

HANMI FINANCIAL CORP  
Form 10-Q  
November 12, 2013  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

**FORM 10-Q**

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the Quarterly Period Ended September 30, 2013**

**or**

.. **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the Transition Period From \_\_\_\_\_ To \_\_\_\_\_**

**Commission File Number: 000-30421**

**HANMI FINANCIAL CORPORATION**  
**(Exact Name of Registrant as Specified in its Charter)**

**Delaware**  
**(State or Other Jurisdiction**  
**of Incorporation or Organization)**

**95-4788120**  
**(I.R.S. Employer**  
**Identification No.)**

**3660 Wilshire Boulevard, Penthouse Suite A**

**Los Angeles, California**  
**(Address of Principal Executive Offices)**

**90010**  
**(Zip Code)**

**(213) 382-2200**

**(Registrant's Telephone Number, Including Area Code)**

**Not Applicable**

**(Former Name, Former Address and Former Fiscal Year, If Changed Since Last Report)**

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer  Accelerated Filer

Non-Accelerated Filer  (Do Not Check if a Smaller Reporting Company) Smaller Reporting Company

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes  No

As of October 31, 2013, there were 31,756,615 outstanding shares of the Registrant's Common Stock.



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**Hanmi Financial Corporation and Subsidiaries**

**Quarterly Report on Form 10-Q**

**Three and Nine Months Ended September 30, 2013**

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**Table of Contents****Part I Financial Information****Item 1. Financial Statements****Hanmi Financial Corporation and Subsidiaries****Consolidated Balance Sheets (Unaudited)***(In thousands, except share data)*

|   | <b>September 30,<br/>2013</b> | <b>December 31,<br/>2012</b> |
|---|-------------------------------|------------------------------|
| <b>Assets</b>   |                               |                              |
| Cash and due from banks   | \$ 78,810                     | \$ 92,350                    |
| Interest-bearing deposits in other banks  | 115,044                       | 175,697                      |
| Cash and cash equivalents   | 193,854                       | 268,047                      |
| Restricted cash   |                               | 5,350                        |
| Securities available-for-sale, at fair value (amortized cost of \$392,773 as of September 30, 2013 and \$443,712 as of December 31, 2012) | 383,057                       | 451,060                      |
| Loans held for sale, at the lower of cost or fair value   | 5,228                         | 8,306                        |
| Loans receivable, net of allowance for loan losses of \$57,639 as of September 30, 2013 and \$63,305 as of December 31, 2012              | 2,102,621                     | 1,986,051                    |
| Accrued interest receivable   | 6,957                         | 7,581                        |
| Premises and equipment, net   | 14,205                        | 15,150                       |
| Other real estate owned, net  | 290                           | 774                          |
| Customers' liability on acceptances   | 1,535                         | 1,336                        |
| Servicing assets  | 6,385                         | 5,542                        |
| Other intangible assets, net  | 1,212                         | 1,335                        |
| Investment in federal home loan bank stock, at cost   | 14,060                        | 17,800                       |
| Investment in federal reserve bank stock, at cost   | 13,200                        | 12,222                       |
| Income tax assets   | 61,747                        | 60,028                       |
| Bank-owned life insurance   | 29,468                        | 29,054                       |
| Prepaid expenses  | 1,986                         | 2,084                        |
| Other assets  | 9,332                         | 10,800                       |
| <b>Total assets</b>   | <b>\$ 2,845,137</b>           | <b>\$ 2,882,520</b>          |
| <b>Liabilities and Stockholders' Equity</b>   |                               |                              |
| <b>Liabilities:</b>   |                               |                              |
| <b>Deposits:</b>  |                               |                              |
| Noninterest-bearing   | \$ 778,345                    | \$ 720,931                   |
| Interest-bearing  | 1,651,362                     | 1,675,032                    |
| <b>Total deposits</b>   | <b>2,429,707</b>              | <b>2,395,963</b>             |
| Accrued interest payable  | 2,705                         | 11,775                       |

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|  |                     |                     |
|--|---------------------|---------------------|
| Bank's liability on acceptances  | 1,535               | 1,336               |
| Federal home loan bank advances  | 2,645               | 2,935               |
| Junior subordinated debentures   |                     | 82,406              |
| Accrued expenses and other liabilities   | 10,589              | 9,741               |
| <b>Total liabilities</b>   | <b>2,447,181</b>    | <b>2,504,156</b>    |
| Stockholders' equity:  |                     |                     |
| Common stock, \$0.001 par value; authorized 62,500,000 shares; issued 32,332,009 shares (31,754,115 shares outstanding) and 32,074,434 shares (31,496,540 shares outstanding) as of September 30, 2013 and December 31, 2012 | 257                 | 257                 |
| Additional paid-in capital   | 551,881             | 550,066             |
| Accumulated other comprehensive (loss) income, net of tax (benefit) expense of (\$5,230) as of September 30, 2013 and \$1,946 as of December 31, 2012  | (4,469)             | 5,418               |
| Accumulated deficit  | (79,855)            | (107,519)           |
| Less: treasury stock, at cost; 577,894 shares as of September 30, 2013 and December 31, 2012   | (69,858)            | (69,858)            |
| <b>Total stockholders' equity</b>  | <b>397,956</b>      | <b>378,364</b>      |
| <b>Total liabilities and stockholders' equity</b>  | <b>\$ 2,845,137</b> | <b>\$ 2,882,520</b> |

See Accompanying Notes to Consolidated Financial Statements (Unaudited)

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**Hanmi Financial Corporation and Subsidiaries**  
**Consolidated Statements of Operations (Unaudited)**

*(In thousands, except share and per share data)*

|  | <b>Three Months Ended<br/>September 30,</b> |               | <b>Nine Months Ended<br/>September 30,</b> |               |
|--|---|---------------|--|---------------|
|  | <b>2013</b>                                 | <b>2012</b>   | <b>2013</b>                                | <b>2012</b>   |
| <b>Interest and Dividend Income:</b>                   |   |               |  |               |
| Interest and fees on loans                             | \$ 29,098                                   | \$ 26,781     | \$ 83,736                                  | \$ 81,564     |
| Taxable interest on investment securities              | 2,040                                       | 1,992         | 6,256                                      | 6,280         |
| Tax-exempt interest on investment securities           | 69  | 98            | 237  | 299           |
| Interest on term federal funds sold                    |   | 191           |  | 684           |
| Interest on federal funds sold                         |   | 20            | 6  | 53            |
| Interest on interest-bearing deposits in other banks   | 28  | 142           | 140  | 269           |
| Dividends on federal reserve bank stock                | 198   | 154           | 577  | 430           |
| Dividends on federal home loan bank stock              | 194   | 24            | 449  | 82            |
| <b>Total interest and dividend income</b>              | <b>31,627</b>                               | <b>29,402</b> | <b>91,401</b>                              | <b>89,661</b> |
| <b>Interest Expense:</b>                               |   |               |  |               |
| Interest on deposits                                   | 3,117                                       | 3,639         | 9,376                                      | 12,511        |
| Interest on federal home loan bank advances            | 36  | 40            | 115  | 126           |
| Interest on junior subordinated debentures             |   | 804           | 678  | 2,400         |
| <b>Total interest expense</b>                          | <b>3,153</b>                                | <b>4,483</b>  | <b>10,169</b>                              | <b>15,037</b> |
| Net interest income before provision for credit losses | 28,474                                      | 24,919        | 81,232                                     | 74,624        |
| Provision for credit losses                            |   |               |  | 6,000         |
| Net interest income after provision for credit losses  | 28,474                                      | 24,919        | 81,232                                     | 68,624        |
| <b>Non-Interest Income:</b>                            |   |               |  |               |
| Service charges on deposit accounts                    | 2,730                                       | 2,851         | 8,662                                      | 8,955         |
| Insurance commissions                                  | 1,273                                       | 1,092         | 3,904                                      | 3,622         |
| Remittance fees  | 481   | 476           | 1,519                                      | 1,417         |
| Trade finance fees                                     | 248   | 274           | 801  | 858           |
| Other service charges and fees                         | 349   | 361           | 1,082                                      | 1,105         |
| Bank-owned life insurance income                       | 230   | 235           | 693  | 872           |
| Gain on sales of SBA loans guaranteed portion          | 994   | 1,772         | 6,064                                      | 7,245         |
| Net loss on sales of other loans                       |   | (515)         | (557)                                      | (8,234)       |

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|   |                  |                  |                  |                  |
|---|------------------|------------------|------------------|------------------|
| Net gain on sales of investment securities                    | 611              | 10               | 923              | 1,392            |
| Other-than-temporary impairment loss on investment securities |                  | (176)            |                  | (292)            |
| Other operating income  | 410              | 140              | 742              | 402              |
| <b>Total non-interest income</b>                              | <b>7,326</b>     | <b>6,520</b>     | <b>23,833</b>    | <b>17,342</b>    |
| <b>Non-Interest Expense:</b>                                  |                  |                  |                  |                  |
| Salaries and employee benefits                                | 9,926            | 9,148            | 28,692           | 27,707           |
| Occupancy and equipment                                       | 2,634            | 2,623            | 7,745            | 7,839            |
| Deposit insurance premiums and regulatory assessments         | 308              | 283              | 1,059            | 3,182            |
| Data processing   | 1,158            | 1,211            | 3,470            | 3,762            |
| Other real estate owned expense                               | (59)             | 352              | (47)             | 377              |
| Professional fees   | 907              | 1,112            | 5,428            | 2,950            |
| Directors and officers liability insurance                    | 219              | 296              | 658              | 888              |
| Supplies and communications                                   | 562              | 669              | 1,687            | 1,803            |
| Advertising and promotion                                     | 1,140            | 1,023            | 2,817            | 2,633            |
| Loan-related expense  | 91               | 164              | 328              | 452              |
| Amortization of other intangible assets                       | 41               | 41               | 123              | 157              |
| Other operating expenses                                      | 2,039            | 1,882            | 6,137            | 5,563            |
| <b>Total non-interest expense</b>                             | <b>18,966</b>    | <b>18,804</b>    | <b>58,097</b>    | <b>57,313</b>    |
| Income before provision (benefit) for income taxes            | 16,834           | 12,635           | 46,968           | 28,653           |
| Provision (benefit) for income taxes                          | 6,584            | (644)            | 17,089           | (47,742)         |
| <b>Net income</b>   | <b>\$ 10,250</b> | <b>\$ 13,279</b> | <b>\$ 29,879</b> | <b>\$ 76,395</b> |
| <b>Earnings per share:</b>                                    |                  |                  |                  |                  |
| Basic   | \$ 0.32          | \$ 0.42          | \$ 0.95          | \$ 2.43          |
| Diluted   | \$ 0.32          | \$ 0.42          | \$ 0.94          | \$ 2.42          |
| <b>Weighted-average shares outstanding:</b>                   |                  |                  |                  |                  |
| Basic   | 31,621,049       | 31,475,976       | 31,583,897       | 31,474,042       |
| Diluted   | 31,733,004       | 31,545,111       | 31,652,795       | 31,506,767       |

