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**UNITED STATES DISTRICT COURT  
SOUTHERN DISTRICT OF NEW YORK**

**ECF CASE**

HAROLD FAVERMAN, Individually And On  
Behalf of All Others Similarly Situated,

**Civil Action No. 05 CV 4026 (JSR)  
Judge Rakoff**

Plaintiff,

**CLASS ACTION COMPLAINT  
FOR VIOLATIONS OF THE  
FEDERAL SECURITIES LAWS**

-against-

DORAL FINANCIAL CORP., SALOMON  
LEVIS, ZOLLA LEVIS, DAVID LEVIS, and  
RICARDO MELENDEZ

**JURY TRIAL DEMANDED**

Defendants.

## **NATURE OF THE ACTION**

1. This is a federal class action on behalf of purchasers of the common stock of Doral Financial Corp. (“Doral” or the “Company”) between March 15, 2004, and April 18, 2005, inclusive (the “Class Period”), seeking to pursue remedies under the Securities Exchange Act of 1934 (the “Exchange Act”).

## **INTRODUCTION**

2. Doral began as a pure mortgage company but has grown into a financial holding company that still engages in mortgage banking while also becoming the fastest growing and fourth largest bank in Puerto Rico. The Company has diversified into insurance and investment banking businesses in Puerto Rico. It has also undertaken a U.S. expansion program in New York City. Doral is principally led by Salomon Levis (CEO), Zolla Levis (President) and Mario Levis (Treasurer). Additionally, David Levis is the president of Doral subsidiary HF Mortgage bankers and Aidiliza Levis is president of Doral subsidiary Centro Hipotecario.

3. In 1999, the Company began a concerted effort to diversify into commercial banking activities. The Company has continually touted that it has made money every quarter since 1972 and, for the past 25 consecutive quarters, has achieved record earnings.

4. Over the last several years, Doral’s stock price has experienced meteoric growth. Since January of 2003, a period that coincided with the mortgage refinancing boom and an era of historically low interest rates, shares of the Company appreciated 172%. In 2004 alone, shares of Doral appreciated 53% while the S&P 500 has risen only 9% during the same period.

5. As part of its business model, Doral creates interest-only (I/O) strips, which are a highly sensitive security created when Doral sells its “non-conforming” mortgages to other financial institutions. Doral’s I/Os have an independent value, which is reflected on the Company’s financial statements.

6. Fair value for I/Os is the basis for the initial measurement and, in most cases, the ongoing measurement of I/Os on a company’s balance sheets. When there is a decline in a I/Os

fair value, the company is required to determine whether an impairment of the I/O strips should be recognized.

7. Given the inherent uncertainty and volatility regarding the initial and ongoing valuation of I/Os, companies have an opportunity to overvalue their I/O assets. When such an overvaluation occurs, the company inappropriately generates "paper profits" (or masked actual losses) through incorrect cash flow modeling, flawed loss assumptions, inaccurate prepayment estimates and inappropriate discount rates.

8. Improper overvaluation often leads to an inflation of capital, making a company appear more financially sound than it is. Embedded within I/Os, is a significant level of credit and prepayment risk that makes their valuation extremely sensitive to changes in underlying assumptions. For example, the discount rate, prepayment speed or performance of the underlying assets can swiftly and dramatically alter their value. Write-downs of the recorded value of I/Os due to changes in assumptions concerning loss, prepayment or discount rates can result in substantial losses to a company.

9. Plaintiff alleges, among other things, that during the Class Period defendants improperly valued its I/Os by using flawed loss assumption, artificially high prepayment assumptions and artificially low discount rates. As a result of defendants' conduct, Doral's stock price traded at artificially inflated levels. This complaint further alleges that during the Class Period defendants caused the Company to falsely report its results through its failure to accurately account for its I/O assets, thereby overstating its net income and revenue and understating the Company's net liabilities in violation U.S. GAAP. This enabled certain defendants and insiders to reap more than \$10,000,000 dollars in insider trading profits, as well as cash incentive bonuses.

10. In addition to the valuation of I/Os, Plaintiff alleges that the Company's business model was not sustainable and that defendants made affirmative misrepresentations concerning the viability of the Company's gain-on-sale margins. Doral makes money from selling off its

mortgages. This is referred to as gain-on-sale margins. The creation of I/O strips is a large component of gain-on-sale.

11. As the interest rate yield curve flattens,<sup>1</sup> mathematically there is a corresponding decline in the margin generated by creating I/O strips. The Complaint alleges that in Mid-2004, the Federal Reserve began raising short-term interest rates. As a result of the yield curve flattening, this should have impacted the Company's gain-on-sale margins. Despite knowing its gain-on-sale margin mathematically would decrease as the yield curve flattened, the Company affirmatively stated that the rise in interest rates would have no impact on Doral's business and not raising interest rates would help its business.

12. In the 4Q:04, the impact of the flattening yield curve caught up to the defendants. In their quarterly filing, Doral recorded a \$97.5 million pretax impairment charge on the I/O strips as the result of an increase in interest rates, specifically a rise in LIBOR -- the London interbank offered rate. Rather than come clean and disclose that they had been misleading investors, defendants attempted to further mislead.

13. In its quarterly filing for 4Q:04, defendants noted that the Company's bottom line had been increased, with a \$77 million tax benefit stemming from a temporary 50% reduction in Puerto Rico's long-term capital gains rate. This tax benefit applied to transactions between July 1, 2004, and June 30, 2005. Defendants claimed that the tax reduction offset a \$95 million trading loss it incurred on some of its I/O strips that were used to hedge against interest rate fluctuations. The Company stated that the new law prompted it to "accelerate" the time frame for recording an impairment charge on the value of its I/O strips.

14. Defendant Salomon Levis, in an email response to a journalist's question about the bank's earnings, tried to further mislead the public about the true nature of Doral's finances. Defendant Salomon Levis characterized the tax benefit and the investment loss as events "that wash out the other." He said the write-down represented a "conservative" move to better prepare

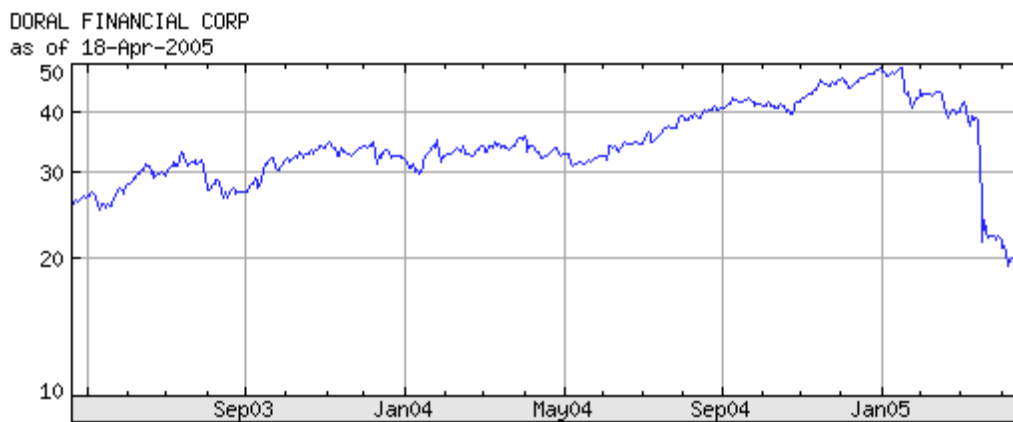
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<sup>1</sup> Flattening of the yield curve occurs when the spread between the yield on the long term and short term Treasury Notes has decreased.

the bank for a further rise in interest rates. He continued to state that Doral's stock was down on misinterpretation of a "one-time tax benefit" and an "extraordinary trading loss" due to a \$97 million impairment charge in the I/O interest-only strip. He further commented that the I/O write-down in the fourth quarter was not related to an issue with the Company's hedging program.

15. These statements were false and misleading when made since defendant Solomon Levis knew that the temporary tax benefit simply "masked" the Company's derivative shortfall and indicated that Doral's hedging strategy against interest rate changes was inadequate to safeguard the value of its I/O portfolio from interest rate swings.

16. In March of 2005, the Company could no longer maintain the charade and finally disclosed the problems at Doral. The stock price crashed, going from a \$49.25 to \$16.15 in less than three months. The graph below illustrates the precipitous drop Doral's stock suffered:



### **JURISDICTION AND VENUE**

17. The claims asserted herein arise under and pursuant to Sections 10(b) and 20(a) of the Exchange Act [15 U.S.C. §§78j(b) and 78t(a)] and Rule 10b-5 promulgated thereunder by the United States Securities and Exchange Commission ("SEC") [17 C.F.R. §240.10b-5].

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

19. Venue is proper in this District pursuant to Section 27 of the Exchange Act, and 28 U.S.C. §1391(b). Doral conducts business in this District through its wholly owned subsidiaries and many of the acts and practices complained of herein occurred in substantial part in this District.

20. In connection with the acts alleged in this complaint, Defendants directly or indirectly used the means and instrumentalities of interstate commerce, including but not limited to the mails, interstate telephone communications and the facilities of the national securities markets.

### **PARTIES**

21. Plaintiff, as set forth in the accompanying certification, purchased the common stock of Doral at artificially inflated prices during the Class Period and has been damaged thereby.

