxable income for each taxable year. Generally, REITs can be classified as equity REITs, mortgage REITs and hybrid REITs. Equity REITs invest the majority of their assets in real property and derive their income primarily from rents and capital gains from appreciation realized through property sales. Mortgage REITs invest the majority of their assets in real estate mortgages and derive their income primarily from interest payments.

*Repurchase Agreements.* The Fund may invest in repurchase agreements. A repurchase agreement is a transaction in which the Fund purchases securities and simultaneously commits to resell the securities to the original seller (a member bank of the Federal Reserve System or a securities dealer who is a member of a national securities exchange or is a market maker in U.S. Government securities) at an agreed upon date and price reflecting a market rate of interest unrelated to the coupon rate or maturity of the purchased securities. Repurchase agreements carry certain risks not associated with direct investments in securities including possible decline in the market value of the underlying securities and costs to the Fund if the other party to the repurchase agreement becomes bankrupt, so that the Fund is delayed or prevented from exercising its rights to dispose of the collateral securities. The value of the underlying securities (or collateral) will be at least equal at all times to the total amount of the repurchase obligation, including the interest factor.

*U.S. Government Securities.* The Fund may invest in U.S. Government securities, including a variety of securities that are issued or guaranteed by the U.S. Government, its agencies or instrumentalities and repurchase agreements secured thereby. These securities include securities issued and guaranteed by the U.S. Government, such as Treasury bills, Treasury notes, and Treasury bonds; obligations supported by the right of the issuer to borrow from the U.S. Treasury, such as those of the Federal Home Loan Banks; and obligations supported only by the credit of the issuer, such as those of the Federal Intermediate Credit Banks.

*When-Issued and Delayed Delivery Transactions.* The Fund may enter into agreements with banks or broker-dealers for the purchase or sale of securities at an agreed-upon price on a specified future date. Such agreements might be entered into, for example, when the Investment Adviser anticipates a decline in interest rates and is able to obtain a more advantageous yield by committing currently to purchase securities to be issued later. When the Fund purchases securities on a when-issued or delayed delivery basis, it is required either (1) to create a segregated account with the Custodian and to maintain in that account cash, U.S. Government securities, or other high grade debt obligations in an amount equal on a weekly basis to the amount of the Fund's when-issued or delayed delivery commitments, or (2) to enter into an offsetting forward sale of securities it owns which are equal in value to those purchased. The Fund will only make commitments to purchase securities on a when-issued or delayed delivery basis with the intention of actually acquiring the securities. However, the Fund may sell these securities before the settlement date if it is deemed advisable as a matter of investment strategy. When the time comes to pay for when-issued or delayed delivery

securities, the Fund will meet its obligations from then available cash flow or the sale of securities, or although it would not normally expect to do so, from the sale of the when-issued or delayed delivery securities themselves (which may have a value greater or less than the Fund's payment obligation).

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## HEDGING AND RELATED INCOME STRATEGIES

*General Description of Hedging and Related Income Strategies.* As discussed in the Prospectus, the Fund may use a variety of financial instruments (“Derivative Instruments”), including securities options, financial futures contracts (“futures contracts”), options on futures contracts, and other interest rate protection transactions such as swap agreements, to attempt to hedge its portfolio of assets. The use of these instruments for income enhancement purposes subjects the Fund to substantial risks of losses which would not be offset by gains on other portfolio assets or acquisitions. The Fund may invest up to 5% of its assets in Derivative Instruments. Such limit may be exceeded only for the purpose of hedging and subject to the approval of the Board of Directors. However, the Fund will not enter into futures contracts or options thereon unless an exclusion or exemption or comparable relief from applicable registration requirements contained in the regulations administered by the CFTC is obtained by the Investment Adviser. There can be no assurance that such relief will be granted or that the strategies discussed in this Appendix F can be implemented.

Hedging strategies can be broadly categorized as “short hedges” and “long hedges.” A short hedge is a purchase or sale of a Derivative Instrument intended partially or fully to offset potential declines in the value of one or more investments held by the Fund. Thus, in a short hedge the Fund takes a position in a Derivative Instrument whose price is expected to move in the opposite direction of the price of the investment being hedged. For example, the Fund might purchase a put option on a security to hedge against a potential decline in the value of that security. If the price of the security declines below the exercise price of the put, the Fund could exercise the put and thus limit its loss below the exercise price to the premium paid plus transaction costs. In the alternative, because the value of the put option can be expected to increase as the value of the underlying security declines, the Fund might be able to close out the put option and realize a gain to offset the decline in the value of the security.