See Accompanying Notes to Consolidated Financial Statements (Unaudited)



Table of Contents**Hanmi Financial Corporation and Subsidiaries****Consolidated Statements of Comprehensive Income (Unaudited)***(In thousands)*

|   | <b>Three Months<br/>Ended<br/>September 30,</b> |                  | <b>Nine Months Ended<br/>September 30,</b> |                  |
|---|---|------------------|--|------------------|
|   | <b>2013</b>                                     | <b>2012</b>      | <b>2013</b>                                | <b>2012</b>      |
| Net Income  | \$ 10,250                                       | \$ 13,279        | \$ 29,879                                  | \$ 76,395        |
| Other comprehensive (loss) income, net of tax   |   |                  |  |                  |
| Unrealized (loss) gain on securities  |   |                  |  |                  |
| Unrealized holding (loss) gain arising during period  | (10,020)  | 1,655            | (16,141)                                   | 2,248            |
| Unrealized holding gain arising from the reclassification of held-to-maturity securities to available-for-sale securities |   | 1,968            |  | 1,968            |
| Less: reclassification adjustment for (gain) loss included in net income  | (611)   | 166              | (923)                                      | (1,100)          |
| Unrealized gain on interest rate swap   |   |                  |  | 9                |
| Unrealized gain (loss) on interest-only strip of servicing assets   |   | 2                | 1  | (4)              |
| Income tax benefit (expense) related to items of other comprehensive income   | 4,528   | (1,581)          | 7,176                                      | (1,281)          |
| Other comprehensive (loss) income   | (6,103)   | 2,210            | (9,887)                                    | 1,840            |
| <b>Comprehensive Income</b>   | <b>\$ 4,147</b>                                 | <b>\$ 15,489</b> | <b>\$ 19,992</b>                           | <b>\$ 78,235</b> |

See Accompanying Notes to Consolidated Financial Statements (Unaudited)

Table of Contents**Hanmi Financial Corporation and Subsidiaries****Consolidated Statements of Changes in Stockholders Equity (Unaudited)***(In thousands, except share data)*

|  | Common Stock - Number of Shares              |                    |  | Stockholders Equity                        |   |                                   |                               |                                 |                   |
|--|--|--------------------|--|--|---|-----------------------------------|-------------------------------|---------------------------------|-------------------|
|  | Gross<br>Shares<br>Issued and<br>Outstanding | Treasury<br>Shares | Net<br>Shares<br>Issued and<br>Outstanding | Additional<br>Common<br>Paid-in<br>Capital | Accumulated<br>Other<br>Comprehensive<br>Income<br>(Loss) | Retained<br>Earnings<br>(Deficit) | Treasury<br>Stock,<br>at Cost | Total<br>Stockholders<br>Equity |                   |
| <b>Balance at<br/>January 1, 2012</b>  | <b>32,067,095</b>                            | <b>(577,894)</b>   | <b>31,489,201</b>                          | <b>\$ 257</b>                              | <b>\$ 549,578</b>   | <b>\$ 3,524</b>                   | <b>\$ (197,893)</b>           | <b>\$ (69,858)</b>              | <b>\$ 285,608</b> |
| Share-based<br>compensation<br>expense   |  |                    |  |  | 144   |                                   |                               |                                 | 144               |
| Comprehensive<br>income:   |  |                    |  |  |   |                                   |                               |                                 |                   |
| Net income   |  |                    |  |  |   |                                   | 76,395                        |                                 | 76,395            |
| Change in<br>unrealized gain<br>on securities<br>Available-for-sale<br>and interest-only<br>strips, net of<br>income taxes |  |                    |  |  |   | 1,840                             |                               |                                 | 1,840             |
| Total<br>comprehensive<br>income   |  |                    |  |  |   |                                   |                               |                                 | 78,235            |
| <b>Balance at<br/>September 30,<br/>2012</b>   | <b>32,067,095</b>                            | <b>(577,894)</b>   | <b>31,489,201</b>                          | <b>\$ 257</b>                              | <b>\$ 549,722</b>   | <b>\$ 5,364</b>                   | <b>\$ (121,498)</b>           | <b>\$ (69,858)</b>              | <b>\$ 363,987</b> |
| <b>Balance at<br/>January 1, 2013</b>  | <b>32,074,434</b>                            | <b>(577,894)</b>   | <b>31,496,540</b>                          | <b>\$ 257</b>                              | <b>\$ 550,066</b>   | <b>\$ 5,418</b>                   | <b>\$ (107,519)</b>           | <b>\$ (69,858)</b>              | <b>\$ 378,364</b> |
| Share-based<br>compensation<br>expense   |  |                    |  |  | 387   |                                   |                               |                                 | 387               |
| Exercises of<br>stock options  | 40,678                                       |                    | 40,678                                     |  | 139   |                                   |                               |                                 | 139               |
| Exercises of<br>stock warrants   | 106,315                                      |                    | 106,315                                    |  | 1,289   |                                   |                               |                                 | 1,289             |
|  | 111,332                                      |                    | 111,332                                    |  |   |                                   |                               |                                 |                   |

|  |                   |                  |                   |               |                   |                   |                    |                    |                   |
|--|-------------------|------------------|-------------------|---------------|-------------------|-------------------|--------------------|--------------------|-------------------|
| Restricted stock awards  |                   |                  |                   |               |                   |                   |                    |                    |                   |
| Restricted stock cancellation                                    | (750)             |                  | (750)             |               |                   |                   |                    |                    |                   |
| Cash dividend  |                   |                  |                   |               |                   | (2,215)           |                    |                    | (2,215)           |
| Comprehensive income:  |                   |                  |                   |               |                   |                   |                    |                    |                   |
| Net income   |                   |                  |                   |               |                   | 29,879            |                    |                    | 29,879            |
| Change in unrealized loss on securities                          |                   |                  |                   |               |                   |                   |                    |                    |                   |
| Available-for-sale and interest-only strips, net of income taxes |                   |                  |                   |               |                   | (9,887)           |                    |                    | (9,887)           |
| Total comprehensive income                                       |                   |                  |                   |               |                   |                   |                    |                    | 19,992            |
| <b>Balance at September 30, 2013</b>                             | <b>32,332,009</b> | <b>(577,894)</b> | <b>31,754,115</b> | <b>\$ 257</b> | <b>\$ 551,881</b> | <b>\$ (4,469)</b> | <b>\$ (79,855)</b> | <b>\$ (69,858)</b> | <b>\$ 397,956</b> |

See Accompanying Notes to Consolidated Financial Statements (Unaudited)

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**Hanmi Financial Corporation and Subsidiaries**  
**Consolidated Statements of Cash Flows (Unaudited)**

*(In thousands)*

|   | <b>Nine Months Ended<br/>September 30,</b> |               |
|---|--|---------------|
|   | <b>2013</b>                                | <b>2012</b>   |
| <b>Cash flows from operating activities:</b>                                      |  |               |
| Net income  | \$ 29,879                                  | \$ 76,395     |
| Adjustments to reconcile net income to net cash provided by operating activities: |  |               |
| Depreciation and amortization of premises and equipment                           | 1,525                                      | 1,606         |
| Amortization of premiums and accretion of discounts on investment securities, net | 1,961                                      | 2,743         |
| Amortization of other intangible assets   | 123  | 157           |
| Amortization of servicing assets  | 1,152                                      | 720           |
| Share-based compensation expense  | 387  | 144           |
| Provision for credit losses   |  | 6,000         |
| Other-than-temporary loss on investment securities                                |  | 292           |
| Gain on sales of investment securities  | (923)                                      | (1,392)       |
| Loss on investment in affordable housing partnership                              | 552  | 660           |
| Gain on sales of loans  | (5,507)                                    | (1,311)       |
| (Gain) loss on sales of other real estate owned                                   | (71)                                       | 92            |
| (Gain) loss on sale of premises and equipment                                     | (13)                                       | 5             |
| Valuation adjustment on other real estate owned                                   | 7  | 301           |
| Valuation adjustment for loans held for sale                                      |  | 2,300         |
| Origination of loans held for sale  | (63,113)                                   | (86,311)      |
| Proceeds from sales of SBA loans guaranteed portion                               | 77,338                                     | 95,856        |
| Change in restricted cash   | 5,350                                      | (2,575)       |
| Change in accrued interest receivable   | 624  | 362           |
| Change in cash surrender value of bank-owned life insurance                       | (693)                                      | (872)         |
| Change in prepaid expenses  | 98   | (641)         |
| Change in other assets  | 717  | (2,843)       |
| Change in income tax assets   | 5,139                                      | (52,714)      |
| Change in accrued interest payable  | (9,070)                                    | (766)         |
| Change in stock warrants payable  | 80   | 177           |
| Change in other liabilities   | 2,435                                      | 1,923         |
| <b>Net cash provided by operating activities</b>                                  | <b>47,977</b>                              | <b>40,308</b> |
| <b>Cash flows from investing activities:</b>                                      |  |               |
| Proceeds from matured term federal funds  |  | 215,000       |
| Proceeds from redemption of federal home loan bank and federal reserve bank stock | 3,740                                      | 3,233         |
| Proceeds from matured or called securities available-for-sale                     | 62,104                                     | 108,701       |
| Proceeds from sales of securities available-for-sale                              | 41,560                                     | 96,538        |
| Proceeds from matured or called securities held to maturity                       |  | 6,704         |