22. Defendant Doral is a Puerto Rican corporation with its principal place of business in San Juan, Puerto Rico. In the United States, Doral conducts business through its subsidiary Doral Money, Inc. Doral describes itself as a financial services company engaged in mortgage banking, including thrift operations, institutional securities operations and insurance agency activities.

23. Defendant Salomon Levis was, during the relevant period, Chief Executive Officer and Chairman of the Board of Directors of the Company.

24. Defendant Zolla Levis was, during the relevant period, Chief Operating Officer and President of the Company.

25. Defendant David Levis was, during the relevant period, President of the HF Mortgage Bankers an operating division at the Company

26. Defendant Ricardo Melendez was, during the relevant period, Chief Operating Officer and Executive President of the Company.

27. Defendants Salomon Levis, Zolla Levis, David Levis and Ricardo Melendez are referred to herein as the “Individual Defendants.”

28. Because of the Individual Defendants’ positions with the Company, they had access to the adverse undisclosed information about its business, operations, products, operational trends, financial statements, markets and present and future business prospects *via* access to internal corporate documents (including the Company’s operating plans, budgets and forecasts and reports of actual operations compared thereto), conversations and connections with other corporate officers and employees, attendance at management and Board of Directors meetings and committees thereof and *via* reports and other information provided to them in connection therewith.

29. It is appropriate to treat the Individual Defendants as a group for pleading purposes and to presume that the false, misleading and incomplete information conveyed in the Company’s public filings, press releases and other publications as alleged herein are the collective actions of the narrowly defined group of defendants identified above. Each of the above officers of Doral, by virtue of their high-level positions with the Company, directly participated in the management of the Company, was directly involved in the day-to-day operations of the Company at the highest levels and was privy to confidential proprietary information concerning the Company and its business, operations, products, growth, financial statements, and financial condition, as alleged herein. Said defendants were involved in drafting, producing, reviewing and/or disseminating the false and misleading statements and information alleged herein, were aware, or deliberately disregarded, that the false and

misleading statements were being issued regarding the Company, and approved or ratified these statements in violation of the federal securities laws.

30. As officers and controlling persons of a publicly-held company whose common stock was and is registered with the SEC pursuant to the Exchange Act was traded on the New York Stock Exchange (the “NYSE”) and is governed by the provisions of the federal securities laws, the Individual Defendants each had a duty to disseminate promptly accurate and truthful information with respect to the Company’s financial condition and performance, growth, operations, financial statements, business, products, markets, management, earnings and present and future business prospects, and to correct any previously-issued statements that had become materially misleading or untrue, so that the market price of the Company’s publicly-traded common stock would be based upon truthful and accurate information. The Individual Defendants’ misrepresentations and omissions during the Class Period violated these basic and fundamental requirements and obligations.

31. The Individual Defendants participated in the drafting, preparation and/or approval of the various public and shareholder and investor reports and other communications complained of herein and were aware of or deliberately disregarded the misstatements contained therein and omissions therefrom and were aware of their materially false and misleading nature. Because of their Board membership and/or executive and managerial positions with Doral, each of the Individual Defendants had access to the adverse undisclosed information about Doral’s business prospects and financial condition and performance as particularized herein and knew (or deliberately disregarded) that these adverse facts rendered the positive representations made by or about Doral and its business issued or adopted by the Company materially false and misleading.

32. The Individual Defendants, because of their positions of control and authority as officers and/or directors of the Company, were able to and did control the content of the various SEC filings, press releases and other public statements pertaining to the Company during the Class Period. Each Individual Defendant was provided with copies of the documents alleged herein to be misleading prior to or shortly after their issuance and/or had the ability and/or opportunity to prevent their issuance or cause them to be corrected. Accordingly, each of the Individual Defendants is responsible for the accuracy of the public reports and releases detailed herein and is therefore primarily liable for the representations contained therein.

33. Each of the defendants is liable as a participant in a fraudulent scheme and course of business that operated as a fraud or deceit on purchasers of Doral common stock by disseminating materially false and misleading statements and/or concealing material adverse facts. The scheme: (i) deceived the investing public regarding Doral's business, operations, management and the intrinsic value of Doral common stock; (ii) enabled the defendants and Company insiders to sell over **\$10,193,910.00** of their personally held Doral stock to investors during the Class Period; and (iii) caused plaintiff and other members of the Class to purchase Doral common stock at artificially inflated prices.

### **CLASS ACTION ALLEGATIONS**

34. Plaintiff brings this action as a class action pursuant to Federal Rule of Civil Procedure 23(a) and (b)(3) on behalf of a Class, consisting of all those who purchased or otherwise acquired the common stock of Doral between March 14, 2004, and April 15, 2005, inclusive, (the "Class") and who were damaged thereby. Excluded from the Class are defendants, the officers and directors of the Company, at all relevant times, members of their

immediate families and their legal representatives, heirs, successors or assigns and any entity in which defendants have or had a controlling interest.

35. The members of the Class are so numerous that joinder of all members is impracticable. Throughout the Class Period, Doral common shares were actively traded on the NYSE. As of December 31, 2004, the Company had over 107,920,000 shares issued and outstanding. While the exact number of Class members is unknown to plaintiff at this time and can only be ascertained through appropriate discovery, plaintiff believes that there are hundreds or thousands of members in the proposed Class. Record owners and other members of the Class may be identified from records maintained by Doral or its transfer agent and may be notified of the pendency of this action by mail, using the form of notice similar to that customarily used in securities class actions.

36. Plaintiff's claims are typical of the claims of the members of the Class as all members of the Class are similarly affected by defendants' wrongful conduct in violation of federal law that is complained of herein.

37. Plaintiff will fairly and adequately protect the interests of the members of the Class and has retained counsel competent and experienced in class and securities litigation.

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

(a) whether the federal securities laws were violated by defendants' acts as alleged herein;

(b) whether statements made by defendants to the investing public during the Class Period misrepresented material facts about the business, operations and management of Doral; and

(c) to what extent the members of the Class have sustained damages and the proper measure of damages.

39. A class action is superior to all other available methods for the fair and efficient adjudication of this controversy since joinder of all members is impracticable. Furthermore, as the damages suffered by individual Class members may be relatively small, the expense and burden of individual litigation make it impossible for members of the Class to individually redress the wrongs done to them. There will be no difficulty in the management of this action as a class action.

### **SUBSTANTIVE ALLEGATIONS**

40. Defendant Doral describes itself as a financial services company engaged in mortgage banking, including thrift operations, institutional securities operations and insurance agency activities.

41. The Class Period begins on April 14, 2004. On that date, Doral issued a press release announcing its financial results for the first quarter of 2004, the period ended March 31, 2004. For 1Q:04, Doral reported net income of \$103.6 million, or \$0.86 per diluted share, compared to \$70.0 million in 1Q:03, or \$0.60 per diluted share, in 1Q:04. Defendant Salomon Levis commented on the announcement stating in pertinent part as follows:

We are very pleased with the excellent results for the first quarter of 2004, in which the Company surpassed \$100 million of quarterly net income for the first time in its history.

The Company once again established historical records in mortgage loan production, mortgage servicing portfolio, secured commercial lending, assets, deposits, earnings, capital and in key financial ratios.

We are now anticipating that loan production for the remainder of 2004 should be stronger than the first quarter and project over \$7.5 billion for the year, well in excess of the \$6.5 billion record levels of 2003.

Results for the first quarter ended March 31, 2004, included a loss on trading activities of \$48.6 million compared to a gain of \$4.9 million for the comparable 2003 period reflecting net costs incurred on options, futures contracts and other derivative instruments used for interest rate management purposes. The loss on trading activities was offset by gains on sale of investment securities, higher gains on mortgage loans sales and fees, and other sources of revenues. The hedging loss was also offset by a \$40.8 million reduction in accumulated comprehensive loss included in stockholders' equity.

Such growth was achieved by successfully penetrating the market with innovative products...

We expect Doral Bank PR's strong growth to continue in 2004, by opening at least 8 more branches for a total of 45 and increasing its lending activities, particularly secured commercial lending which we anticipate will grow by at least 75% during 2004.

*Based on the Company's historical achievements, including the last 25 consecutive quarters of record earnings attained in a six-year period with different interest rate environments, we anticipate that each of Doral's business segments will contribute to solid financial results. We look forward to continue enhancing shareholders' value.*

42. Following Doral's earnings release, analysts issued highly positive reports on the Company and encouraged investors with "Outperform" and "BUY" ratings. For example:

**14-April-04 Wachovia Securities (Jim Shanahan) DRL: Beats By A Nickel Raising Estimates Management Guides to \$7.5B in Loan Production in 2004**

Key Points:

Q1 2004 EPS BEATS OUR ESTIMATE BY A NICKEL – DRL reported Q1 2004 diluted EPS of \$0.86, \$0.05 ahead of our estimate of \$0.81. Mortgage loan production totaled \$1.84B, 6.4% higher than \$1.73B in the linked quarter and above our estimate of \$1.75B. Record mortgage loan production lead to gain on mortgage loan sales of \$136.9 million, \$21.2 million above our estimate of \$115.6 million. DRL is now forecasting 2004 loan production of \$7.5B, ahead of our prior forecast of \$7.1B.