Conversely, a long hedge is a purchase or sale of a Derivative Instrument intended partially or fully to offset potential increases in the cost of one or more investments that the Fund intends to acquire. Thus, in a long hedge the Fund takes a position in the Derivative Instrument whose price is expected to move in the same direction as the price of the prospective investment being hedged. For example, the Fund might purchase a call option on a security it intends to purchase in order to hedge against an increase in the cost of the security. If the price of the security increases above the exercise price of the call, the Fund could exercise the call and thus limit its acquisition cost to the exercise price plus the premium paid and transaction costs. Alternatively, the Fund might be able to offset the price increase by closing out an appreciated call option and realizing a gain.

Derivative Instruments on securities generally are used to hedge against both price movements in one or more particular securities positions that the Fund owns or intends to acquire or fluctuations in interest rates. Derivative Instruments on bond indices, in contrast, generally are used to hedge against price movements in broad fixed income market sectors in which the Fund has invested or expects to invest.

In addition to the products, strategies and risks described below and in this Prospectus, the Investment Adviser expects to seek additional opportunities in connection with securities options, futures contracts and other hedging techniques. These new opportunities may become available as regulatory authorities broaden the range of permitted transactions and as new options, futures contracts or other techniques are developed. The Investment Adviser may utilize these opportunities to the extent that they are consistent with the Fund's investment objective and permitted by the Fund's investment limitations and applicable regulatory authorities.

*Special Risks of Hedging Strategies.* The use of Derivative Instruments involves special considerations and risks, as described below. Risks pertaining to particular Derivative Instruments are described in the sections that follow:

(1) Successful use of most Derivative Instruments depends upon the Investment Adviser's ability to predict movements of the overall securities and interest rate markets, which requires different skills than predicting changes in the prices of individual securities. While the Investment Adviser is experienced in the use of Derivative Instruments, there can be no assurance that any particular hedging strategy adopted will succeed.

(2) There might be imperfect correlation, or even no correlation, between price movements of a Derivative Instrument and price movements of the investments being hedged. For example, if the value of a Derivative Instrument used in a short hedge increased by less than the decline in value of the hedged investment, the hedge would not be fully successful. Such a lack of correlation might occur due to factors unrelated to the value of the investments being hedged, such as speculative or other pressures on the markets in which Derivative Instruments are traded. The effectiveness of hedges using Derivative Instruments on indices will depend on the degree of correlation between price movements in the index and price movements in the securities being hedged.

(3) Hedging strategies, if successful, can reduce risk of loss by wholly or partially offsetting the negative effect of unfavorable price movements in the investments being hedged. However, hedging strategies can also reduce opportunity for gain by offsetting the positive effect of favorable price movements in the hedged investments. For example, if the Fund entered into a short hedge because the Investment Adviser projected a decline in the price of a security in the Fund, and the price of that security increased instead, the gain from that increase might be wholly or partially offset by a decline in the price of the Derivative Instrument. Moreover, if the price of the Derivative Instrument declined by more than the increase in the price of the security, the Fund could suffer a loss. Depending on the degree of correlation between a Derivative Instrument and the security or interest rate being hedged, it is possible that the Fund could sustain losses on both positions. Similarly, transaction costs incurred in connection with a Derivative Instrument can exceed the amount of the benefits received. In any such case, the Fund would have been in a better position had it not hedged at all.

(4) As described below, the Fund might be required to maintain assets as “cover,” maintain segregated accounts or make margin payments when it takes positions in Derivative Instruments involving obligations to third parties (i.e., Derivative Instruments other than purchase options). If the Fund is unable to close out its positions in such Derivative Instruments, it might be required to continue to maintain such assets or accounts or make such payments until the position expires or matures. These requirements might impair the Fund's ability to sell a portfolio security or make an investment at a time when it would otherwise be favorable to do so, or require that the Fund sell a portfolio security at a disadvantageous time. The Fund's ability to close out a position in a Derivative Instrument prior to expiration or maturity depends on the existence of a liquid secondary market or, in the absence of such a market, the ability and willingness of a counterparty to enter into a transaction closing out the position. Therefore, there is no assurance that any hedging position can be closed out at a time and price that is favorable to the Fund.

(5) Although the Fund intends to purchase or sell futures contracts only if there is an active market for such contracts, no assurance can be given that a liquid market will exist for the contracts at any particular time. Most futures exchanges limit the amount of fluctuation permitted in futures contract prices during a single trading day. Once the daily limit has been reached in a particular contract, no trades may be made that day at a price beyond that limit. Futures contract prices could move the daily limit for several consecutive trading days with little or no trading, thereby preventing prompt liquidation of futures positions and subjecting some futures traders to substantial losses. In such event and in the event of adverse price movements, the Fund will be required to make daily cash payments of variation margin. In such circumstances, an increase in the value of the portion of the portfolio assets being hedged, if any, may offset, partially or completely, losses on the futures contract.