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|   |                   |                   |
|---|-------------------|-------------------|
| Proceeds from sales of other real estate owned                  | 1,645             | 1,850             |
| Proceeds from sales of loans held for sale                      | 5,380             | 87,979            |
| Proceeds from insurance settlement on bank-owned life insurance | 279               | 345               |
| Change in loans receivable                                      | (131,169)         | (59,026)          |
| Purchases of term federal fund                                  |                   | (155,000)         |
| Purchases of securities available-for-sale                      | (53,762)          | (179,080)         |
| Purchases of premises and equipment                             | (567)             | (420)             |
| Purchases of loans receivable                                   |                   | (82,885)          |
| Purchases of federal reserve bank stock                         | (978)             | (1,703)           |
| <b>Net cash (used in) provided by investing activities</b>      | <b>(71,768)</b>   | <b>42,236</b>     |
| <b>Cash flows from financing activities:</b>                    |                   |                   |
| Change in deposits  | 33,744            | 18,475            |
| Repayment of long-term federal home loan bank advances          | (290)             | (274)             |
| Redemption of junior subordinated debentures                    | (82,406)          |                   |
| Proceeds from exercise of stock options                         | 460               |                   |
| Proceeds from exercise of stock warrants                        | 305               |                   |
| Cash dividend paid  | (2,215)           |                   |
| <b>Net cash (used in) provided by financing activities</b>      | <b>(50,402)</b>   | <b>18,201</b>     |
| <b>Net (decrease) increase in cash and cash equivalents</b>     | <b>(74,193)</b>   | <b>100,745</b>    |
| Cash and cash equivalents at beginning of year                  | 268,047           | 201,683           |
| <b>Cash and cash equivalents at end of period</b>               | <b>\$ 193,854</b> | <b>\$ 302,428</b> |

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|  |           |           |
|--|-----------|-----------|
| Cash paid during the period for:   |           |           |
| Interest paid  | \$ 19,239 | \$ 15,803 |
| Income taxes paid  | \$ 11,910 | \$ 4,912  |
| Non-cash activities:   |           |           |
| Transfer of loans receivable to other real estate owned                          | \$ 1,090  | \$ 2,558  |
| Transfer of loans receivable to loans held for sale                              | \$ 8,010  | \$ 89,792 |
| Transfer of loans held for sale to loans receivable                              | \$ 2,534  | \$ 1,779  |
| Reclassification of held-to-maturity securities to available-for-sale securities | \$        | \$ 52,674 |
| Conversion of stock warrants into common stock                                   | \$ 981    | \$        |
| Income tax benefit related to items of other comprehensive loss                  | \$ 7,176  | \$        |
| Change in unrealized loss in accumulated other comprehensive income              | \$ 16,140 | \$        |

See Accompanying Notes to Consolidated Financial Statements (Unaudited)

Table of Contents**Hanmi Financial Corporation and Subsidiaries****Notes to Consolidated Financial Statements (Unaudited)****Three and Nine Months Ended September 30, 2013 and 2012****Note 1 Basis of Presentation**

Hanmi Financial Corporation ( Hanmi Financial, the Company, we or us ) is a Delaware corporation and is subject to the Bank Holding Company Act of 1956, as amended. Our primary subsidiary is Hanmi Bank (the Bank ), a California state chartered bank. Our other subsidiaries are Chun-Ha Insurance Services, Inc., a California corporation ( Chun-Ha ), and All World Insurance Services, Inc., a California corporation ( All World ).

In management's opinion, the accompanying unaudited consolidated financial statements of Hanmi Financial Corporation and its subsidiaries reflect all adjustments of a normal and recurring nature that are necessary for a fair presentation of the results for the interim period ended September 30, 2013, but are not necessarily indicative of the results that will be reported for the entire year or any other interim period. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with U.S. generally accepted accounting principles ( GAAP ) have been condensed or omitted. The aforementioned unaudited consolidated financial statements are in conformity with GAAP. Such interim consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q pursuant to the rules and regulations of the Securities and Exchange Commission. The interim information should be read in conjunction with our Annual Report on Form 10-K for the fiscal year ended December 31, 2012 (the 2012 Annual Report on Form 10-K ).

The preparation of interim consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Descriptions of our significant accounting policies are included in *Note 2 Summary of Significant Accounting Policies* in our 2012 Annual Report on Form 10-K.

**Note 2 Investment Securities**

The following is a summary of investment securities available-for-sale as of September 30, 2013 and December 31, 2012:

|  | Amortized<br>Cost     | Gross<br>Unrealized<br>Gain | Gross<br>Unrealized<br>Loss | Estimated<br>Fair<br>Value |
|--|-----------------------|-----------------------------|-----------------------------|----------------------------|
|  | <i>(In thousands)</i> |                             |                             |                            |
| <b>September 30, 2013</b>                          |                       |                             |                             |                            |
| Mortgage-backed securities <sup>(1)</sup>          | \$ 129,463            | \$ 793                      | \$ 3,171                    | \$ 127,085                 |
| U.S. government agency securities                  | 98,844                | 4                           | 5,970                       | 92,878                     |
| Collateralized mortgage obligations <sup>(1)</sup> | 85,191                | 773                         | 854                         | 85,110                     |
| Municipal bonds-tax exempt                         | 6,438                 | 61                          | 13                          | 6,486                      |

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|  |                   |                 |                  |                   |
|--|-------------------|-----------------|------------------|-------------------|
| Municipal bonds-taxable                    | 35,290            | 219             | 721              | 34,788            |
| Corporate bonds                            | 20,478            | 210             | 205              | 20,483            |
| SBA loan pool securities                   | 13,826            |                 | 905              | 12,921            |
| Other securities                           | 3,025             |                 | 104              | 2,921             |
| Equity securities                          | 218               | 167             |                  | 385               |
| <b>Total securities available-for-sale</b> | <b>\$ 392,773</b> | <b>\$ 2,227</b> | <b>\$ 11,943</b> | <b>\$ 383,057</b> |

**December 31, 2012**

|  |                   |                 |               |                   |
|--|-------------------|-----------------|---------------|-------------------|
| Mortgage-backed securities <sup>(1)</sup>          | \$ 157,185        | \$ 3,327        | \$ 186        | \$ 160,326        |
| U.S. government agency securities                  | 92,990            | 222             | 94            | 93,118            |
| Collateralized mortgage obligations <sup>(1)</sup> | 98,821            | 1,775           | 109           | 100,487           |
| Municipal bonds-tax exempt                         | 12,209            | 603             |               | 12,812            |
| Municipal bonds-taxable                            | 44,248            | 2,029           | 135           | 46,142            |
| Corporate bonds                                    | 20,470            | 176             | 246           | 20,400            |
| SBA loan pool securities                           | 14,104            | 4               | 82            | 14,026            |
| Other securities                                   | 3,331             | 73              | 47            | 3,357             |
| Equity securities                                  | 354               | 78              | 40            | 392               |
| <b>Total securities available-for-sale</b>         | <b>\$ 443,712</b> | <b>\$ 8,287</b> | <b>\$ 939</b> | <b>\$ 451,060</b> |

(1) Collateralized by residential mortgages and guaranteed by U.S. government sponsored entities



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The amortized cost and estimated fair value of investment securities as of September 30, 2013, by contractual maturity, are shown below. Although mortgage-backed securities and collateralized mortgage obligations have contractual maturities through 2063, expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

|                                     | <b>Available-for-Sale</b> |                                     |
|-------------------------------------|---------------------------|-------------------------------------|
|                                     | <b>Amortized<br/>Cost</b> | <b>Estimated<br/>Fair<br/>Value</b> |
|                                     | <i>(In thousands)</i>     |                                     |
| Within one year                     | \$                        | \$                                  |
| Over one year through five years    | 33,325                    | 33,315                              |
| Over five years through ten years   | 105,186                   | 100,320                             |
| Over ten years                      | 39,390                    | 36,842                              |
| Mortgage-backed securities          | 129,463                   | 127,085                             |
| Collateralized mortgage obligations | 85,191                    | 85,110                              |
| Equity securities                   | 218                       | 385                                 |
| <b>Total</b>                        | <b>\$ 392,773</b>         | <b>\$ 383,057</b>                   |

FASB ASC 320, *Investments Debt and Equity Securities*, requires us to periodically evaluate our investments for other-than-temporary impairment ( OTTI ). There was no OTTI charge during the nine months ended September 30, 2013.