ADDING BALANCE SHEET LEVERAGE? – In a significant development, DRL reported a net increase in assets of \$1.6 billion. We believe that DRL is in the early stages of a plan to add leverage to the balance sheet. We anticipate that the Company will build a portfolio of U.S. Treasury securities to be held within the International Banking Entity (IBE) earning tax-exempt interest income. These investments will be funded mostly with short duration repurchase agreements. We believe that DRL has the flexibility to add quite a bit of leverage, as the Company

currently has excess capital. For DRL, the ratio of total equity to assets is over 14%, much higher than most mainland banks.

**BANKING SEGMENT LEADS THE WAY** – In the first quarter, DRL reported that the contribution to net income from the banking segment was 58%, compared to 38% for all of 2003. We attribute the dramatic reversal to contributions from the IBE which are now included in banking earnings.

**Investment Thesis:** *We rate DRL shares Outperform. DRL has consistently beat our earning estimates, due to outstanding execution in mortgage banking and growing contributions from retail banking and insurance operations.*

**15-April-04 Merrill Lynch (Kenneth Bruce) Doral Financial Corp.: Record Earnings Should Continue BUY**

Doral Financial reported Q1'04 EPS of \$0.86 versus the consensus estimate of \$0.81 and our estimate of \$0.80. Doral's quarterly performance appears stronger than at least some investor's expectations, which could be a positive catalyst for the stock today.

We are raising our 2004 EPS estimate from \$3.44 to \$3.66, which is \$0.21 above the current consensus of \$3.45, through consensus likely will rise materially on the strong quarterly performance. We are raising our 2005 EPS estimate from \$4.17 to \$4.40.

We are also raising our Price Objective from \$41.50 to \$44.00, based on a 10x EPS multiple and our revised 2005 EPS estimate of \$4.40.

43. On June 2, 2004, Doral issued a press release announcing it had agreed to sell \$115.0 million of its Floating Rate Senior Notes due December 7, 2005, at a price to the public of 100% of the principal amount.

44. Following the publication of Defendants' release analysts at major brokerage houses continued to issue very positive reports on the Company and encouraged investors to "BUY" shares of Doral and, in fact, certain brokerage houses such as Merrill Lynch raised earnings and earning asset growth guidance going forward, stating in pertinent part, as follows:

**3-June-04 Merrill Lynch (K.Bruce) Doral Financial Corp. Poised for Growth "BUY"**

**Reason for Report: Revised Estimates Higher**

HIGHLIGHTS:

Doral Financial issued \$115M of floating rate debt to modestly improve the funding costs for its construction loan portfolio. **The transaction...suggests that DRL could grow assets modestly faster than we previously estimated.**

**We are revising our 2004 EPS estimate higher by \$0.02 to \$3.68 from \$3.66 due to modestly faster asset growth.** We are revising our estimate for Q3'04 EPS by \$0.01 to \$0.94 from \$0.93 and Q4'04 EPS by \$0.01 to \$0.98 from \$0.97.

**We are revising our estimate for earning asset growth higher** for the quarter by \$120M...

**4-June-04 Wachovia Securities (Jim Shanahan) DRL : Highlights from West Coast Investor Meetings**

Key Points:

DEBT TRANSACTION CONSISTENT WITH DRLS' CONSERVATIVE APPROACH TO BALANCE SHEET MAMANGEMENT-DRL announced the issuance of \$115 million senior floating-rate notes. ...we estimate that DRL is effectively locking-in an interest rate spread...

45. On June 29, 2004, Doral issued a press release entitled *Doral Financial Anticipates Record Load Production in 2004 Despite Expected Increase in Interest Rates* in which Defendant Salomon Levis stated that:

contrary to recent announcements by US-based mortgage lenders he did not believe that the expected increase in interest rates would have an adverse impact on the Company's operations. In fact, Mr. Levis stated that the anticipated increase in interest rates during 2004 represented an opportunity for Doral Financial to realize additional profits.

46. On July 14, 2004, Doral issued a press release announcing its financial results for the second quarter of 2004. That release provided that:

For 2Q:04 Doral reported record net income of \$114.9 million, compared to \$75.0 million in 2Q:03, an increase of 53%. For the first six months of 2004, Doral reported it earned a record \$218.5 million, compared to \$145.0 million for the same period the pervious year, an increase of 51%. For 2Q:04 Doral the second quarter of 2004, consolidated earnings per diluted share were \$0.96, compared to \$0.64 for the second quarter of 2003, which represents an increase of 50%. For the first half of 2004, consolidated earnings per diluted share were \$1.82, compared to \$1.24 for the first six months of 2003, an increase of 47%.

For 2Q:04 net interest income amounted to \$66.6 million, compared to \$39.9 million for the same period a year ago, an increase of 67%. For the first six months of 2004, net interest income amounted to \$125.7 million, compared to \$81.2 million for the first half of 2003, an increase of 55%. The increase in net interest income resulted from higher net interest earning assets during the 2004 periods.

For 2Q:04 loan production volume was a record \$1.9 billion, compared to \$1.6 billion for the comparable 2003 period, an increase of \$339.3 million or 21%, and \$103.9 million or 6% higher than the first quarter of 2004.

Trading activities for the second quarter of 2004 improved to a gain of \$6.0 million in the second quarter of 2004 from a loss of \$48.6 million in the immediately preceding quarter, principally due to rising long term interest rates that resulted in gains on the Company's derivatives activities undertaken for risk management purposes. At the same time, the Company, restructured its investment portfolio by selling lower yielding securities at a loss of \$17.5 million, compared to a gain of \$16.2 million in the immediately preceding quarter, and replacing the securities sold with higher yielding instruments. The improved trading results are reflected principally in the mortgage banking segment while the losses in sale of investment securities affected the banking segment results.

Defendant Salomon Levis commented on the announcement stating pertinent part:

We are delighted with the excellent record performance for the second quarter of 2004. Each of Doral's business segments contributed in achieving these results. The Company is carefully monitoring its interest rate management program to protect our assets and liabilities against rising interest rates. Our interest rate management program has proven successful under different interest rate environments and has been instrumental in Doral achieving 26 consecutive quarters of record earnings.

[t]he results for the first six months of 2004 continued to fuel his optimism for the Company's prospects.

47. Following Doral's earnings release, analysts issued highly positive reports on the Company and encouraged investors with "Outperform" and "BUY" ratings. For example:

**14-July-04 Wachovia Securities (Jim Shanahan) DRL: Beats Again, Raising Estimates & Valuation Range**

**Key Points:**

Versus our estimates, DRL delivered better than expected gains from sales of mortgage loans, due to stronger than expected mortgage loan production, a mix-shift towards more profitable loan production and higher margin versus our

forecast. Net interest was also stronger than expected, as the net interest margin and earning asset growth both exceeded our expectations

Earnings Outlook- We are raising our 2004 EPS estimate to \$3.80 from \$3.75 and our 2005 EPS to \$4.45 from \$4.40.

Investment Thesis: *We rate DRL shares Outperform. DRL has consistently beat our earning estimates, due to outstanding execution in mortgage banking and growing contributions from retail banking and insurance operations.*

**15-July-04 Merrill Lynch (K.Bruce) Doral Financial Corp. Strong Quarter, Raising Estimates “BUY”**

**HIGHLIGHTS:**

We are raising our 2004 EPS estimate from \$3.68 to \$3.80 and our 2005 EPS estimate from 4.40 to \$4.45, based on better asset growth and more robust lending margins, offset by lower net interest margin and certain trading losses from portfolio restructuring.

We are raising our price objective modestly from\$44.00 to \$44.50, based on a conservative 10x EPS multiple and our revised 2005 EPS estimate of \$4.45.

**Estimate revisions**

We have re-calibrated our earnings model for what we estimate will be faster asset growth than we previously forecasted, lower net interest margin, higher gain-on-sale margins and additional losses on the sale of securities as the company re-deploys capital into higher yielding assets.

The quarterly and annual EPS revisions follow in Chart 1.

**Chart 1: DRL 2004 & 2005 EPS estimates**

	<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Q4</u>	<u>2004</u>
Previous	\$0.86	\$0.90	\$0.94	\$0.98	\$3.68
Revised	\$0.86 - A	\$0.96 - A	\$0.98	\$1.00	\$3.80

	<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Q4</u>	<u>2005</u>
Previous	\$1.02	\$1.08	\$1.13	\$1.17	\$4.40
Revised	\$1.04	\$1.09	\$1.14	\$1.18	\$4.45

**15-July-04 Cohen Bros.& Company (JoeGladue) Doral Financial Corporation (DRL: Outperform)**

**Key Investment Points:**

Doral reported 2Q04 EPS of \$0.96, up 9.1% sequentially, \$0.08 better than our estimate and \$0.07 ahead of the First Call consensus estimate.

Mortgage origination volumes remain strong as volume set a new record of \$1.9 billion in 2Q04, up 21% from a year ago and 6% from 1Q04.

Rising interest rates have not hurt originations, but impairment charges are likely to be reduced going forward.