(6) If the Fund has hedged against the possibility of an increase in interest rates adversely affecting the value of securities held in its portfolio and rates decrease instead, the Fund will lose part or all of the benefit of the increased value of the securities which it has hedged because it will have offsetting losses in its futures positions. In addition, in such situations, if the Fund has insufficient cash, it may have to sell securities to meet daily variation margin requirements at a time when it may be disadvantageous to do so. These sales of securities may, but will not necessarily be at increased prices which reflect the decline in interest rates.

(7) Because of the low margin deposits normally required in futures contract trading (typically between 2% and 5% of the value of the contract purchased or sold), an extremely high degree of leverage is typical of a futures contract trading account. As a result, a relatively small price movement in a futures interest contract may result in immediate and substantial losses to the investor. For example, if at the time of purchase 5% of the price of a contract is deposited as margin, a 5% decrease in the value of the contract would, if the contract is then closed out, result in a total loss of the margin deposit before any deduction for brokerage commissions. A decrease of more than 5% would result in a loss of more than the total margin deposit. Thus, like other leveraged investments, any purchase or sale of a futures interest contract may result in losses in excess of the amount invested.

(8) Most U.S. commodity exchanges limit fluctuations in certain futures interest contract prices during a single day by regulations referred to as “daily price fluctuation limits” or “daily limits.” Pursuant to such regulations, during a single trading day no trades may be executed at prices beyond the daily limits. Once the price of a contract for a particular commodity has increased or decreased by an amount equal to the daily limit, positions in the commodity can neither be taken nor liquidated unless traders are willing to effect trades at or within the limit. Prices in various contracts have occasionally moved the daily limit for several consecutive days with little or no trading. Similar occurrences could prevent the Fund from promptly liquidating unfavorable positions and subject the Fund to substantial losses. While daily limits may reduce or effectively eliminate the liquidity of a particular market, they do not limit ultimate losses, and may in fact substantially increase losses because they may prevent the liquidation of unfavorable positions.

In addition, the Fund may not be able to execute trades at favorable prices if little trading in the contracts involved is taking place. Under some circumstances, the Fund may be required to accept or make delivery of the underlying financial

instrument if the position cannot be liquidated prior to its expiration date. It also is possible that an exchange or the CFTC may suspend trading in a particular contract, order immediate liquidation and settlement of a particular contract, or order that trading in a particular contract be conducted for liquidation only.

(9) The CFTC and the U.S. commodity exchanges have established limits referred to as “speculative position limits” or “position limits” on the maximum net long or net short position which any person or group of persons may own, hold, or control in particular futures contracts. Under currently applicable regulations, the Fund as a whole will be required to comply with position limits as if it were a single trader. Position limits may prevent the Fund from acquiring positions which might otherwise have been highly profitable. Any violation of speculative position limits would lead to mandatory liquidation of positions, possibly on unfavorable terms.

*Cover.* Transactions using Derivative Instruments which are not transacted on or subject to the rules of a regulated futures contract exchange or securities exchange, other than purchased options, will expose the Fund to an obligation to another party. The Fund will not enter into any such transactions unless it owns either (1) an offsetting (“covered”) position in securities or other options or futures contracts, or (2) cash, receivables, and/or short-term debt securities, with a value sufficient at all times to cover its potential obligations to the extent not covered as provided in (1) above.

Assets used as cover cannot be sold while the position in the corresponding Derivative Instrument is open, unless they are replaced with similar assets. As a result, the commitment of a large portion of the Fund's assets to cover could impede portfolio management or the Fund's ability to meet other current obligations.

*Covered Straddles.* The Fund may purchase and write (sell) covered straddles on securities or bond indices. A long straddle is a combination of a call and a put option purchased on the same security or on the same futures contract, where the exercise price of the put is less than or equal to the exercise price of the call. The Fund would enter into a long straddle when the Investment Adviser believes that it is likely that interest rates will be more volatile during the term of the option than the option pricing implies. A short straddle is a combination of a call and a put written on the same security where the exercise price of the put is less than or equal to the exercise price of the call. The Fund would enter into a short straddle when the Investment Adviser believes that it is unlikely that interest rates will be as volatile during the term of the options as the option pricing implies.

*Options.* The Fund may purchase put and call options, and write covered put and call options, on debt securities and bond indices. The purchase of call options serves as a long hedge, and the purchase of put options serves as a short hedge. Writing covered put options can enable the Fund to enhance income by reason of the premiums paid by the purchasers of such options. However, if the market price of the underlying security declines to less than the exercise price on the option, minus the premium received, the Fund would expect to suffer a loss. Writing covered call options serves as a limited short hedge, because declines in the value of the hedged investment would be offset to the extent of the premium received for writing the option. However, if the security appreciates to a price higher than the exercise price of the call option, it can be expected that the option will be exercised, and the Fund will be obligated to sell the security at less than its market value.

The value of an option position will reflect, among other things, the current market value of the underlying investment, the time remaining until expiration, the relationship of the exercise price to the market price of the underlying investment, the historical price volatility of the underlying investment and general market conditions. Options normally have expiration dates of up to nine months. Options that expire unexercised have no value.