Gross unrealized losses on investment securities available-for-sale, the estimated fair value of the related securities and the number of securities aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, were as follows as of September 30, 2013 and December 31, 2012:

|                                     | <b>Holding Period</b>                              |                                     |                                     |                                      |                                     |                                     |                                      |                                     |                                     |
|-------------------------------------|--|-------------------------------------|-------------------------------------|--------------------------------------|-------------------------------------|-------------------------------------|--------------------------------------|-------------------------------------|-------------------------------------|
|                                     | <b>Less Than 12 Months</b>                         |                                     |                                     | <b>12 Months or More</b>             |                                     |                                     |                                      |                                     |                                     |
|                                     | <b>Gross<br/>Unrealized<br/>Loss</b>               | <b>Estimated<br/>Fair<br/>Value</b> | <b>Number<br/>of<br/>Securities</b> | <b>Gross<br/>Unrealized<br/>Loss</b> | <b>Estimated<br/>Fair<br/>Value</b> | <b>Number<br/>of<br/>Securities</b> | <b>Gross<br/>Unrealized<br/>Loss</b> | <b>Estimated<br/>Fair<br/>Value</b> | <b>Number<br/>of<br/>Securities</b> |
|                                     | <i>(In thousands, except number of securities)</i> |                                     |                                     |                                      |                                     |                                     |                                      |                                     |                                     |
| <b>September 30, 2013</b>           |  |                                     |                                     |                                      |                                     |                                     |                                      |                                     |                                     |
| Mortgage-backed securities          | \$ 1,552   | \$ 64,931                           | 21                                  | \$ 1,619                             | \$ 22,774                           | 9                                   | \$ 3,171                             | \$ 87,705                           | 30                                  |
| U.S. government agency securities   | 4,577  | 70,263                              | 26                                  | 1,393                                | 19,603                              | 7                                   | 5,970                                | 89,866                              | 33                                  |
| Collateralized mortgage obligations | 500  | 24,478                              | 12                                  | 354                                  | 9,610                               | 4                                   | 854                                  | 34,088                              | 16                                  |
| Municipal bonds-tax exempt          | 13   | 4,065                               | 2                                   |                                      |                                     |                                     | 13                                   | 4,065                               | 2                                   |
|                                     | 479  | 19,783                              | 14                                  | 242                                  | 3,876                               | 4                                   | 721                                  | 23,659                              | 18                                  |

|                          |                 |                   |           |                 |                  |           |                  |                   |            |
|--------------------------|-----------------|-------------------|-----------|-----------------|------------------|-----------|------------------|-------------------|------------|
| Municipal bonds-taxable  |                 |                   |           |                 |                  |           |                  |                   |            |
| Corporate bonds          | 91              | 4,899             | 1         | 114             | 6,874            | 2         | 205              | 11,773            | 3          |
| SBA loan pool securities | 229             | 2,714             | 1         | 676             | 10,207           | 3         | 905              | 12,921            | 4          |
| Other securities         | 18              | 1,994             | 3         | 86              | 927              | 2         | 104              | 2,921             | 5          |
| <b>Total</b>             | <b>\$ 7,459</b> | <b>\$ 193,127</b> | <b>80</b> | <b>\$ 4,484</b> | <b>\$ 73,871</b> | <b>31</b> | <b>\$ 11,943</b> | <b>\$ 266,998</b> | <b>111</b> |

**December 31, 2012**

|                                     |               |                  |           |               |                  |          |               |                  |           |
|-------------------------------------|---------------|------------------|-----------|---------------|------------------|----------|---------------|------------------|-----------|
| Mortgage-backed securities          | \$ 186        | \$ 28,354        | 10        | \$            | \$               |          | \$ 186        | \$ 28,354        | 10        |
| U.S. government agency securities   | 94            | 26,894           | 9         |               |                  |          | 94            | 26,894           | 9         |
| Collateralized mortgage obligations | 109           | 14,344           | 5         |               |                  |          | 109           | 14,344           | 5         |
| Municipal bonds-taxable             | 126           | 4,587            | 4         | 9             | 1,964            | 3        | 135           | 6,551            | 7         |
| Corporate bonds                     |               |                  |           | 246           | 10,738           | 3        | 246           | 10,738           | 3         |
| SBA loan pool securities            | 82            | 11,004           | 3         |               |                  |          | 82            | 11,004           | 3         |
| Other securities                    | 1             | 12               | 1         | 46            | 953              | 1        | 47            | 965              | 2         |
| Equity securities                   | 40            | 96               | 1         |               |                  |          | 40            | 96               | 1         |
| <b>Total</b>                        | <b>\$ 638</b> | <b>\$ 85,291</b> | <b>33</b> | <b>\$ 301</b> | <b>\$ 13,655</b> | <b>7</b> | <b>\$ 939</b> | <b>\$ 98,946</b> | <b>40</b> |

All individual securities that have been in a continuous unrealized loss position for 12 months or longer as of September 30, 2013 and December 31, 2012 had investment grade ratings upon purchase. The issuers of these securities have not established any cause for default on these securities and the various rating agencies have reaffirmed these securities' long-term investment grade status as of September 30, 2013. These securities have fluctuated in value since their purchase dates as market interest rates have fluctuated.

FASB ASC 320 requires other-than-temporarily impaired investment securities to be written down when fair value is below amortized cost in circumstances where: (1) an entity has the intent to sell a security; (2) it is more likely than not that an entity will be required to sell the security before recovery of its amortized cost basis; or (3) an entity does not expect to recover the entire amortized cost basis of the security. If an entity intends to sell a security or if it is more likely than not the entity will be required to sell the security before recovery, an OTTI write-down is recognized in earnings equal to the entire difference between the security's amortized cost basis and its fair value. If an entity does not intend to sell the security or it is not more likely than not that it will be required to sell the security before recovery, the OTTI write-down is separated into an amount representing credit loss, which is recognized in earnings, and the amount related to all other factors, which is recognized in other comprehensive income.

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The Company does not intend to sell these securities and it is not more likely than not that we will be required to sell the investments before the recovery of its amortized cost basis. In addition, the unrealized losses on municipal and corporate bonds are not considered other-than-temporarily impaired as the bonds are rated investment grade and there are no credit quality concerns with the issuers. Interest payments have been made as scheduled, and management believes this will continue in the future and that the bonds will be repaid in full as scheduled. Therefore, in management's opinion, all securities that have been in a continuous unrealized loss position for the past 12 months or longer as of September 30, 2013 and December 31, 2012 were not other-than-temporarily impaired, and therefore, no impairment charges as of September 30, 2013 and December 31, 2012 were warranted.

Realized gains and losses on sales of investment securities, proceeds from sales of investment securities and the tax expense on sales of investment securities were as follows for the periods indicated:

|   | <b>Three Months Ended</b> |              | <b>Nine Months Ended</b> |                 |
|---|---------------------------|--------------|--------------------------|-----------------|
|   | <b>September 30,</b>      |              | <b>September 30,</b>     |                 |
|   | <b>2013</b>               | <b>2012</b>  | <b>2013</b>              | <b>2012</b>     |
|   | <i>(In thousands)</i>     |              |                          |                 |
| Gross realized gains on sales of investment securities      | \$ 619                    | \$ 10        | \$ 932                   | \$ 1,442        |
| Gross realized losses on sales of investment securities     | (8)                       |              | (9)                      | (50)            |
| <b>Net realized gains on sales of investment securities</b> | <b>\$ 611</b>             | <b>\$ 10</b> | <b>\$ 923</b>            | <b>\$ 1,392</b> |
| Proceeds from sales of investment securities                | \$ 26,661                 | \$ 8,000     | \$ 51,425                | \$ 96,538       |
| Tax expense on sales of investment securities               | \$ 257                    | \$ 4         | \$ 388                   | \$ 585          |

For the three months ended September 30, 2013, there was a \$611,000 net gain in earnings resulting from the sale of investment securities that had previously been recorded as net unrealized gains of \$899,000 in comprehensive income. For the three months ended September 30, 2012, there was a \$10,000 net gain in earnings resulting from the redemption of investment securities that had previously been recorded as net unrealized gains of \$4,000 in comprehensive income.

For the nine months ended September 30, 2013, there was a \$923,000 net gain in earnings resulting from the redemption and sale of investment securities that had previously been recognized as net unrealized gains of \$2.4 million in comprehensive income. For the nine months ended September 30, 2012, there was a \$1.4 million net gain in earnings resulting from the redemption and sale of investment securities that had previously been recorded as net unrealized gains of \$1.7 million in comprehensive income.

Investment securities available-for-sale with carrying values of \$50.5 million and \$18.2 million as of September 30, 2013 and December 31, 2012, respectively, were pledged to secure FHLB advances, public deposits and for other purposes as required or permitted by law.

**Table of Contents****Note 3 Loans**

The Board of Directors and management review and approve the Bank's loan policy and procedures on a regular basis to reflect issues such as regulatory and organizational structure changes, strategic planning revisions, concentrations of credit, loan delinquencies and non-performing loans, problem loans, and policy adjustments.

Real estate loans are loans secured by liens or interest in real estate, to provide purchase, construction, and refinance on real estate properties. Commercial and industrial loans consist of commercial term loans, commercial lines of credit, and Small Business Administration (SBA) loans. Consumer loans consist of auto loans, credit cards, personal loans, and home equity lines of credit. We maintain management loan review and monitoring departments that review and monitor pass graded loans as well as problem loans to prevent further deterioration.

Concentrations of Credit: The majority of the Bank's loan portfolio consists of commercial real estate and commercial and industrial loans. The Bank has been diversifying and monitoring commercial real estate loans based on property types, tightening underwriting standards, and portfolio liquidity and management, and has not exceeded certain specified limits set forth in the Bank's loan policy. Most of the Bank's lending activity occurs within Southern California.