We are raising our 2004 and 2005 EPS estimates to \$3.78 and \$4.45, respectively, from \$3.64 and \$4.38. **Our new 12-month target price, of \$44** is based on the stock's current trailing P/E and our revised EPS estimates. **We are reiterating our OUTPERFORM rating on Doral stock.**

48. On August 27, 2004, Doral issued a press release announcing it had agreed to sell an additional \$125.0 million of its Floating Rate Senior Notes due July 20, 2007 at a price to the public of 100.2153% of the principal amount.

49. On September 16, 2004, Doral issued a press release announcing it had agreed to sell an additional \$150.0 million of its Floating Rate Senior Notes due July 20, 2007 at a price to the public of 100.2343% of the principal amount.

50. Following the publication of Defendants' release analysts at Wachovia Securities issued a very positive report on the Company and maintained its "OUTPERFORM" rating on the Company and which stated in pertinent part, as follows:

**17-Sept-04 Wachovia Securities (Jim Shanahan) DRL: Senior Note Issuance Signals A Strong Pipeline**

**Key Points:**

DRL announced the pricing of an additional \$150 million of floating rate senior notes

CONSTRUCTION LOAN PIPELINE STRONG--DRL appears to now have more outstanding senior notes than construction loans, which totalled \$581 million at June 30, 2005. We believe that DRL's construction loan pipeline is strong, potentially as high as \$200 million, which could close in the next few months.

Based on the strong construction loan pipeline and DRL's target of \$240 million in commercial loan originations in 2004, DRL's total portfolio of construction and commercial loans is likely to be more than \$1.1 billion by year-end. This compares to \$766 million at the end of 2003, a growth rate of more than 40%.

51. On October 13, 2004, Doral issued a press release announcing its financial results for the third quarter of 2004. That release provided that:

For 3Q:04 Doral reported net income of \$120.6 million, compared to \$81.7 million in 3Q:03, an increase of 48%. For the first nine months of the same period, Doral earned a record \$339.1 million, compared to \$226.6 million for the same period a year ago, an increase of 50%. For 3Q:04, consolidated earnings per diluted share were \$1.01, compared to \$0.70 for the 3Q:03, which represents an increase of 44%. For the first nine months of 2004, consolidated earnings per diluted share were \$2.83, compared to \$1.94 for the first nine months of 2003, an increase of 46%.

For 3Q:04 Doral reported net interest income of \$69.9 million, compared to \$42.9 million in 3Q:03, an increase of 63%. For the first nine months of 2004, net interest income amounted to \$195.6 million, compared to \$124.1 million for the first nine months of 2003, an increase of 58%. The increase in net interest income resulted from higher net interest earning assets during the 2004 periods.

During 3Q:04, Doral issued \$625.0 million of unsecured debt, which was favorably received by investors.

For 3Q:04 loan production volume was a record \$2.0 billion, compared to \$1.7 billion for the comparable 2003 period, an increase of \$304.5 million or 18%. For the first nine months of 2004, loan production volume was \$5.8 billion, compared to \$4.7 billion for the corresponding 2003 period, an increase of 22%.

Investment activities for the third quarter of 2004 resulted in a loss of \$50.7 million, principally attributable to derivatives undertaken for risk management purposes, as a result of an average reduction of approximately 75 basis points in intermediate and long-term interest rates during the quarter. The Company's interest rate risk management is designed to protect the value of the Company's assets and income from substantial increases in interest rates. While the reduction in interest rates increased the cost associated with the use of derivatives, it also impacted favorably gain and fees on loan sales, net interest income and other income.

Defendant Salomon Levis commented on the announcement stating impertinent part:

We are most pleased with the record performance for the third quarter of 2004. Each of Doral's business segments contributed in achieving our 27th consecutive quarter of record earnings.

\* \* \*

Results for the first nine months of 2004 continued to fuel his optimism for the Company's prospects.

52. Following Doral's earnings release, analysts issued highly positive reports on the Company and encouraged investors with "Outperform" and "BUY" ratings. For example:

**13-Oct-04 Wachovia Securities (Jim Shanahan) DRL: Q3 Results \$0.02 Better Than Our Estimates Considerable Earning Power Remains, In Our View**

Key Points:

DRL reported Q3 2004 EPS of \$1.01 per share, \$0.02 above our estimate of \$0.99 and \$0.03 above the First Call consensus EPS estimate of \$0.98.

**MORTGAGE SALE GAINS \$41 MILLION BETTER THAN OUR FORECAST** - DRL delivered not only stronger mortgage production than we had estimated (\$1.99B versus our estimate of \$1.95B), but also reported stronger margins (7.24%, compared to our estimate of 6.40% and 6.91% in Q2 2004).

**14-Oct-04 Merrill Lynch (K.Bruce) Doral Financial Corp. Hedge Loss: Negative or Positive? "BUY"**

HIGHLIGHTS

Doral Financial reported Q3'04 earnings of \$1.01 per share after the market close last night, \$0.03 above our \$0.98 in line estimate.

We are raising our 2004 estimates by \$0.06, from \$3.80 to \$3.86, to reflect the \$0.03 beat in Q3 and a \$0.03 increase in Q4'04 from \$1.00 to \$1.03, due to better gain-on-sale margins than we had anticipated.

We maintain our BUY rating and our \$44.50 Price Objective, which is conservatively based on a 10x EPS multiple and our \$4.45 2005 EPS estimate.

**18-Oct-04 Cohen Bros.& Company (Joe Gladue) Doral Financial Corporation (DRL: Outperform)**

**Key Investment Points:**

Doral reported 3Q04 EPS of \$1.01, up 5.2% sequentially, and \$0.03 better than our estimate and the First Call consensus estimate.

We are raising our 2004 and 2005 EPS estimates to \$3.87 and \$4.48, respectively, from \$3.78 and \$4.45. **Our new 12-month target price of \$50, up from \$44**, is based on the stock's current trailing P/E and our revised EPS estimates. **We are reiterating our OUTPERFORM rating on Doral stock.**

53. On October 21, 2004 Doral issued a press release in which Defendant Salomon Leivs stated in pertinent part that:

...[C]ontrary to recent announcements by US-based mortgage lenders, the Company's loan production for the third quarter of 2004, as reported on October 13, 2004 was a record \$2.0 billion...

The Company expected a record level of loan production for the fourth quarter 2004

54. Soon after the publication of the October 21, 2004 press release, an analyst at a major brokerage house issued a positive report on the Company rating the shares of the Company as an "OUTPERFORM" and raising EPS estimates based on a meeting with Doral's management. That report provided in pertinent part:

**12-Nov-04 Wachovia Securities (Jim Shanahan) DRL: Recent Island Visit Underscores Mortgage Market Strength Raising Q4 2004 and 2005 EPS Estimates**

**Key Points:**

The week of November 8th, we visited DRL management at their San Juan headquarters. Based on our meetings, we continue to believe that the fundamentals of DRL's core mortgage banking business remain strong.

**RAISING ESTIMATES** - We are raising our Q4 EPS estimate from \$1.04 to \$1.06, and our 2005 EPS estimate from \$4.50 to \$4.60. Despite boosting our estimates, we believe that they may be conservative.

NET INTEREST INCOME GROWTH STILL PART OF THE STORY – As we have been discussing for several months, we expect that DRL will be able to increase net interest income by reinvesting the liquidity portfolio at higher yields and by adding modest balance sheet leverage

55. On January 7, 2005, the Company issued a press release announcing that it had achieved record mortgage production for the fourth quarter of 2004 of approximately \$2.03 billion, with December posting the strongest monthly production in the Company's history. Production for fiscal 2004 was purportedly approximately \$47.8 billion, a new record. The release further stated that Defendant Salomon Levis anticipated that the Company would again achieve another year of strong loan production during 2005.

56. On January 18, 2005, Doral stock price closed at an all time high of \$49.50

57. After the close of the market on January 18, 2005, Doral issued a press release announcing its financial results for the year ended December 31, 2004. That release provided that:

Net income for the fourth quarter of 2004 amounted to \$150.5 million, compared to \$94.7 million for the fourth quarter of 2003, an increase of 59%. For the year ended December 31, 2004, Doral earned a record \$489.6 million, compared to \$321.3 million for the same period a year ago, an increase of 52%. For the fourth quarter of 2004, consolidated earnings per diluted share were \$1.22, compared to \$0.76 for the fourth quarter of 2003, which represents an increase of 61%.

For the year ended December 31, 2004, consolidated earnings per diluted share were \$3.95, compared to \$2.70 for the same period of 2003, an increase of 46%.

Investment activities for the fourth quarter of 2004 resulted in a loss of \$95.4 million, compared to a loss of \$8.0 million for the fourth quarter of 2003. *The loss on investment activities during the fourth quarter of 2004 was principally due to an impairment on the value of the Company's interest-only strips (IOs) of \$97.5 million as a result of increases in the 3-month London Interbank Offered Rate ("LIBOR") which reduced the anticipated spread of the Company's variable rate IOs. If contrary to what is generally expected, LIBOR decreases, a portion of the impairment charges on the value of the IOs could be recovered. The Company recorded impairment charges on the value of its IOs of \$131.0 million for the year ended December 31, 2004, compared to a positive valuation adjustment of \$7.3 million for the corresponding 2003 period.* Investment

activities resulted in a loss of \$190.1 million for the year ended December 31, 2004, compared to a gain of \$11.0 million for the respective 2003 period. The loss on investment activities experienced during 2004 also included derivatives undertaken for interest rate management purposes.