The Fund may effectively terminate its right or obligation under an option by entering into a closing transaction. For example, the Fund may terminate its obligations under a call option that it has written by purchasing an identical call option. This is known as a closing purchase transaction. Conversely, the Fund may terminate a position in a put or call option it has purchased by writing an identical put or call option. This is known as a closing sale transaction. Closing transactions permit the Fund to realize profits or limit losses on an option position prior to its exercise or expiration.

The Fund may purchase or write both exchange-traded and OTC options. Exchange markets for options on debt securities exist but are relatively new, and these instruments are primarily traded on the OTC market. Exchange-traded options in the U.S. are issued by a clearing organization affiliated with the exchange on which the option is listed which, in effect, guarantees completion of every exchange-traded option transaction. In contrast, OTC options are contracts between the Fund and a counterparty (usually a securities dealer or a bank) with no clearing organization guaranty. Thus, when the Fund purchases or writes an OTC option, it relies on the party from whom it purchased the option or to whom it has written the option (the “counterparty”) to make or take delivery of the underlying investment upon exercise of the option. Failure by the counterparty to do so would result in the loss of any premium paid by the Fund as well as the loss of any expected benefit of the transaction.

Generally, the OTC debt options used by the Fund will be European-style options. This means that the option is only exercisable immediately prior to its expiration. This is in contrast to American-style options, which are exercisable at any time prior to the expiration date of the option.

The Fund's ability to establish and close out positions in exchange-listed options depends on the existence of a liquid market. The Fund intends to purchase or write only those exchange-traded options for which there appears to be a liquid secondary market. However, there can be no assurance that such a market will exist at any particular time. Closing transactions can be made for OTC options only by negotiating directly with the counterparty, or by a transaction in the secondary market if any such market exists. Although the Fund will enter into OTC options only with contra parties that are expected to be capable of entering into closing transactions with the Fund, there is no assurance that the Fund will in fact be able to close out an OTC option position at a favorable price prior to expiration. In the event of insolvency of the counterparty, the Fund might be unable to close out an OTC option position at any time prior to its expiration.

If the Fund were unable to effect a closing transaction for an option it had purchased it would have to exercise the option to realize any profit. The inability to enter into a closing purchase transaction for a covered call option written by the Fund could cause material losses because the Fund would be unable to sell the investment used as cover for the written option until the option expires or is exercised.

*Guideline for Options on Securities.* In view of the risks involved in using the options strategies described above, the Board of Directors has determined that the Fund may purchase a put or call option, including any straddles or spreads, only if the premium paid when aggregated with the premiums on all other options held by the Fund does not exceed 5% of the Fund's total assets. This guideline may be modified by the Board without Shareholder vote. Adoption of this guideline does not limit the percentage of the Fund's assets at risk to 5%.

*Futures.* The Fund may purchase and sell interest rate futures contracts and bond index futures contracts. The Fund may also purchase put and call options, and write covered put and call options, on futures in which it invests. The purchase of futures or call options thereon can serve as a long hedge, and the sale of futures or the purchase of put options thereon can serve as a short hedge. Writing covered call options on futures contracts can serve as a limited short hedge, using a strategy similar to that used for writing covered call options on securities or indices. Similarly, writing covered put options on futures contracts can serve as a limited long hedge.

The Fund may also write put options on interest rate futures contracts while at the same time purchasing call options on the same futures contracts in order synthetically to create a long futures contract position. Such options would have the same strike prices and expiration dates. The Fund will engage in this strategy only when it is more advantageous to the Fund than is purchasing the futures contract.

No price is paid upon entering into a futures contract. Instead, at the inception of a futures contract the Fund is required to deposit in a segregated account with its Custodian, in the name of the futures broker through whom the transaction was effected, "initial margin" consisting of cash, U.S. Government securities or other liquid, high-grade debt securities, in an amount generally equal to 2% to 5% or less of the contract, in accordance with applicable exchange rules. Unlike margin in securities transactions, initial margin on futures contracts does not represent a borrowing, but rather is in the nature of a performance bond or good-faith deposit that is returned to the Fund at the termination of the transaction if all contractual obligations have been satisfied. Under certain circumstances, such as periods of high volatility, the Fund may be required by an exchange to increase the level of its initial margin payment, and initial margin requirements might be increased generally in the future by regulatory actions.

Subsequent "variation margin" payments are made to and from the futures broker daily as the value of the futures position varies, a process known as "marking to market." Variation margin does not involve borrowing, but rather represents a daily settlement of the Fund's obligations to or from a futures broker. When the Fund purchases an option on a futures contract, the premium paid plus transaction costs is all that is at risk. In contrast, when the Fund purchases or sells a futures contract or writes a put or call option thereon, it is subject to daily variation margin calls that could be substantial in the event of adverse price movements. If the Fund has insufficient cash to meet daily variation margin requirements, it might need to sell securities at a time when such sales are disadvantageous.