**Loans Receivable**

Loans receivable consisted of the following as of the dates indicated:

|   | September 30,<br>2013 | December 31,<br>2012 |
|---|-----------------------|----------------------|
|   | <i>(In thousands)</i> |                      |
| Real estate loans:                        |                       |                      |
| Commercial property                       | \$ 887,576            | \$ 787,094           |
| Residential property                      | 82,519                | 101,778              |
| Total real estate loans                   | 970,095               | 888,872              |
| Commercial and industrial loans:          |                       |                      |
| Commercial term <sup>(1)</sup>            | 913,021               | 884,364              |
| Commercial lines of credit <sup>(2)</sup> | 54,374                | 56,121               |
| SBA loans <sup>(3)</sup>                  | 153,990               | 148,306              |
| International loans                       | 33,726                | 34,221               |
| Total commercial and industrial loans     | 1,155,111             | 1,123,012            |
| Consumer loans                            | 34,065                | 36,676               |
| <b>Total gross loans</b>                  | <b>2,159,271</b>      | <b>2,048,560</b>     |
| Allowance for loans losses                | (57,639)              | (63,305)             |
| Deferred loan fees                        | 989                   | 796                  |
| <b>Loans receivable, net</b>              | <b>\$ 2,102,621</b>   | <b>\$ 1,986,051</b>  |

- (1) Includes owner-occupied property loans of \$816.0 million and \$774.2 million as of September 30, 2013 and December 31, 2012, respectively.*
- (2) Includes owner-occupied property loans of \$540,000 and \$1.4 million as of September 30, 2013 and December 31, 2012, respectively.*
- (3) Includes owner-occupied property loans of \$145.0 million and \$128.4 million as of September 30, 2013 and December 31, 2012, respectively.*

Accrued interest on loans receivable was \$5.1 million and \$5.4 million at September 30, 2013 and December 31, 2012, respectively. At September 30, 2013 and December 31, 2012, loans receivable totaling \$629.7 million and \$524.0 million, respectively, were pledged to secure advances from the FHLB and the FRB's federal discount window.

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The following table details the information on the sales and reclassifications of loans receivable to loans held for sale by portfolio segment for the three months ended September 30, 2013 and 2012:

|   | Real Estate           | Commercial<br>and Industrial | Consumer  | Total            |
|---|-----------------------|------------------------------|-----------|------------------|
|   | <i>(In thousands)</i> |                              |           |                  |
| <b>September 30, 2013</b>                                     |                       |                              |           |                  |
| Balance at beginning of period                                | \$ 780                | \$ 1,773                     | \$        | \$ 2,553         |
| Origination of loans held for sale                            |                       | 17,135                       |           | 17,135           |
| Reclassification from loans held for sale to loans receivable | (774)                 | (1,760)                      |           | (2,534)          |
| Sales of loans held for sale                                  |                       | (11,906)                     |           | (11,906)         |
| Principal payoffs and amortization                            | (6)                   | (14)                         |           | (20)             |
| <b>Balance at end of period</b>                               | <b>\$</b>             | <b>\$ 5,228</b>              | <b>\$</b> | <b>\$ 5,228</b>  |
| <b>September 30, 2012</b>                                     |                       |                              |           |                  |
| Balance at beginning of period                                | \$ 1,289              | \$ 3,849                     | \$        | \$ 5,138         |
| Origination of loans held for sale                            |                       | 25,722                       |           | 25,722           |
| Reclassification from loans receivable to loans held for sale | 8,917                 | 16,404                       |           | 25,321           |
| Sales of loans held for sale                                  | (8,828)               | (36,050)                     |           | (44,878)         |
| Principal payoffs and amortization                            | (21)                  | (27)                         |           | (48)             |
| Valuation adjustments   |                       | (519)                        |           | (519)            |
| <b>Balance at end of period</b>                               | <b>\$ 1,357</b>       | <b>\$ 9,379</b>              | <b>\$</b> | <b>\$ 10,736</b> |

For the three months ended September 30, 2013, there was no reclassification of loans receivable as loans held for sale, and loans held for sale of \$11.9 million were sold. For the three months ended September 30, 2012, loans receivable of \$25.3 million were reclassified as loans held for sale, and loans held for sale of \$44.9 million were sold.

The following table details the information on the sales and reclassifications of loans receivable to loans held for sale by portfolio segment for the nine months ended September 30, 2013 and 2012:

|   | Real Estate           | Commercial<br>and Industrial | Consumer | Total    |
|---|-----------------------|------------------------------|----------|----------|
|   | <i>(In thousands)</i> |                              |          |          |
| <b>September 30, 2013</b>                                     |                       |                              |          |          |
| Balance at beginning of period                                | \$                    | \$ 8,306                     | \$       | \$ 8,306 |
| Origination of loans held for sale                            |                       | 63,113                       |          | 63,113   |
| Reclassification from loans receivable to loans held for sale | 780                   | 7,230                        |          | 8,010    |
| Reclassification from Loans held for sale to loan receivables | (774)                 | (1,760)                      |          | (2,534)  |

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|  |                 |           |              |                  |
|--|-----------------|-----------|--------------|------------------|
| Sales of loans held for sale   |                 | (71,627)  |              | (71,627)         |
| Principal payoffs and amortization                                   | (6)             | (34)      |              | (40)             |
| <b>Balance at end of period</b>                                      | <b>\$</b>       | <b>\$</b> | <b>5,228</b> | <b>\$</b>        |
|  |                 |           |              | <b>\$ 5,228</b>  |
| <b>September 30, 2012</b>  |                 |           |              |                  |
| Balance at beginning of period                                       | \$ 11,068       | \$        | 11,519       | \$ 22,587        |
| Origination of loans held for sale                                   |                 |           | 86,311       | 86,311           |
| Reclassification from loans receivable to loans held for sale        | 41,141          |           | 48,651       | 89,792           |
| Reclassification from loans held for sale to other real estate owned | (360)           |           |              | (360)            |
| Reclassification from loans held for sale to loans receivable        | (1,647)         |           | (132)        | (1,779)          |
| Sales of loans held for sale   | (47,531)        |           | (135,505)    | (183,036)        |
| Principal payoffs and amortization                                   | (190)           |           | (289)        | (479)            |
| Valuation adjustments  | (1,124)         |           | (1,176)      | (2,300)          |
| <b>Balance at end of period</b>                                      | <b>\$ 1,357</b> | <b>\$</b> | <b>9,379</b> | <b>\$ 10,736</b> |

For the nine months ended September 30, 2013, loans receivable of \$8.0 million were reclassified as loans held for sale, and loans held for sale of \$71.6 million were sold. For the nine months ended September 30, 2012, loans receivable of \$89.8 million were reclassified as loans held for sale, and loans held for sale of \$183.0 million were sold.

**Table of Contents****Allowance for Loan Losses and Allowance for Off-Balance Sheet Items**

In the first quarter of 2010, the look-back period was reduced from twelve quarters to eight quarters, with 60 percent weighting given to the most recent four quarters and 40 percent to the oldest four quarters, to place greater emphasis on losses taken by the Bank during the economic downturn. In the second quarter of 2013, management reevaluated the look-back period and restored the twelve quarter look-back period in order to capture a period of higher losses that would have otherwise been excluded. Risk factor calculations are weighted at 50 percent for the most recent four quarters, 33 percent for the next four quarters, and 17 percent for the oldest four quarters. As homogenous loans are bulk graded, the risk grade is not factored into the historical loss analysis. The change in methodology maintained the Bank's allowance at a level consistent with the prior quarter. Under the previous methodology, the Bank would have recognized a negative provision of \$5.9 million in the second quarter of 2013, which the Bank did not consider to be prudent, given the uncertainty in the economy.

Activity in the allowance for loan losses and allowance for off-balance sheet items was as follows for the periods indicated:

|   | As of and for the<br>Three Months Ended |                  |                       | As of and for the<br>Nine Months Ended |                       |
|---|---|------------------|-----------------------|--|-----------------------|
|   | September 30,<br>2013                   | June 30,<br>2013 | September 30,<br>2012 | September 30,<br>2013                  | September 30,<br>2012 |
|   | <i>(In thousands)</i>                   |                  |                       |  |                       |
| <b>Allowance for loan losses:</b>             |   |                  |                       |  |                       |
| Balance at beginning of period                | \$ 59,876                               | \$ 61,191        | \$ 71,893             | \$ 63,305                              | \$ 89,936             |
| Actual charge-offs                            | (4,610)                                 | (3,490)          | (7,223)               | (11,124)                               | (34,260)              |
| Recoveries on loans previously charged off    | 2,383                                   | 1,867            | 1,320                 | 4,964                                  | 3,681                 |
| Net loan charge-offs                          | (2,227)                                 | (1,623)          | (5,903)               | (6,160)                                | (30,579)              |
| Provision charged to operating expense        | (10)                                    | 308              | 117                   | 494                                    | 6,750                 |
| <b>Balance at end of period</b>               | <b>\$ 57,639</b>                        | <b>\$ 59,876</b> | <b>\$ 66,107</b>      | <b>\$ 57,639</b>                       | <b>\$ 66,107</b>      |
| <b>Allowance for off-balance sheet items:</b> |   |                  |                       |  |                       |
| Balance at beginning of period                | \$ 1,320                                | \$ 1,628         | \$ 2,348              | \$ 1,824                               | \$ 2,981              |
| Provision charged to operating expense        | 10                                      | (308)            | (117)                 | (494)                                  | (750)                 |
| <b>Balance at end of period</b>               | <b>\$ 1,330</b>                         | <b>\$ 1,320</b>  | <b>\$ 2,231</b>       | <b>\$ 1,330</b>                        | <b>\$ 2,231</b>       |