Net interest income for the fourth quarter of 2004 amounted to \$70.3 million, compared to \$57.4 million for the same period a year ago, an increase of 23%. For the year ended December 31, 2004, net interest income amounted to \$265.9 million, compared to \$181.5 million for the year ended December 31, 2003, an increase of 47%. The increase in net interest income resulted from higher net interest earning assets during the 2004 periods.

Loan production volume for the fourth quarter of 2004 was a record \$2.0 billion, compared to \$1.7 billion for the comparable 2003 period, an increase of \$299.2 million or 17%. For the year ended December 31, 2004, loan production volume was \$7.8 billion, compared to \$6.5 billion for the corresponding 2003 period, an increase of 20%.

58. On the surface Doral's reported financials appeared to be very favorable – with Doral reporting earnings of \$150.5 million, or \$1.22 a share, compared with \$94.7 million, or 76 cents a share, in the year-ago period. The Company's bottom line, however, was inflated by a \$77 million tax benefit stemming from a temporary 50% reduction in Puerto Rico's long-term capital gains rate. The tax benefit applies to transactions between July 1, 2004, and June 30, 2005. Doral claimed the tax reduction merely offset a \$95 million trading loss it incurred on some its I/O strips which are used to hedge against interest rate fluctuations. The Company stated that the new law prompted it to "accelerate" the time frame for recording an impairment charge on the value of its I/O strips. Doral recorded a \$97.5 million pretax impairment charge on the I/O strips as the result of an increase in interest rates, specifically a rise in LIBOR.

59. According to TheStreet.com, in an article entitled *Doral Fails Street Smell Test*, written by Matthew Goldstein, that was published on January 19, 2005:

Salomon Levis, in an email response to a question about the bank's earnings, characterized the tax benefit and the investment loss as events "that wash out the other." He said the writedown represents a "conservative" move to better prepare the bank for a further rise in interest rates.

“The stock is down on misinterpretation of a 'one'-time tax benefit and an extraordinary trading loss due to a \$97 million impairment charge in the I/O

interest-only strip," the bank said in a statement. "The I/O writedown in the fourth quarter is not related to an issue with the company's hedging program."

60. Despite Defendant Salomon Levis' positive "spin" the Company's financial data revealed a hidden flaw in Doral's use of derivatives to safeguard the value of its investment portfolio from big swings in interest rates and started to raise questions about the assumptions Doral used to value its I/Os.

61. On January 19, 2005, following the announcement of these results, shares of the Company lost \$5.68 per share, to close trading at \$43.82 per share, on heavy trading volume.

62. Soon after the publication of the January 18, 2005 press release, analysts at Merrill Lynch reiterated a "BUY" rating on shares of the Company and stated that "***Doral Financial continues to be a compelling earnings growth story***" in addition to the following:

We are reiterating our Buy recommendation and maintain our \$55 price target...

Doral's reported results suggest that mortgage-related earnings remain quite robust and the earnings power that be generated from a larger portfolio remains in tack

In our view Doral Financial continues to be a compelling growth story and should continue to attract investors interest as it grows its earning meaningfully in what could prove to be a rising interest rate environment

63. On February 23, 2005, Doral issued a press release where Defendant Salomon Levi reiterated that:

despite an uncertain interest rate environment the fundamentals of the Company remained health with continued strong demand fro new housing loans, strong production of refinancing loans for debt consolidation purposes, growth in banking operations and increased fee income, principally from the insurance agency business

64. As further evidence that defendants' attempts to condition the market to believe that Doral's business model was sustainable Doral Executive Vice President and Treasurer Mario

S. Levis met with analysts from Deutsche Bank in the first week of March 2005. As a result of that meeting, on March 7, 2005, Deutsche Bank issued a report reiterating a “BUY” rating on shares of the Company and stating that “*These meetings gave us further confidence in our Buy rating and \$55 target price....*”

### **THE TRUTH EMERGES**

65. On March 9, 2005, the Company issued a press release announcing that it intended to file its Form 10-K for the year 2004 on March 15, 2005. The Company then took the unprecedented step of scheduling an investor conference call on March 17, 2005, to discuss the filing

66. On March 15, 2005, after the close of the market Doral filed its Form 10-K with the SEC. At this time, defendants revealed that Company that the company has been too aggressive in valuing its I/O instruments and that further impairments/write-downs may occur. If such impairments were to occur the Company's reported profits would suffer as would, its capital structure making the Company less robust than defendants led the market to believe. The 10-K also revealed that the Company was much more interest rate sensitive than the Company had previously stated. As a result any interest rate hikes by the Federal Reserve would result in further impairment; thus hurting earnings. Finally, the 10-K revealed that questions exist about the sustainability of Doral's gain-on-sale margins-the money that the Company makes selling off its mortgages. The creation of I/O strips is a large component of gain-on-sale and, as the interest rate yield curve flattens, mathematically, there has to be a decline in the margin generated by creating I/O strips.

67. Immediately following the publication of these results, shares of the Company again traded down precipitously, falling from a closing price of \$38.29 on March 15, 2005, to a low of \$25.61 per share on March 17, 2005, again on tremendous trading volume.

68. Immediately thereafter, analysts at Wachovia Capital Markets Equity Research Department and Merrill Lynch Downgraded the Company and issued reports which stated, in part, the following:

**15-Mar. 2005 Wachovia Capital Markets Equity Research Department( Jim Shanahan) DRL: Downgrading To Underperform, Lowering Estimates**

**Key Points**

Tuesday evening, DRL filed Form 10-K with the SEC. After reviewing certain disclosures within that document, we have concluded that DRL's earnings quality has significantly weakened in recent quarters. Specifically, ***DRL is using much more aggressive assumptions to generate gain on sale income***, as well as to value its retained interests in mortgage loan sales.

First, DRL has been lowering its prepayment speed assumption, which results in a longer cash flow stream. After using 13.3-13.5% annualized prepayment speeds for much of 2001-2003, DRL began to use a prepayment speed of 18% at year-end 2003. We suspect that this was based on the observation of faster prepayment speeds within the off-balance sheet portfolio. By September 30 and December 31, 2004, DRL had significantly lowered their prepayment assumptions to 10.5% and 7.2%, respectively. ***While DRL may be observing much lower prepayment speeds within that portfolio, we simply do not believe a lifetime prepayment speed of 7.2% is appropriate.***

Second, ***DRL has employed a much lower rate to discount those cash flows*** back to the present. The discount rate was falling consistently with long-term interest rates, from 12% at YE 2001 to 9% by YE 2003. Despite slightly higher long-term interest rates at September 30 and December 31, 2004, DRL lowered their discount rate assumptions again, to 8.25% and 7.63%, respectively. ***In our view, there is a disconnect here that DRL will find difficult to defend...***

We have lowered our EPS estimates to reflect what we believe to be a more conservative gain on sale assumption going forward. After applying a slightly lower multiple on those earnings, we see sufficient downside to our valuation range to warrant a lower investment rating.

**Investment Thesis**

We rate DRL shares Underperform. Based on information filed on Form 10-K pertaining to the assumptions used to value retained interests in mortgage loan sales, we believe that earnings quality has declined considerably in the last two quarters. We also believe that DRL will have difficulty defending their more aggressive assumptions in a conference call scheduled for later this week. Based on a revised earnings outlook, which we believe considers more appropriate gain

on sale assumptions, and a lower multiple on those earnings, we believe that there is sufficient downside to our valuation range to warrant an Underperform rating.

**17-Mar. 2005 Merrill Lynch (K. Bruce) Doral Financial Corp.  
Downgrade on I/O Uncertainty**

**Highlights:**

Doral Financial disclosed valuation assumptions for the controversial interest-only securities portfolios that seem aggressive to us and could warrant a downward revision prospectively, which would reduce earnings and capital. DRL's 10K filing also incorporated a sensitivity analysis suggesting meaningfully higher interest rate sensitivity than we anticipated.

**We are downgrading DRL to a Neutral from Buy due to the higher level of uncertainty surrounding the I/O valuation**, which could lower near-term EPS if the I/Os are impaired further, and the potential for gain-on-sale margins to erode meaningfully, should the I/Os be valued lower due to rising interest rates or adjustments to the valuation parameters

69. On March 17, 2005, after the closing bell, Standard & Poor's revised its outlook on Doral to negative from stable, citing increased concern about the sustainability of the company's business model in a more adverse environment with interest rates on the rise. S&P affirmed its ratings on the company, including its 'BBB-' long-term counterpart credit rating.

70. On March 18, 2005, shares of Doral stock hit a 52-week low of \$19.60 per share eventually closing at \$ 21.50 per share on volume of more than 28 million shares traded. When the damage was done, 51.4 million shares of Company stock traded hands by the end of the week of March 18, 2005, roughly six times the weekly average.