Holders and writers of futures positions and options on futures can enter into offsetting closing transactions, similar to closing transactions on options, by selling or purchasing, respectively, an instrument identical to the instrument held or written. Positions in futures and options on futures may be closed only on an exchange or board of trade that provides a secondary market.

The Fund intends to enter into futures transactions only on exchanges or boards of trade where there appears to be a liquid secondary market. However, there can be no assurance that such a market will exist for a particular contract at a particular time. Secondary markets for options on futures are currently in the development stage, and the Fund will not trade options on futures on any exchange or board of trade unless, in the Investment Adviser's opinion, the markets for such options have developed sufficiently that the liquidity risks for such options are not greater than the corresponding risks for futures.

Under certain circumstances, futures exchanges may establish daily limits on the amount that the price of a future or related option can vary from the previous day's settlement price; once that limit is reached, no trades may be made that day at a price beyond the limit. Daily price limits do not limit potential losses because prices could move to the daily limit for several consecutive days with little or no trading, thereby preventing liquidation of unfavorable positions.

If the Fund was unable to liquidate a futures or related options positions due to the absence of a liquid secondary market or the imposition of price limits, it could incur substantial losses. The Fund would continue to be subject to market risk with respect to the position. In addition, except in the case of purchased options, the Fund would continue to be required to make daily variation margin payments and might be required to maintain the position being hedged by the future or option.

Certain characteristics of the futures market might increase the risk that movements in the prices of futures contracts or related options might not correlate perfectly with movements in the prices of the investments being hedged. For example, all participants in the futures and related options markets are subject to daily variation margin calls and might be compelled to liquidate futures or related options positions whose prices are moving unfavorably to avoid being subject to further calls. These liquidations could increase price volatility of the instruments and distort the normal price relationship between the futures or options and the investments being hedged. Also, because initial margin deposit requirements in the futures market are less onerous than margin requirements in the securities markets, there might be increased participation by speculators in the futures markets. This participation also might cause temporary price distortions. In addition, activities of large traders in both the futures and securities markets involving arbitrage, "program trading" and other investment strategies might result in temporary price distortions.

**Guideline for Futures and Related Options.** In view of the risks involved in using the futures and options strategies that are described above, the Board of Directors has determined that the Fund will not purchase or sell futures contracts or related options if, immediately thereafter, the sum of the amount of initial margin deposits on existing futures positions and initial margin deposits and premiums paid for related options would exceed 5% of the Fund's total assets. This guideline may be modified by the Board without Shareholder vote. For purposes of this guideline, options on futures contracts traded on a commodities exchange are considered "related options." Adoption of this guideline will not limit the percentage of the Fund's assets at risk to 5%.

The Fund may use the following Derivative Instruments:

*Options on Debt Securities.* A call option is a short-term contract pursuant to which the purchaser of the option, in return for a premium, has the right to buy the security underlying the option at a specified price at any time during the term of the option. The writer of the call option who receives the premium, has the obligation, upon exercise of the option during the option term, to deliver the underlying security against payment of the exercise price. A put option is a similar contract that gives its purchaser, in return for a premium, the right to sell the underlying security at a specified price during the option term. The writer of the put option, who receives the premium, has the obligation, upon exercise of the option during the option term, to buy the underlying security at the exercise price.

*Options on Bond Indices.* A bond index assigns relative values to the debt securities included in the index and fluctuates with changes in the market values of those debt securities. A bond index option operates in the same way as a more traditional option on a debt security, except that exercise of a bond index option is effective with cash payment and does not involve delivery of securities. Thus, upon exercise of a bond index option, the purchaser will realize, and the writer will pay, an amount based on the difference between the exercise price and the closing price of the bond index.

*Interest Rate Futures Contracts.* Interest rate futures contracts are bilateral agreements pursuant to which one party agrees to make, and the other party agrees to accept, delivery of a specified type of debt security or other interest rate instruments at a specified future time and at a specified price or its equivalent cash-settled value. Although such futures contracts by their terms call for actual delivery or acceptance of debt securities or other interest rate instruments, in most cases the contracts are closed out before the settlement date without the making or taking of delivery of the debt security or other interest rate instrument.



*Options on Futures Contracts.* Options on futures contracts are similar to options on securities, except that an option on a futures contract gives the purchaser the right, in return for the premium, to assume a position in a futures contract (a long position if the option is a call and a short position if the option is a put), rather than to purchase or sell a security, at a specified price at any time during the option term. Upon exercise of the option, the delivery of the futures position to the holder of the option will be accompanied by delivery of the accumulated balance that represents the amount by which the market price of the futures contract exceeds, in the case of a call, or is less than, in the case of a put, the exercise price of the option on the future. The writer of an option, upon exercise, will assume a short position in the case of a call and a long position in the case of a put.