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The following table details the information on the allowance for loan losses by portfolio segment for the three months ended September 30, 2013 and 2012:

|   | Real Estate           | Commercial<br>and Industrial | Consumer         | Unallocated     | Total               |
|---|-----------------------|------------------------------|------------------|-----------------|---------------------|
|   | <i>(In thousands)</i> |                              |                  |                 |                     |
| <b>September 30, 2013</b>                             |                       |                              |                  |                 |                     |
| <b>Allowance for loan losses:</b>                     |                       |                              |                  |                 |                     |
| Beginning balance                                     | \$ 18,480             | \$ 39,034                    | \$ 1,884         | \$ 478          | \$ 59,876           |
| Charge-offs   |                       | (4,592)                      | (18)             |                 | (4,610)             |
| Recoveries on loans previously charged off            | 726                   | 1,652                        | 5                |                 | 2,383               |
| Provision   | (118)                 | (1,289)                      | (232)            | 1,629           | (10)                |
| <b>Ending balance</b>                                 | <b>\$ 19,088</b>      | <b>\$ 34,805</b>             | <b>\$ 1,639</b>  | <b>\$ 2,107</b> | <b>\$ 57,639</b>    |
| Ending balance: individually evaluated for impairment | \$ 25                 | \$ 2,014                     | \$ 330           | \$              | \$ 2,369            |
| Ending balance: collectively evaluated for impairment | \$ 19,063             | \$ 32,791                    | \$ 1,309         | \$ 2,107        | \$ 55,270           |
| <b>Loans receivable:</b>                              |                       |                              |                  |                 |                     |
| <b>Ending balance</b>                                 | <b>\$ 970,095</b>     | <b>\$ 1,155,111</b>          | <b>\$ 34,065</b> | <b>\$</b>       | <b>\$ 2,159,271</b> |
| Ending balance: individually evaluated for impairment | \$ 6,385              | \$ 35,507                    | \$ 1,574         | \$              | \$ 43,466           |
| Ending balance: collectively evaluated for impairment | \$ 963,710            | \$ 1,119,604                 | \$ 32,491        | \$              | \$ 2,115,805        |
| <b>September 30, 2012</b>                             |                       |                              |                  |                 |                     |
| <b>Allowance for loan losses:</b>                     |                       |                              |                  |                 |                     |
| Beginning balance                                     | \$ 21,406             | \$ 46,810                    | \$ 1,757         | \$ 1,920        | \$ 71,893           |
| Charge-offs   | (1,321)               | (5,571)                      | (331)            |                 | (7,223)             |
| Recoveries on loans previously charged off            | 58                    | 1,251                        | 11               |                 | 1,320               |
| Provision   | 1,080                 | 174                          | 783              | (1,920)         | 117                 |
| <b>Ending balance</b>                                 | <b>\$ 21,223</b>      | <b>\$ 42,664</b>             | <b>\$ 2,220</b>  | <b>\$</b>       | <b>\$ 66,107</b>    |
| Ending balance: individually evaluated for impairment | \$ 768                | \$ 5,148                     | \$ 398           | \$              | \$ 6,314            |
| Ending balance: collectively evaluated for impairment | \$ 20,455             | \$ 37,516                    | \$ 1,822         | \$              | \$ 59,793           |

|  |            |              |           |    |              |
|--|------------|--------------|-----------|----|--------------|
| <b>Loans receivable:</b>                                 |            |              |           |    |              |
| Ending balance   | \$ 840,061 | \$ 1,079,814 | \$ 38,415 | \$ | \$ 1,958,290 |
| Ending balance: individually evaluated<br>for impairment | \$ 16,315  | \$ 41,084    | \$ 1,238  | \$ | \$ 58,637    |
| Ending balance: collectively evaluated for<br>impairment | \$ 823,746 | \$ 1,038,730 | \$ 37,177 | \$ | \$ 1,899,653 |

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The following table details the information on the allowance for loan losses by portfolio segment for the nine months ended September 30, 2013 and 2012:

|   | Real Estate      | Commercial<br>and Industrial | Consumer<br><i>(In thousands)</i> | Unallocated     | Total            |
|---|------------------|------------------------------|-----------------------------------|-----------------|------------------|
| <b>September 30, 2013</b>                             |                  |                              |                                   |                 |                  |
| <b>Allowance for loan losses:</b>                     |                  |                              |                                   |                 |                  |
| Beginning balance                                     | \$ 18,180        | \$ 41,928                    | \$ 2,280                          | \$ 917          | \$ 63,305        |
| Charge-offs   | (359)            | (10,547)                     | (218)                             |                 | (11,124)         |
| Recoveries on loans previously charged off            | 1,776            | 3,128                        | 60                                |                 | 4,964            |
| Provision   | (509)            | 296                          | (483)                             | 1,190           | 494              |
| <b>Ending balance</b>                                 | <b>\$ 19,088</b> | <b>\$ 34,805</b>             | <b>\$ 1,639</b>                   | <b>\$ 2,107</b> | <b>\$ 57,639</b> |
| Ending balance: individually evaluated for impairment | \$ 25            | \$ 2,014                     | \$ 330                            | \$              | \$ 2,369         |
| Ending balance: collectively evaluated for impairment | <b>\$ 19,063</b> | <b>\$ 32,791</b>             | <b>\$ 1,309</b>                   | <b>\$ 2,107</b> | <b>\$ 55,270</b> |
| <b>Loans receivable:</b>                              |                  |                              |                                   |                 |                  |
| Ending balance  | \$ 970,095       | \$ 1,155,111                 | \$ 34,065                         | \$              | \$ 2,159,271     |
| Ending balance: individually evaluated for impairment | \$ 6,385         | \$ 35,507                    | \$ 1,574                          | \$              | \$ 43,466        |
| Ending balance: collectively evaluated for impairment | \$ 963,710       | \$ 1,119,604                 | \$ 32,491                         | \$              | \$ 2,115,805     |
| <b>September 30, 2012</b>                             |                  |                              |                                   |                 |                  |
| <b>Allowance for loan losses:</b>                     |                  |                              |                                   |                 |                  |
| Beginning balance                                     | \$ 19,637        | \$ 66,005                    | \$ 2,243                          | \$ 2,051        | \$ 89,936        |
| Charge-offs   | (9,406)          | (24,079)                     | (775)                             |                 | (34,260)         |
| Recoveries on loans previously charged off            | 575              | 3,053                        | 53                                |                 | 3,681            |
| Provision   | 10,419           | (2,317)                      | 699                               | (2,051)         | 6,750            |
| <b>Ending balance</b>                                 | <b>\$ 21,225</b> | <b>\$ 42,662</b>             | <b>\$ 2,220</b>                   | <b>\$</b>       | <b>\$ 66,107</b> |
| Ending balance: individually evaluated for impairment | \$ 768           | \$ 5,148                     | \$ 398                            | \$              | 6,314            |
| Ending balance: collectively evaluated for impairment | \$ 20,457        | \$ 37,514                    | \$ 1,822                          | \$              | 59,793           |

|   |            |              |           |    |           |
|---|------------|--------------|-----------|----|-----------|
| <b>Loans receivable:</b>                              |            |              |           |    |           |
| Ending balance  | \$ 840,061 | \$ 1,079,814 | \$ 38,415 | \$ | 1,958,290 |
| Ending balance: individually evaluated for impairment | \$ 16,315  | \$ 41,084    | \$ 1,238  | \$ | 58,637    |
| Ending balance: collectively evaluated for impairment | \$ 823,746 | \$ 1,038,730 | \$ 37,177 | \$ | 1,899,653 |

### Credit Quality Indicators

As part of the on-going monitoring of the credit quality of our loan portfolio, we utilize an internal loan grading system to identify credit risk and assign an appropriate grade (from (0) to (8)) for each and every loan in our loan portfolio. All loans are reviewed by a third-party loan reviewer on a semi-annual basis. Additional adjustments are made when determined to be necessary. The loan grade definitions are as follows:

**Pass:** Pass loans, grades (0) to (4), are in compliance in all respects with the Bank's credit policy and regulatory requirements, and do not exhibit any potential or defined weaknesses as defined under Special Mention (5), Substandard (6) or Doubtful (7). This category is the strongest level of the Bank's loan grading system. It incorporates all performing loans with no credit weaknesses. It includes cash and stock/security secured loans or other investment grade loans. The following are sub categories within the Pass category, or grades (0) to (4):

- Pass (0): Loans or commitments secured in full by cash or cash equivalents.
- Pass (1): Loans or commitments requiring a very strong, well-structured credit relationship with an established borrower. The relationship should be supported by audited financial statements indicating cash flow well in excess of debt service requirements, excellent liquidity, and very strong capital.
- Pass (2): Loans or commitments requiring a well-structured credit that may not be as seasoned or as high quality as grade (1). Capital, liquidity, debt service capacity, and collateral coverage must all be well above average. This grade includes individuals with substantial net worth supported by liquid assets and strong income.
- Pass (3): Loans or commitments to borrowers exhibiting a fully acceptable credit risk. These borrowers should have sound balance sheets and significant cash flow coverage, although they may be somewhat more leveraged and exhibit greater fluctuations in earning and financing but generally would be considered very attractive to the Bank as a borrower. The borrower has historically demonstrated the ability to manage economic adversity. Real estate and asset-based loans with this grade must have characteristics that place them well above the minimum underwriting requirements. Asset-based borrowers assigned this grade must exhibit extremely favorable leverage and cash flow characteristics and consistently demonstrate a high level of unused borrowing capacity.

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Pass (4): Loans or commitments to borrowers exhibiting either somewhat weaker balance sheets or positive, but inconsistent, cash flow coverage. These borrowers may exhibit somewhat greater credit risk, and as a result, the Bank may have secured its exposure to mitigate the risk. If so, the collateral taken should provide an unquestionable ability to repay the indebtedness in full through liquidation, if necessary. Cash flows should be adequate to cover debt service and fixed obligations, although there may be a question about the borrower's ability to provide alternative sources of funds in emergencies. Better quality real estate and asset-based borrowers who fully comply with all underwriting standards and are performing according to projections would be assigned this grade.

**Special Mention:** A Special Mention credit, grade (5), has potential weaknesses that deserve management's close attention. If not corrected, these potential weaknesses may result in deterioration of the repayment of the debt and result in a Substandard classification. Loans that have significant actual, not potential, weaknesses are considered more severely classified.

**Substandard:** A Substandard credit, grade (6), has a well-defined weakness that jeopardizes the liquidation of the debt. A credit graded Substandard is not protected by the sound worth and paying capacity of the borrower, or of the value and type of collateral pledged. With a Substandard loan, there is a distinct possibility that the Bank will sustain some loss if the weaknesses or deficiencies are not corrected.