71. Despite a disastrous week for the Company Defendants continued to attempt to mislead investors by trying to put a positive "spin" on Doral's financial results and, rather than disclosing that it was then foreseeable that business would suffer in a more adverse interest rate environment Defendants attempted to continue to mislead investors to believe that all was well at the Company. Then, soon after a peer company reported an SEC investigation into that

companies business practices, on Monday March 21, 2005, the Company issued a statement from Defendant Salomon Levis Johnson wherein he stated that:

the Company knows of no relevant events or material information causing the unusual activity in the Company's common stock on the New York Exchange other than the recent downgrade of its common stock by certain analysts. Standard & Poor's had also changed the Company's credit outlook to negative from stable when it reaffirmed the Company's investment grade credit rating.

the Company held an investor call yesterday during which management reiterated that the fundamentals of the Company such as loan originations and fee income remained strong and that the Company was anticipating record mortgage production, record commercial loans and record insurance fee income for the first quarter of 2005 .

72. In substantial part, as a result of these false positive reassurances, shares of the Company did not trade lower and, following Defendants' comments, shares of Doral rebounded trading as high as \$24.07 per share, and closing up \$2.40 a share to end the session at \$23.90 on volume of more than 11.0 million shares traded.

73. On March 21, 2005, Business Wire ran a story entitled *No Change on Doral Financial Corp. Rating After Fitch's Review*. That story provided:

CHICAGO--(BUSINESS WIRE)--March 21, 2005--Fitch Ratings has assessed Doral Financial's (Doral) ongoing effort to more effectively manage its interest-rate risk position. This review was prompted by heightened concern with Doral's exposure to increasing short-term rates and the impact on interest-only strips. The increase in short-term rates and the flattening of the yield curve has presented Doral with challenges. Recent actions taken by management coupled with the buffer provided by current strong capitalization, gives Fitch comfort that the current ratings (rated 'BBB+/F2' by Fitch) remain appropriate.

Fitch recognizes the volatility of the interest-only strips held on Doral's balance sheet. Despite the hedging performance to this point, Fitch acknowledges that effective hedging is a complex and dynamic process that must be continually refined on a regular basis. The evolution of Doral's balance sheet, including the growth in the interest-only asset and the somewhat unique characteristics of the mortgage market in Puerto Rico, has increased the need for Doral to implement more comprehensive market risk management techniques. ***Hedges in place in late 2004 anticipated an increase in market rates. However, the hedge position at this time was not designed and therefore ineffective in offsetting the valuation***

*declines resulting from the increase in rates being primarily focused on the short end of the curve. Doral management has improved their hedging recently to minimize future impairment to the company's interest-only strips.* Additional hedges are expected to provide better protection in the event of further rate increases and a continued flat curve. Although future impairment to the interest-only strips is likely, comfort is garnered by the company's earnings prospects and good capitalization levels, which could cushion impairments.

Capitalization, measured by equity-to-assets of 13.06% at Dec. 31, 2004 or by using Fitch's risk-adjusted capital model, is good for the rating category. Fitch requires a more significant level of capital against Doral's higher risk assets, such as capitalized mortgage servicing rights and interest-only securities. Doral's current capitalization level improves their ability to withstand risk-related shocks, such as a retained interest impairment. Therefore, maintenance of capital at or near current levels is a critical rating factor until greater clarity of the effectiveness of hedging can be demonstrated.

Profitability metrics will be pressured with the increased cost of hedging and the potential rising interest-rate environment; however, Doral's market position should provide consistent origination volume. Loan production volume for the fourth-quarter 2004 was a record \$2.0 billion, compared with \$1.7 billion for the comparable 2003 period. For the year ended Dec. 31, 2004, loan production volume was \$7.8 billion, compared with \$6.5 billion for the corresponding 2003 period, an increase of 20%. The increase reflected the continued high demand for new housing in Puerto Rico and Doral's strong share of the new housing market.

74. On March 23, 2005 Doral announced that it was in preliminary talks with a major financial institution regarding the possible sale of a portion of its portfolio of interest-only strips.

75. On April 15, 2005, Doral analyst Merrill Lynch lowered its rating on Doral to "SELL" from "NEUTRAL." That report provided in pertinent part:

**14-Apr. 2005 Merrill Lynch (K. Bruce) Doral Financial Corp.  
Alternatives Could Introduce More Volatility SELL**

**Highlights:**

**Downgrading Doral Financial to Sell from Neutral.**

...we think the stock could continue to witness weakness due to uncertainty surrounding the company's Q1'05 earnings and the potential for significant changes to the company's business model

**Our revised financial model suggests a theoretical fair value range of between \$10-\$21, after adjusting for what we think is an appropriate adjustment**

to book value and earnings from potential write-down of the DRL's interest-only (IO) securities portfolio.

**Delay in Q1'05 earnings could foreshadow changes to the accounting for DRL's interest-only securities or possible disclosure surrounding alternatives to resolve investors' concerns.**

#### **Short Term Pain**

Presuming the company moves forward with the sale of interest-only securities or if it has to revalue the portfolio more conservatively, we think it's possible that DRL could be forced to further impair its I/O securities portfolio...

76. Immediately following the publication of Merrill Lynch downgrade, shares of Doral skidded once more to close at \$17.29 down from the previous day close of \$19.31 per share again on heavy trading volume.

77. Finally, on April 19, 2005, the Company revealed that it would be required to reduce up to five years of reported earnings by as much as \$435 million as it writes down certain securities holdings. The Company indicated that the write-down was necessary to correct how it valued certain I/Os and would require restating financial statements from roughly 2000 through 2004. The Company further stated that its prior 2000-2004 financial statements should no longer be relied upon and that Doral also would be delaying the release of its first-quarter 2005 results. Previously indicated preliminary talks to sell some of the strips to an unspecified "major financial institution," which the Company had announced in March 2005, were also off. On this news, Doral's stock price fell even further to close at \$16.15 – a mere 32% of its class period high of \$49.45 – on huge volume exceeding 9.96 million shares.

#### **UNDISCLOSED ADVERSE INFORMATION**

78. Doral's actual financial results and the true status of its operations were concealed by defendants, and operated to artificially inflate or maintain the market price for Doral securities during the Class Period. Each release, SEC filing and statement particularized herein

was false and misleading and misrepresented and/or failed to disclose the following adverse information:

(a) Doral was overly aggressive in their valuation of the I/Os, thus materially inflating the Company's reported profits as well as the Company's capital structure;

(b) Doral's assumptions on gain on sale margin was artificially high and failed to account for the flattening of the interest yield curve;

(c) Doral failed to disclose that as the yield curve flattened the spread between short-term and long-term interest rates was reduced thereby reducing Doral's profits earned from the "carry trade;"

(d) Doral overvalued its I/O assets and inappropriately thereby generated 'paper profits' though:

(i) Flawed loss assumptions

(ii) Inaccurate (artificially high) mortgage prepayment assumptions<sup>2</sup>

(iii) Inaccurate (artificially low) discount rates;<sup>3</sup>

(e) Doral had an inadequate hedge strategy to protect the I/O strips from yield curve flattening;

(f) As a result of the inappropriate valuation of Doral's I/Os, they are subject to further impairment;

(g) Doral's investment in I/Os had caused it to suffer losses when interest rate flattened out, but the Company concealed, ongoing, current losses through falsification of its financial results;

(h) Doral failed to include disclosures to make it possible for investors to understand the trends in its business.

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<sup>2</sup> As average mortgage life assumptions decline the value of the I/O increases

<sup>3</sup> As the discount rate declines the value of the I/O increase

## **DORAL'S FALSE FINANCIAL REPORTING DURING THE CLASS PERIOD**

79. For the reasons discussed below, these statements were false and misleading as to the financial results released during the Class Period because the financial information was neither prepared in accordance with GAAP, nor did the financial information “present fairly” the Company’s operations due to improper accounting for Capstead’s interest-only investments, mortgage-servicing rights, and retained interests in securitizations, which caused the Company’s earnings to be materially overstated in violation of GAAP and SEC rules.

80. GAAP are those principles recognized by the accounting profession as the conventions, rules and procedures necessary to define accepted accounting practice at a particular time. Regulation S-X (17 C.F.R. §210.4-01(a)(1)) states that financial statements filed with the SEC that are not prepared in compliance with GAAP are presumed to be misleading and inaccurate. Regulation S-X requires that interim financial statements must also comply with GAAP, with the exception that interim financial statements need not include disclosure that would be duplicative of disclosures accompanying annual financial statements. 17 C.F.R. §210.10-01(a).

81. Financial Accounting Standards Board (“FASB”) Statement of Concepts No. 5, ¶87 states:

An expense or loss is recognized if it becomes evident that previously recognized future economic benefits of an asset have been reduced or eliminated, or that a liability has been incurred or increased, without associated economic benefits.

82. GAAP, as set forth in FASB Statement of Financial Accounting Standards (“SFAS”) No. 115, Accounting for Certain Investments in Debt and Equity Securities, requires that:

9. An enterprise shall not classify a debt security as held-to-maturity if the enterprise has the intent to hold the security for only an indefinite period. Consequently, a debt security should not, for example, be classified as held-to-maturity if the enterprise anticipates that the security would be available to be sold in response to:

- a. Changes in market interest rates and related changes in security's prepayment risk

\* \* \*

*Trading Securities and Available-for-Sale Securities*

12. Investments in debt securities that are not classified as held-to-maturity and equity securities that have readily determinable fair values shall be classified in one of the following categories and measured at fair value in the statement of financial position:

- a. *Trading securities.* Securities that are bought and held principally for the purpose of selling them in the near term (thus held for only a short period of time) shall be classified as trading securities. Trading generally reflects active and frequent buying and selling, and trading securities are generally used with the objective of generating profits net short-term differences in price. Mortgage-backed securities that are held for sale in conjunction with mortgage banking activities, as described in FASB Statement No. 65, *Accounting for Certain Mortgage Banking Activities* shall be classified as trading securities. (Other mortgage-backed securities not held for sale in conjunction with mortgage banking activities shall be classified based on the criteria in this paragraph and paragraph 7.)