*Bond Index Futures.* A bond index futures contract is a bilateral agreement pursuant to which one party agrees to accept, and the other party agrees to make, delivery of an amount of cash equal to a specified dollar amount times the difference between the bond index value at the close of trading of the contract and the price at which the futures contract is originally struck. No physical delivery of the debt securities comprising the index is made. Generally, contracts are closed out prior to the expiration date of the contract.

*Swaps and Interest Rate Protection Transactions.* The Fund may enter into interest rate and other swaps, including interest rate protection transactions, interest rate caps, collars and floors. Swap transactions involve an agreement between two parties to exchange payments that are based, respectively, on indices or specific securities or other assets, such as variable and fixed rates of interest that are calculated on the basis of a specified amount of principal (the “notional principal amount”) for a specified period of time. Interest rate cap and floor transactions involve an agreement between two parties in which the first party agrees to make payments to the counterparty when a designated market interest rate goes above (in the case of a cap) or below (in the case of a floor) a designated level on predetermined dates or during a specified time period. Interest rate collar transactions involve an agreement between two parties in which the first party makes payments to the counterparty when a designated market interest rate goes above a designated level of predetermined dates or during a specified time period, and the counterparty makes payments to the first party when a designated market interest rate goes below a designated level on predetermined dates or during a specified time period.

The Fund will engage in swap transactions directly with other counterparties. This subjects the Fund to the credit risk that a counterparty will default on an obligation to the Fund. Such a risk contrasts with transactions done through exchange markets, wherein credit risk is reduced through the collection of variation margin and through the interposition of a clearing organization as the guarantor of all transactions. Clearing organizations transform the credit risk of individual counterparties into the more remote risk of the failure of the clearing organization. Additionally, the financial integrity of swap transactions is generally unsupported by other regulatory or self-regulatory protections such as margin requirements, capital requirements, or financial compliance programs. Therefore, there are much greater risks of defaults with respect to swap transactions than with respect to exchange-traded futures or securities transactions.

The Fund expects to enter into interest rate protection transactions to preserve a return or spread on a particular investment or portion of its portfolios to protect against any increase in the price of securities the Fund anticipates purchasing at a later date or to effectively fix the rate of interest that it pays on one or more borrowings or series of borrowings. The Fund intends to use these transactions as a hedge and not as a speculative investment.

The Fund may enter into swaps, caps, collars and floors on either an asset-based or liability-based basis, depending on whether it is hedging its assets or its liabilities, and will usually enter into interest rate swaps on a net basis, i.e., the two payment streams are netted out, with the Fund receiving or paying, as the case may be, only the net amount of the two payments. Inasmuch as these transactions are entered into for good faith hedging purposes, the Investment Adviser and the Fund believe such obligations do not constitute debt securities and accordingly, will not treat them as being subject to its borrowing restrictions.

The Fund will enter into such transactions only with banks and recognized securities dealers believed by the Investment Adviser to present minimal credit risks in accordance with guidelines established by the Fund's Board of Directors. If there is a default by the other party to such a transaction, the Fund will have to rely on its contractual remedies (which may be limited by bankruptcy, insolvency or similar laws) pursuant to the agreements related to the transaction.

The swap market has grown substantially in recent years with a large number of banks and investment banking firms acting both as principals and as agents utilizing standardized swap documentation. Caps, collars and floors are more recent innovations for which documentation is less standardized, and accordingly, they are less liquid than swaps.

## MORTGAGE LOANS<sup>1</sup>

### Conventional Loans

A conventional loan is a mortgage loan other than a VA, an FHA or a Rural Housing Service (RHS) loan. A conventional loan may be conforming or non-conforming.

***Conforming Loans:*** A loan that conforms to the guidelines established by Fannie Mae or Freddie Mac is considered a conforming loan. Fannie Mae and Freddie Mac are stockholder corporations that were federally chartered to help make homeownership more available and affordable for low -to middle- income households. These guidelines establish the maximum loan amount, down payment, borrower credit and income requirements, and whether a specific property is considered suitable in accordance with such guidelines. The guidelines are structured to minimize the risk that borrowers will default on their loans. Loans that conform to the guidelines can then be pooled together as securities and sold on the open market to investors. These securities are not guaranteed by the full faith and credit of the government of the United States.

Conforming loans generally have three basic requirements:

- **Borrower Must Have a Minimum of Debt:** Lenders look at the ratio of monthly debt to income. Regular monthly expenses (including mortgage payments, property taxes, insurance) should total no more than 25 to 28% of gross monthly income (called “front end ratio”). Furthermore, monthly expenses, plus other long-term debt payments (e.g., student loan, automobile, alimony, child support) should total no more than 36% of gross monthly income (called “back end ratio”). These ratios can sometimes be increased if the borrower has excellent credit or other compensating factors.
- **Good Credit Rating:** The borrower must be current on installment payments. FNMA and FHLMC guidelines require that borrower meet certain minimum credit scores.
- **Funds to Close:** The borrower must have the requisite down payment (generally 20% of the purchase price), proof of source of funds, and a few months of cash reserves in the bank. However, some exceptions could be made based upon other compensating factors such as providing a credit enhancement.