**Doubtful:** A Doubtful credit, grade (7), is one that has critical weaknesses that would make the collection or liquidation of the full amount due improbable. However, there may be pending events which may work to strengthen the credit, and therefore the amount or timing of a possible loss cannot be determined at the current time.

**Loss:** A loan classified as Loss, grade (8), is considered uncollectible and of such little value that their continuance as active bank assets is not warranted. This classification does not mean that the loan has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this asset even though partial recovery may be possible in the future. Loans classified Loss will be charged off in a timely manner.

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As of September 30, 2013 and December 31, 2012, pass (grade 0-4), criticized (grade 5) and classified (grade 6-7) loans, disaggregated by loan class, were as follows:

|                                  | <b>Pass<br/>(Grade<br/>0-4)</b> | <b>Criticized<br/>(Grade 5)</b> | <b>Classified<br/>(Grade 6-7)</b> | <b>Total<br/>Loans</b> |
|----------------------------------|---------------------------------|---------------------------------|-----------------------------------|------------------------|
|                                  | <i>(In thousands)</i>           |                                 |                                   |                        |
| <b>September 30, 2013</b>        |                                 |                                 |                                   |                        |
| Real estate loans:               |                                 |                                 |                                   |                        |
| Commercial property              |                                 |                                 |                                   |                        |
| Retail                           | \$ 448,429                      | \$ 11,435                       | \$ 4,778                          | \$ 464,642             |
| Land                             | 5,430                           |                                 | 164                               | 5,594                  |
| Other                            | 396,021                         | 8,750                           | 12,569                            | 417,340                |
| Residential property             | 80,568                          |                                 | 1,951                             | 82,519                 |
| Commercial and industrial loans: |                                 |                                 |                                   |                        |
| Commercial term                  |                                 |                                 |                                   |                        |
| Unsecured                        | 82,806                          | 1,797                           | 12,391                            | 96,994                 |
| Secured by real estate           | 764,787                         | 13,568                          | 37,672                            | 816,027                |
| Commercial lines of credit       | 52,630                          | 198                             | 1,546                             | 54,374                 |
| SBA loans                        | 142,346                         | 664                             | 10,980                            | 153,990                |
| International loans              | 32,046                          | 500                             | 1,180                             | 33,726                 |
| Consumer loans                   | 31,342                          | 175                             | 2,548                             | 34,065                 |
| <b>Total gross loans</b>         | <b>\$ 2,036,405</b>             | <b>\$ 37,087</b>                | <b>\$ 85,779</b>                  | <b>\$ 2,159,271</b>    |
| <b>December 31, 2012</b>         |                                 |                                 |                                   |                        |
| Real estate loans:               |                                 |                                 |                                   |                        |
| Commercial property              |                                 |                                 |                                   |                        |
| Retail                           | \$ 386,650                      | \$ 3,971                        | \$ 2,324                          | \$ 392,945             |
| Land                             | 5,491                           |                                 | 8,516                             | 14,007                 |
| Other                            | 366,518                         | 12,132                          | 1,492                             | 380,142                |
| Residential property             | 99,250                          |                                 | 2,528                             | 101,778                |
| Commercial and industrial loans: |                                 |                                 |                                   |                        |
| Commercial term                  |                                 |                                 |                                   |                        |
| Unsecured                        | 87,370                          | 663                             | 22,139                            | 110,172                |
| Secured by real estate           | 710,723                         | 13,038                          | 50,431                            | 774,192                |
| Commercial lines of credit       | 53,391                          | 863                             | 1,867                             | 56,121                 |
| SBA loans                        | 136,058                         | 1,119                           | 11,129                            | 148,306                |
| International loans              | 34,221                          |                                 |                                   | 34,221                 |
| Consumer loans                   | 33,707                          | 201                             | 2,768                             | 36,676                 |
| <b>Total gross loans</b>         | <b>\$ 1,913,379</b>             | <b>\$ 31,987</b>                | <b>\$ 103,194</b>                 | <b>\$ 2,048,560</b>    |

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The following is an aging analysis of past due loans, disaggregated by loan class, as of September 30, 2013 and December 31, 2012:

|                                  | 30-59 Days Past Due   | 60-89 Days Past Due | 90 Days or More Past Due | Total Past Due   | Current             | Total Loans         | Accruing 90 Days or More Past Due |
|----------------------------------|-----------------------|---------------------|--------------------------|------------------|---------------------|---------------------|-----------------------------------|
|                                  | <i>(In thousands)</i> |                     |                          |                  |                     |                     |                                   |
| <b>September 30, 2013</b>        |                       |                     |                          |                  |                     |                     |                                   |
| Real estate loans:               |                       |                     |                          |                  |                     |                     |                                   |
| Commercial property              |                       |                     |                          |                  |                     |                     |                                   |
| Retail                           | \$ 2,270              | \$                  | \$                       | \$ 2,270         | \$ 462,372          | \$ 464,642          | \$                                |
| Land                             |                       |                     |                          |                  | 5,594               | 5,594               |                                   |
| Other                            |                       | 1,768               |                          | 1,768            | 415,572             | 417,340             |                                   |
| Residential property             |                       |                     | 561                      | 561              | 81,958              | 82,519              |                                   |
| Commercial and industrial loans: |                       |                     |                          |                  |                     |                     |                                   |
| Commercial term                  |                       |                     |                          |                  |                     |                     |                                   |
| Unsecured                        | 1,309                 | 389                 | 692                      | 2,390            | 94,604              | 96,994              |                                   |
| Secured by real estate           | 285                   | 300                 | 415                      | 1,000            | 815,027             | 816,027             |                                   |
| Commercial lines of credit       |                       |                     |                          |                  |                     |                     |                                   |
| SBA loans                        | 1,743                 | 1,086               | 4,542                    | 7,371            | 54,374              | 54,374              |                                   |
| International loans              |                       |                     |                          |                  | 146,619             | 153,990             |                                   |
| Consumer loans                   | 316                   | 27                  | 295                      | 638              | 33,726              | 34,065              |                                   |
| <b>Total gross loans</b>         | <b>\$ 5,923</b>       | <b>\$ 3,570</b>     | <b>\$ 6,505</b>          | <b>\$ 15,998</b> | <b>\$ 2,143,273</b> | <b>\$ 2,159,271</b> | <b>\$</b>                         |
| <b>December 31, 2012</b>         |                       |                     |                          |                  |                     |                     |                                   |
| Real estate loans:               |                       |                     |                          |                  |                     |                     |                                   |
| Commercial property              |                       |                     |                          |                  |                     |                     |                                   |
| Retail                           | \$                    | \$ 111              | \$                       | \$ 111           | \$ 392,834          | \$ 392,945          | \$                                |
| Land                             |                       |                     | 335                      | 335              | 13,672              | 14,007              |                                   |
| Other                            |                       |                     |                          |                  | 380,142             | 380,142             |                                   |
| Residential property             |                       | 588                 | 311                      | 899              | 100,879             | 101,778             |                                   |
| Commercial and industrial loans: |                       |                     |                          |                  |                     |                     |                                   |
| Commercial term                  |                       |                     |                          |                  |                     |                     |                                   |
| Unsecured                        | 918                   | 1,103               | 1,279                    | 3,300            | 106,872             | 110,172             |                                   |
| Secured by real estate           | 1,949                 |                     | 926                      | 2,875            | 771,317             | 774,192             |                                   |
| Commercial lines of credit       |                       |                     |                          |                  |                     |                     |                                   |
| SBA loans                        | 3,759                 | 1,039               | 2,800                    | 7,598            | 55,517              | 56,121              |                                   |
| International loans              |                       |                     |                          |                  | 140,708             | 148,306             |                                   |
| Consumer loans                   | 61                    | 146                 | 538                      | 745              | 34,221              | 34,221              |                                   |
|                                  |                       |                     |                          |                  | 35,931              | 36,676              |                                   |

|                          |                 |                 |                 |                  |                     |                     |           |
|--------------------------|-----------------|-----------------|-----------------|------------------|---------------------|---------------------|-----------|
| <b>Total gross loans</b> | <b>\$ 6,687</b> | <b>\$ 3,175</b> | <b>\$ 6,605</b> | <b>\$ 16,467</b> | <b>\$ 2,032,093</b> | <b>\$ 2,048,560</b> | <b>\$</b> |
|--------------------------|-----------------|-----------------|-----------------|------------------|---------------------|---------------------|-----------|

### **Impaired Loans**

Loans are considered impaired when non-accrual and principal or interest payments have been contractually past due for 90 days or more, unless the loan is both well-collateralized and in the process of collection; or they are classified as Troubled Debt Restructuring ( TDR ) loans to offer terms not typically granted by the Bank; or when current information or events make it unlikely to collect in full according to the contractual terms of the loan agreements; or there is a deterioration in the borrower s financial condition that raises uncertainty as to timely collection of either principal or interest; or full payment of both interest and principal is in doubt according to the original contractual terms.

We evaluate loan impairment in accordance with applicable GAAP. Impaired loans are measured based on the present value of expected future cash flows discounted at the loan s effective interest rate or, as a practical expedient, at the loan s observable market price or the fair value of the collateral if the loan is collateral dependent, less costs to sell. If the measure of the impaired loan is less than the recorded investment in the loan, the deficiency will be charged off against the allowance for loan losses or, alternatively, a specific allocation will be established. Additionally, loans that are considered impaired are specifically excluded from the quarterly migration analysis when determining the amount of the allowance for loan losses required for the period.

The allowance for collateral-dependent loans is determined by calculating the difference between the outstanding loan balance and the value of the collateral as determined by recent appraisals. The allowance for collateral-dependent loans varies from loan to loan based on the collateral coverage of the loan at the time of designation as non-performing. We continue to monitor the collateral coverage, using recent appraisals, on these loans on a quarterly basis and adjust the allowance accordingly.