- b. *Available-for-sale securities.* Investments not classified as trading securities (nor as held-to-maturity securities) shall be classified as available-for-sale securities.

*Reporting Change, in Fair Value*

13. Unrealized holding ***gains and losses*** for trading securities shall be included in earnings. Unrealized holding gains and losses for available-for-sale securities (including those classified as current assets) shall be excluded from earnings and reported as a net amount in a separate component of shareholders equity until realized. Paragraph 36 of FASB Statement No. 109, *Accounting for Income Taxes*, provides guidance on reporting the tax effects of unrealized holding gains and losses reported in a separate component of shareholders' equity.

\* \* \*

128. Statement 65 is amended as follows:

\* \* \*

Mortgage-backed securities held for sale in conjunction with mortgage banking activities shall be classified as trading securities and reported at fair value in accordance with the provisions of FASB Statement No. 115, *Accounting for Certain investments in Debt and Equity Securities*.

b. In paragraph 5, and mortgage-backed securities is deleted.

c. In the first sentence of paragraph 6, or mortgage-backed security is deleted. In the last sentence of paragraph 6, or *mortgage-backed security* and or *security* is deleted. The following is added to paragraph 6 immediately after the first sentence:

The securitization of a mortgage loan held for sale shall be accounted for as the sale of the mortgage loan and the purchase of a mortgage-backed security classified as a trading security at fair value.

d. In paragraph 1, all references to or mortgage-backed security and or security are deleted.

e. In the last sentence of paragraph 8. as being held for sale is replaced by as being either mortgage loans held for sale or mortgage-backed securities classified as trading securities under Statement 115.

f. In the first sentence of paragraph 9(a), and mortgage-backed securities is deleted. The following is added to the end of paragraph 9(a):

If the fair value of a mortgage-backed security subject to an investor purchase commitment exceeds the commitment price, the implicit loss on the commitment shall be recognized.

g. In each sentence of paragraph 9(c), the first usage of market value is replaced by fair value.

h. In paragraph 12. all references to or mortgage-backed securities and or securities are deleted.

i. The following is added to the penultimate sentence in paragraph 17 after investor:

(or fair value of the mortgage loan at the time it is securitized)

j. In paragraphs 28 and 29, and mortgage-backed securities is deleted.

83. According to SFAS No. 125, ¶14:

Interest-only strips, loans, other receivables, or retained interests in securitizations that can contractually be prepaid or otherwise settled in such a way that the holder would not recover substantially all of its recorded investment shall be subsequently measured like investments in debt securities classified as available-for-sale or trading under Statement 115, as amended by this Statement (paragraph 233).

\* \* \*

237. FASB Statement No. 65, Accounting for Certain Mortgage Banking Activities, is amended as follows:

- a. The second sentence of paragraph 6 that was added by Statement 115 is replaced by the following:

After the securitization of a mortgage loan held for sale, the mortgage-backed security shall be classified as a trading security.

- b. Paragraph 8, as amended by Statement 115, is deleted.

- c. The last sentence of paragraph 9(a) is deleted.

- d. In paragraph 10, (paragraphs 16 through 19) is deleted and replaced by (paragraph 13 of FASB

*Statement No. 125. Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities).*

- e. Paragraph 11 and footnote 4 are deleted.

- f. In paragraph 15, the reference to paragraph 18 (as amended by Statement 122) is deleted and the following is added to the end of paragraph 15 replacing the sentence added by Statement 122:

The rate used to determine the present value shall be an appropriate long-term interest rate. For this purpose, estimates of future servicing revenue shall include expected late charges and other ancillary revenue. Estimates of expected future servicing costs shall include direct costs associated with performing the servicing function and appropriate allocations of other costs. Estimated future servicing costs may be determined on an incremental cost basis. The amount capitalized

shall be amortized in proportion to, and over the period of, estimated net servicing income – the excess of servicing revenues over servicing costs.

g. Paragraphs 16-19 and 30 and footnote 6. as amended by Statement 122, are deleted.

h. The three paragraphs added by Statement 122 to paragraph 30 are deleted.

i. In paragraph 34, the terms current (normal) servicing fee rate and servicing and their definitions are deleted.

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

85. Throughout the Class Period, the market for Doral's common stock was open, well-developed and efficient at all relevant times. As a result of these materially false and misleading statements and failures to disclose, Doral common stock traded at artificially inflated prices during the Class Period. Plaintiff and other members of the Class purchased or otherwise acquired Doral common stock upon the integrity of the market price of Doral common stock and market information relating to Doral, and have been damaged thereby.

86. During the Class Period, Defendants materially misled the investing public, thereby inflating the price of Doral common stock by publicly issuing false and misleading statements and omitting to disclose material facts necessary to make defendants' statements, as set forth herein, not false and misleading. Said statements and omissions were materially false and misleading in that they failed to disclose material adverse information and misrepresented the truth about the Company, its business and operations, as alleged herein.

87. At all relevant times, the material misrepresentations and omissions particularized in this Complaint directly or proximately caused or were a substantial contributing cause of the damages sustained by plaintiff and other members of the Class. As described herein, during the Class Period, defendants made or caused to be made a series of materially false or misleading statements about Doral's business, prospects and operations. These material misstatements and omissions had the cause and effect of creating in the market an unrealistically positive assessment of Doral and its business, prospects and operations, thus causing the Company's common stock to be overvalued and artificially inflated at all relevant times. Defendants' materially false and misleading statements during the Class Period resulted in plaintiff and other members of the Class purchasing the Company's common stock at artificially inflated prices, thus causing the damages complained of herein.

#### **ADDITIONAL SCIENTER ALLEGATIONS**

88. As alleged herein, defendants acted with scienter in that each defendant knew that the public documents and statements issued or disseminated in the name of the Company were materially false and misleading; knew that such statements or documents would be issued or disseminated to the investing public; and knowingly and substantially participated or acquiesced in the issuance or dissemination of such statements or documents as primary violations of the federal securities laws. As set forth elsewhere herein in detail, defendants, by virtue of their receipt of information reflecting the true facts regarding Doral, their control over, and/or receipt and/or modification of Doral's allegedly materially misleading misstatements and/or their associations with the Company which made them privy to confidential proprietary information concerning Doral, participated in the fraudulent scheme alleged herein.

89. In addition, throughout the Class Period Defendant Salomon Levis had motivation to make, participate or acquiesce in the issuance or dissemination of the allegedly materially

misleading misstatements alleged in this complaint in order to profit under the terms of his employment agreement with the Company. According to the Company's most recent Proxy Statement dated March 15, 2005, Doral entered into a two year employment agreement with defendant Salomon Levis that provides:

The 2004 Employment Agreement became effective as of January 1, 2004 and terminates on December 31, 2005. As in the past, the Compensation Committee continues to believe that return on equity is of material importance to the overall long-term growth and profitability of Doral Financial. Accordingly, as with Mr. Levis' prior employment agreements, in addition to a base annual salary, the 2004 Employment Agreement provides for a cash incentive bonus equal to 15% of Doral Financial's adjusted net income over a minimum threshold of a 15% return on common stockholders' equity.

In addition, throughout the Class Period, while in possession of material adverse non-public information, Defendants caused the Company to issue and/or register for the sale of millions of shares of Company stock. Defendants were motivated to materially misrepresent to the SEC and investors the true financial condition of the Company in order to reap **over \$10,193,910.00** in total proceeds from the sales of their privately held Doral common stock in the public markets, as follows:

(a) TOTAL INSIDER TRADING PROCEEDS				
Officer	Date	Shares	Price	Proceeds
<b>Richard Bonini, Secretary</b>	5/3/2004	100,000	\$ 32.55	\$ 3,255,000.00
<b>Ricardo Melendez, EVP &amp; CFO</b>	10/29/2004	10,000	\$ 42.00	\$ 420,000.00
	11/1/2004	8,100	\$ 42.00	\$ 340,200.00
	11/2/2004	1,900	\$ 42.00	\$ 79,800.00
		<b>20,000</b>		<b>\$ 840,000.00</b>
<b>Edison Velez, EVP</b>	8/10/2004	10,000	\$ 39.17	\$ 391,700.00
	8/11/2004	7,000	\$ 39.18	\$ 274,260.00
	8/11/2004	10,000	\$ 39.22	\$ 392,200.00
		<b>27,000</b>		<b>\$ 1,058,160.00</b>
<b>Mario Levis, SEVP &amp; Treasurer</b>	1/24/2005	25,000	\$ 43.18	\$ 1,079,500.00
<b>Edgar Cullman, Jr., Director</b>	5/5/2004	55,000	\$ 32.81	\$ 1,804,550.00
	5/5/2004	70,000	\$ 30.81	\$ 2,156,700.00
		<b>125,000</b>		<b>\$ 3,961,250.00</b>
<b>TOTAL PROCEEDS</b>				<b>\$10,193,910.00</b>

**APPLICABILITY OF PRESUMPTION OF RELIANCE:**

**FRAUD-ON-THE-MARKET DOCTRINE**

90. At all relevant times, the market for Doral's common stock was an efficient market for the following reasons, among others:

(a) Doral's stock met the requirements for listing, and was listed and actively traded on the NYSE National Market Exchange, a highly efficient and automated market;

(b) As a regulated issuer, Doral filed periodic public reports with the SEC and the NYSE;

(c) Doral regularly communicated with public investors *via* established market communication mechanisms, including through regular disseminations of press releases on the national circuits of major newswire services and through other wide-ranging public disclosures, such as communications with the financial press and other similar reporting services; and

(d) Doral was followed by several securities analysts employed by major brokerage firm(s) who wrote reports which were distributed to the sales force and certain customers of their respective brokerage firm(s). Each of these reports was publicly available and entered the public marketplace.