Lenders that originate loans under these guidelines may sell those loans to FNMA or FHLMC. These lenders may retain the servicing on these loans so that a borrower will continue to make payments to the original lender. Conforming loans make up the majority of loans in the U.S. mortgage loan market.

In addition there is a limit on the principal balances of conforming loans. The 2004 conforming loan limits for first mortgages are:

Loan Limits for	2004	2003*	2002	2001	2000	1999	1998
One-family	\$333,700	\$322,700	\$300,700	\$275,000	\$252,700	\$240,000	\$227,150
Two-family	\$427,150	\$413,100	\$384,900	\$351,950	\$323,400	\$307,100	\$290,650
Three-family	\$516,300	\$499,300	\$465,200	\$425,400	\$390,900	\$371,200	\$351,300
Four-family	\$641,650	\$620,500	\$578,150	\$528,700	\$485,800	\$461,350	\$436,600
* The 1998 - 2003 loan amounts are provided for historical reference.							

The 2004 loan limit for second mortgages in Puerto Rico is \$166,850. The sum of the original loan amounts of the first and second mortgages cannot exceed \$333,700.

<sup>1</sup> The information provided in this Appendix H has been provided by R&G Financial and its affiliates. Neither the Fund nor UBS Financial Services Incorporated of Puerto Rico or its affiliates are responsible for its accuracy.

### Non-conforming Loans:

A loan that does not conform to the guidelines established by FNMA or FHLMC is called a non-conforming loan. Many worthy home buyers do not meet conforming loan guidelines for a variety of reasons. Non-conforming loans offer alternatives for these customers. Non-conforming loans are designed to benefit borrowers who among others:

- Are self employed
- Request loans with loan to value in excess of 80% without private mortgage insurance
- Request loans with principal balances in excess of the limit for conforming loans
- Provided non-audited financial statements in lieu of tax returns
- Have higher debt ratios
- Have affected credit scores including those because of lack of credit experience
- Request second lien mortgages

Non-conforming Loans underwritten by R-G Premier, R&G Mortgage and R-G Crown: The non-conforming loans that R-G Premier, R&G Mortgage and R-G Crown (collectively, the “R-G Lenders/Originators”) originate are underwritten in accordance with their respective underwriting guidelines (the “Underwriting Guidelines”). They base their underwriting decisions on assessment of the borrower's ability to pay as reflected in the borrower's debt ratios, historical patterns of debt repayment, the amount of equity in the borrower's property and other compensating factors. R-G Lenders/Originators believe that they have developed underwriting processes and criteria that generate high quality borrower data and valid appraisals that give them the ability to make sound underwriting and pricing decisions in originating non-conforming loans. Under the Underwriting Guidelines, they require all the documentation which is required by FNMA and FHLMC. In addition, although rarely, the R-G Lender/Originators may acquire non-conforming loans from third unaffiliated parties and in such instances said acquired loans meet the Underwriting Guidelines described above.

The Underwriting Guidelines are intended to evaluate the prospective mortgagor's credit standing and repayment ability, and the value and adequacy of the proposed mortgaged property as collateral. Pursuant to the Underwriting Guidelines, each prospective mortgagor is required to complete an application which may include information about the applicant's assets, liabilities, income, credit history, employment history and other related items, and furnish an authorization to apply for a credit report which summarizes the prospective mortgagor's credit history. In order to establish the prospective mortgagor's ability to make timely payments, the R-G Lenders/Originators, under its full mortgage documentation program requires evidence regarding the mortgagor's employment, income, liabilities and possibly assets. The R-G Lenders/Originators also originate mortgage loans under a stated income documentation program. Under the stated income documentation program, the Underwriting Guidelines require certain loan-to-value ratios, loan amounts, credit scores and asset amounts, to be met and utilizes income as stated by the mortgagor in the loan application. In addition, under the stated income documentation program, the mortgagor's employment status is verbally verified and an underwriter assesses whether or not the stated income is consistent with the mortgagor's employment status.

The Underwriting Guidelines generally follow prudent and generally accepted mortgage industry underwriting standards. In determining the adequacy of the property as collateral, an independent appraisal is generally made of each property considered for financing. The appraiser may be required to inspect the property and verify that it is in good condition and that construction, if new, has been completed. The appraisal is based on the appraiser's judgment of values, giving appropriate weight to both the market value of comparable homes and the cost of replacing the property. The Underwriting Guidelines require that the underwriters be satisfied that the value of the property being financed supports, and will continue to support, the outstanding loan balance, and provides sufficient value.

Under the Underwriting Guidelines the R-G Lenders/Originators do not engage in “sub-prime” lending. “Sub-prime” lending can be defined as lending that involves extremely affected credit. Whereas prime loans are typically made to borrowers who have a strong credit history and can demonstrate a capacity to repay their loans, “sub-prime” loans are typically made to borrowers who are perceived as deficient on either or both of these grounds. In addition, “sub-prime” loans tend to have a higher rate of serious delinquency than prime mortgages and thus carry higher interest rates than those for prime mortgage loans.

Due mostly to competitive factors in the mortgage market in Puerto Rico, a significant number of mortgage loan origination is non-conforming because they do not meet the loan-to-value ratio required by conforming loans. It is an accepted practice in

Puerto Rico to grant mortgage loans with a loan-to-value ratio of 80% or higher without requiring private mortgage insurance since real estate property values in Puerto Rico have historically had an appreciation on average ranging from 5% to 8% per year.

## **U.S. Government Loans**

Loans purchased or guaranteed by government organizations such as the Government National Mortgage Association (GNMA or GinnieMae) are U.S. Government loans. Ginnie Mae, which is part of HUD, helps increase the supply of affordable housing by guaranteeing securities issued by private lenders backed by pools of residential mortgages insured by three federal agencies -- the Federal Housing Administration (FHA), the Department of Veterans Affairs (VA) and the Rural Housing Service.

*FHA Loans:* The Federal Housing Administration (FHA), which is part of the U.S. Dept. of Housing and Urban Development (HUD), administers various mortgage loan programs. FHA loans have lower down payment requirements and are easier to qualify than conventional loans. FHA loans cannot exceed the statutory limit.

*VA loans:* VA loans are guaranteed by U.S. Dept. of Veterans Affairs. The guaranty allows veterans and service persons to obtain home loans with favorable loan terms, usually without a down payment. In addition, it is easier to qualify for a VA loan than a conventional loan. Lenders generally limit the maximum VA loan to \$203,000. The U.S. Department of Veterans Affairs does not make loans, it guarantees loans made by lenders. VA determines the eligibility and, if qualified, VA will issue the borrower a certificate of eligibility to be used in applying for a VA loan. VA-guaranteed loans are obtained by making application to private lending institutions.

*RHS Loan Programs:* The Rural Housing Service (RHS) of the U.S. Dept. of Agriculture guarantees loans for rural residents with minimal closing costs and no down payment.

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**PRIVACY POLICY**

The Fund is committed to protecting the personal information that it collects about individuals who are prospective, former or current investors. The Fund collects personal information for business purposes to process requests and transactions and to provide customer service. Personal information is obtained from the following sources:

*Investor applications and other forms*, which may include your name(s), address, social security number, or tax identification number;

*Written and electronic correspondence*, including telephone contacts; and

*Account history*, including information about Fund transactions and balances in your accounts with UBS Financial Services, Inc. or our affiliates, other fund holdings in the UBS Financial Services family of funds, and any affiliation with UBS and its subsidiaries, as well as information in your accounts or holdings with R&G Financial and its affiliates.

The Fund limits access to personal information to those employees who need to know that information in order to process transactions and service accounts. Employees are required to maintain and protect the confidentiality of personal information. The Fund maintains physical, electronic, and procedural safeguards to protect personal information.

The Fund may share personal information described above with their affiliates for business purposes, such as to facilitate the servicing of accounts. The Fund may share the personal information described above for business purposes with a non-affiliated third party only if the entity is under contract to perform transaction processing, servicing or maintaining investor accounts on behalf of the Fund. The Fund may share personal information with its affiliates or other companies who are not affiliates of the Fund that perform marketing services on the Fund's behalf or to other financial institutions with whom it has marketing agreements for joint products or services. These companies are not permitted to use personal information for any purposes beyond the intended use (or as permitted by law). The Fund does not sell personal information to third parties for their independent use. The Fund may also disclose personal information to regulatory authorities or otherwise as permitted by law.

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No person has been authorized to give any information or to make any representations in connection with this offering other than those contained in this Prospectus and if given or made, such other information and representations must not be relied upon as having been authorized by the Fund or the Underwriters. Neither the delivery of this Prospectus nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the Fund since the date hereof or that the information contained herein is correct as of any time subsequent to its date. This Prospectus does not constitute an offer to sell or a solicitation of an offer to buy any securities other than the securities to which it relates. This Prospectus does not constitute an offer to sell or a solicitation of an offer to buy such securities in any circumstances in which such offer or solicitation is unlawful.

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## PUERTO RICO MORTGAGE-BACKED & U.S. GOVERNMENT SECURITIES FUND, INC.

**Common Stock**  
Par Value \$0.01

## PROSPECTUS



**UBS Financial Services**  
Incorporated of Puerto Rico



**November 3, 2004**