91. As a result of the foregoing, the market for Doral securities promptly digested current information regarding Doral from all publicly available sources and reflected such information in Doral stock price. Under these circumstances, all purchasers of Doral common stock during the Class Period suffered similar injury through their purchase of Doral common stock at artificially inflated prices and a presumption of reliance applies.

### **NO SAFE HARBOR**

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

### **BASIS OF ALLEGATIONS**

93. Plaintiff has alleged the following based upon the investigation of plaintiff’s counsel, which included a review of SEC filings by Doral, as well as regulatory filings and reports, securities analysts’ reports and advisories about the Company, press releases and other public statements issued by the Company, and media reports about the Company, and plaintiff believes that substantial additional evidentiary support will exist for the allegations set forth herein after a reasonable opportunity for discovery.

## FIRST CLAIM

### **Violation Of Section 10(b) Of The Exchange Act And Rule 10b-5 Promulgated Thereunder Against All Defendants**

94. Plaintiff repeats and realleges each and every allegation contained above as if fully set forth herein.

95. During the Class Period, defendants carried out a plan, scheme and course of conduct which was intended to and, throughout the Class Period, did: (i) deceive the investing public, including plaintiff and other Class members, as alleged herein; (ii) enable the Individual Defendants and other Doral insiders **to sell more than \$10,000,000 of their personally held Doral common stock to the unsuspecting public**; and (iii) cause plaintiff and other members of the Class to purchase Doral common stock at artificially inflated prices. In furtherance of this unlawful scheme, plan and course of conduct, defendants, jointly and individually (and each of them) took the actions set forth herein.

96. Defendants: (a) employed devices, schemes, and artifices to defraud; (b) made untrue statements of material fact and/or omitted to state material facts necessary to make the statements not misleading; and (c) engaged in acts, practices, and a course of business which operated as a fraud and deceit upon the purchasers of the Company's common stock in an effort to maintain artificially high market prices for Doral's common stock in violation of Section 10(b) of the Exchange Act and Rule 10b-5. All defendants are sued either as primary participants in the wrongful and illegal conduct charged herein or as controlling persons as alleged below.

97. Defendants, individually and in concert, directly and indirectly, by the use, means or instrumentalities of interstate commerce and/or of the mails, engaged and participated in a continuous course of conduct to conceal adverse material information about the business, operations and future prospects of Doral as specified herein.

98. These defendants employed devices, schemes and artifices to defraud, while in possession of material adverse non-public information and engaged in acts, practices, and a course of conduct as alleged herein in an effort to assure investors of Doral's value and performance and continued substantial growth, which included the making of, or the participation in the making of, untrue statements of material facts and omitting to state material facts necessary in order to make the statements made about Doral and its business operations and future prospects in the light of the circumstances under which they were made, not misleading, as set forth more particularly herein, and engaged in transactions, practices and a course of business which operated as a fraud and deceit upon the purchasers of Doral common stock during the Class Period.

99. Each of the Individual Defendants' primary liability, and controlling person liability, arises from the following facts: (i) the Individual Defendants were high-level executives and/or directors at the Company during the Class Period and members of the Company's management team or had control thereof; (ii) each of these defendants, by virtue of his responsibilities and activities as a senior officer and/or director of the Company was privy to and participated in the creation, development and reporting of the Company's internal budgets, plans, projections and/or reports; (iii) each of these defendants enjoyed significant personal contact and familiarity with the other defendants and was advised of and had access to other members of the Company's management team, internal reports and other data and information about the Company's finances, operations, and sales at all relevant times; and (iv) each of these defendants was aware of the Company's dissemination of information to the investing public which they knew or deliberately disregarded was materially false and misleading.

100. The defendants had actual knowledge of the misrepresentations and omissions of material facts set forth herein, or acted with deliberate disregard for the truth in that they failed to

ascertain and to disclose such facts. Such defendants' material misrepresentations and/or omissions were done knowingly or with deliberate for the purpose and effect of concealing Doral's operating condition and future business prospects from the investing public and supporting the artificially inflated price of its common stock. As demonstrated by defendants' overstatements and misstatements of the Company's business, operations and earnings throughout the Class Period, defendants, if they did not have actual knowledge of the misrepresentations and omissions alleged, were deliberate in failing to obtain such knowledge by deliberately refraining from taking those steps necessary to discover whether those statements were false or misleading.

101. As a result of the dissemination of the materially false and misleading information and failure to disclose material facts, as set forth above, the market price of Doral common stock was artificially inflated during the Class Period. In ignorance of the fact that market prices of Doral's publicly-traded common stock were artificially inflated, and relying directly or indirectly on the false and misleading statements made by defendants, or upon the integrity of the market in which the securities trade, and/or on the absence of material adverse information that was known to or deliberately disregarded by defendants but not disclosed in public statements by defendants during the Class Period, plaintiff and the other members of the Class acquired Doral common stock during the Class Period at artificially high prices and were damaged thereby.

102. At the time of said misrepresentations and omissions, plaintiff and other members of the Class were ignorant of their falsity, and believed them to be true. Had plaintiff and the other members of the Class and the marketplace known the truth regarding the problems that Doral was experiencing, which were not disclosed by defendants, plaintiff and other members of the Class would not have purchased or otherwise acquired their Doral common stock, or, if they

had acquired such common stock during the Class Period, they would not have done so at the artificially inflated prices which they paid.

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

104. As a direct and proximate result of defendants' wrongful conduct, plaintiff and the other members of the Class suffered damages in connection with their respective purchases and sales of the Company's common stock during the Class Period.

### **SECOND CLAIM**

#### **Violation Of Section 20(a) Of The Exchange Act Against Individual Defendants**

105. Plaintiff repeats and realleges each and every allegation contained above as if fully set forth herein.

106. The Individual Defendants acted as controlling persons of Doral within the meaning of Section 20(a) of the Exchange Act as alleged herein. By virtue of their high-level positions, and their ownership and contractual rights, participation in and/or awareness of the Company's operations and/or intimate knowledge of the false financial statements filed by the Company with the SEC and disseminated to the investing public, the Individual Defendants had the power to influence and control and did influence and control, directly or indirectly, the decision-making of the Company, including the content and dissemination of the various statements which plaintiff contends are false and misleading. The Individual Defendants were provided with or had unlimited access to copies of the Company's reports, press releases, public filings and other statements alleged by plaintiff to be misleading prior to and/or shortly after these statements were issued and had the ability to prevent the issuance of the statements or cause the statements to be corrected.

107. In particular, each of these defendants had direct and supervisory involvement in the day-to-day operations of the Company and, therefore, is presumed to have had the power to control or influence the particular transactions giving rise to the securities violations as alleged herein, and exercised the same.

108. As set forth above, Doral and the Individual Defendants each violated Section 10(b) and Rule 10b-5 by their acts and omissions as alleged in this Complaint. By virtue of their positions as controlling persons, the Individual Defendants are liable pursuant to Section 20(a) of the Exchange Act. As a direct and proximate result of defendants' wrongful conduct, plaintiff and other members of the Class suffered damages in connection with their purchases of the Company's common stock during the Class Period.

**WHEREFORE**, plaintiff prays for relief and judgment, as follows:

A. Determining that this action is a proper class action, designating plaintiff as Lead Plaintiff and certifying plaintiff as a class representative under Rule 23 of the Federal Rules of Civil Procedure and plaintiff's counsel as Lead Counsel;

B. Awarding compensatory damages in favor of plaintiff and the other Class members against all defendants, jointly and severally, for all damages sustained as a result of defendants' wrongdoing, in an amount to be proven at trial, including interest thereon;

C. Awarding plaintiff and the Class their reasonable costs and expenses incurred in this action, including counsel fees and expert fees;

D. Awarding extraordinary, equitable and/or injunctive relief as permitted by law, equity and the federal statutory provisions sued hereunder, pursuant to Rules 64 and 65 and any appropriate state law remedies to assure that the Class has an effective remedy; and

E. Such other and further relief as the Court may deem just and proper.

**JURY TRIAL DEMANDED**

Plaintiff hereby demands a trial by jury.

DATED: April 20, 2005

**WECHSLER HARWOOD LLP**

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