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The following table provides information on impaired loans, disaggregated by loan class, as of the dates indicated:

|                                  | <b>Recorded Investment</b> | <b>Unpaid Principal Balance</b> | <b>With No Related Allowance Recorded</b> | <b>With an Allowance Recorded</b> | <b>Related Allowance</b> |
|----------------------------------|----------------------------|---------------------------------|---|-----------------------------------|--------------------------|
| <i>(In thousands)</i>            |                            |                                 |   |                                   |                          |
| <b>September 30, 2013</b>        |                            |                                 |   |                                   |                          |
| Real estate loans:               |                            |                                 |   |                                   |                          |
| Commercial property              |                            |                                 |   |                                   |                          |
| Retail                           | \$ 2,234                   | \$ 2,309                        | \$ 2,234                                  | \$                                | \$                       |
| Land                             |                            |                                 |   |                                   |                          |
| Other                            | 1,169                      | 1,169                           | 649                                       | 520                               | 25                       |
| Residential property             | 2,982                      | 3,072                           | 2,982                                     |                                   |                          |
| Commercial and industrial loans: |                            |                                 |   |                                   |                          |
| Commercial term                  |                            |                                 |   |                                   |                          |
| Unsecured                        | 10,072                     | 10,361                          | 1,743                                     | 8,329                             | 1,371                    |
| Secured by real estate           | 17,948                     | 19,181                          | 17,193                                    | 755                               | 163                      |
| Commercial lines of credit       | 830                        | 1,055                           | 830                                       |                                   | 471                      |
| SBA loans                        | 5,477                      | 8,785                           | 4,112                                     | 1,365                             | 9                        |
| International loans              | 1,180                      | 1,180                           | 608                                       | 572                               | 330                      |
| Consumer loans                   | 1,574                      | 1,662                           | 399                                       | 1,175                             |                          |
| <b>Total gross loans</b>         | <b>\$ 43,466</b>           | <b>\$ 48,774</b>                | <b>\$ 30,750</b>                          | <b>\$ 12,716</b>                  | <b>\$ 2,369</b>          |
| <b>December 31, 2012</b>         |                            |                                 |   |                                   |                          |
| Real estate loans:               |                            |                                 |   |                                   |                          |
| Commercial property              |                            |                                 |   |                                   |                          |
| Retail                           | \$ 2,930                   | \$ 3,024                        | \$ 2,930                                  | \$                                | \$                       |
| Land                             |                            |                                 |   |                                   |                          |
| Other                            | 527                        | 527                             |   | 527                               | 67                       |
| Residential property             | 3,265                      | 3,308                           | 1,866                                     | 1,399                             | 94                       |
| Commercial and industrial loans: |                            |                                 |   |                                   |                          |
| Commercial term                  |                            |                                 |   |                                   |                          |
| Unsecured                        | 14,532                     | 15,515                          | 6,826                                     | 7,706                             | 2,144                    |
| Secured by real estate           | 22,050                     | 23,221                          | 9,520                                     | 12,530                            | 2,319                    |
| Commercial lines of credit       | 1,521                      | 1,704                           | 848                                       | 673                               | 230                      |
| SBA loans                        | 6,170                      | 10,244                          | 4,294                                     | 1,876                             | 762                      |
| International loans              |                            |                                 |   |                                   |                          |
| Consumer loans                   | 1,652                      | 1,711                           | 449                                       | 1,203                             | 615                      |
| <b>Total gross loans</b>         | <b>\$ 54,744</b>           | <b>\$ 61,561</b>                | <b>\$ 28,830</b>                          | <b>\$ 25,914</b>                  | <b>\$ 6,231</b>          |

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The following table provides information on impaired loans, disaggregated by loan class, as of dates indicated:

|                                  | Average<br>Recorded<br>Investment for<br>the<br>Three<br>Months Ended | Interest Income<br>Recognized<br>for<br>the Three<br>Months<br>Ended | Average<br>Recorded<br>Investment for<br>the Nine<br>Months Ended | Interest Income<br>Recognized<br>for<br>the Nine<br>Months<br>Ended |
|----------------------------------|---|--|---|---|
| <i>(In thousands)</i>            |   |  |   |   |
| <b>September 30, 2013</b>        |   |  |   |   |
| Real estate loans:               |   |  |   |   |
| Commercial property              |   |  |   |   |
| Retail                           | \$ 2,243  | \$ 21  | \$ 2,287  | \$ 65   |
| Land                             |   |  | 1,116   | 80  |
| Other                            | 1,170   | 13   | 740   | 23  |
| Residential property             | 2,992   | 33   | 3,026   | 92  |
| Commercial and industrial loans: |   |  |   |   |
| Commercial term                  |   |  |   |   |
| Unsecured                        | 10,179  | 148  | 12,122  | 555   |
| Secured by real estate           | 18,023  | 336  | 17,358  | 954   |
| Commercial lines of credit       | 840   | 23   | 1,137   | 48  |
| SBA loans                        | 5,542   | 299  | 5,870   | 851   |
| International loans              | 1,197   |  | 1,342   |   |
| Consumer loans                   | 1,581   | 27   | 1,624   | 54  |
| <b>Total gross loans</b>         | <b>\$ 43,767</b>  | <b>\$ 900</b>  | <b>\$ 46,622</b>  | <b>\$ 2,722</b>   |
| <b>September 30, 2012</b>        |   |  |   |   |
| Real estate loans:               |   |  |   |   |
| Commercial property              |   |  |   |   |
| Retail                           | \$ 2,597  | \$ 47  | \$ 2,162  | \$ 95   |
| Land                             | 2,054   | 45   | 2,134   | 136   |
| Other                            | 534   | 5  | 937   | 38  |
| Construction                     | 7,868   | 29   | 8,016   | 207   |
| Residential property             | 3,279   | 34   | 3,265   | 118   |
| Commercial and industrial loans: |   |  |   |   |
| Commercial term                  |   |  |   |   |
| Unsecured                        | 13,723  | 214  | 14,079  | 644   |
| Secured by real estate           | 19,990  | 342  | 21,834  | 1,300   |
| Commercial lines of credit       | 1,555   | 16   | 1,742   | 46  |
| SBA loans                        | 6,168   | 330  | 7,489   | 813   |
| Consumer loans                   | 1,257   | 49   | 1,021   | 59  |
| <b>Total gross loans</b>         | <b>\$ 59,025</b>  | <b>\$ 1,111</b>  | <b>\$ 62,679</b>  | <b>\$ 3,456</b>   |

The following is a summary of interest foregone on impaired loans for the periods indicated:

|  | <b>Three Months Ended</b> |                      | <b>Nine Months Ended</b> |                      |
|--|---------------------------|----------------------|--------------------------|----------------------|
|  | <b>September 30,</b>      | <b>September 30,</b> | <b>September 30,</b>     | <b>September 30,</b> |
|  | <b>2013</b>               | <b>2012</b>          | <b>2013</b>              | <b>2012</b>          |
|  | <i>(In thousands)</i>     |                      |                          |                      |
| Interest income that would have been recognized had impaired loans performed in accordance with their original terms | \$ 1,058                  | \$ 1,382             | \$ 3,183                 | \$ 4,315             |
| Less: Interest income recognized on impaired loans   | (900)                     | (1,111)              | (2,722)                  | (3,456)              |
| <b>Interest foregone on impaired loans</b>   | <b>\$ 158</b>             | <b>\$ 271</b>        | <b>\$ 461</b>            | <b>\$ 859</b>        |

There were no commitments to lend additional funds to borrowers whose loans are included above.

**Table of Contents****Non-Accrual Loans**

Loans are placed on non-accrual status when, in the opinion of management, the full timely collection of principal or interest is in doubt. Generally, the accrual of interest is discontinued when principal or interest payments become more than 90 days past due, unless management believes the loan is adequately collateralized and in the process of collection. However, in certain instances, we may place a particular loan on non-accrual status earlier, depending upon the individual circumstances surrounding the loan's delinquency. When a loan is placed on non-accrual status, previously accrued but unpaid interest is reversed against current income. Subsequent collections of cash are applied as principal reductions when received, except when the ultimate collectability of principal is probable, in which case interest payments are credited to income. Non-accrual loans may be restored to accrual status when principal and interest payments become current and full repayment is expected.

The following table details non-accrual loans, disaggregated by loan class, as of the dates indicated:

|   | <b>September 30,<br/>2013</b> | <b>December 31,<br/>2012</b> |
|---|-------------------------------|------------------------------|
|   | <i>(In thousands)</i>         |                              |
| <b>Real estate loans:</b>               |                               |                              |
| <b>Commercial property</b>              |                               |                              |
| Retail                                  | \$ 768                        | \$ 1,079                     |
| Land                                    |                               | 2,097                        |
| Residential property                    | 1,659                         | 1,270                        |
| <b>Commercial and industrial loans:</b> |                               |                              |
| <b>Commercial term</b>                  |                               |                              |
| Unsecured                               | 2,490                         | 8,311                        |
| Secured by real estate                  | 5,591                         | 8,679                        |
| Commercial lines of credit              | 830                           | 1,521                        |
| SBA loans                               | 9,959                         | 12,563                       |
| Consumer loans                          | 1,479                         | 1,759                        |
| <b>Total non-accrual loans</b>          | <b>\$ 22,776</b>              | <b>\$ 37,279</b>             |

The following table details non-performing assets as of the dates indicated:

|   | <b>September 30,<br/>2013</b> | <b>December 31,<br/>2012</b> |
|---|-------------------------------|------------------------------|
|   | <i>(In thousands)</i>         |                              |
| Non-accrual loans                                 | \$ 22,776                     | \$ 37,279                    |
| Loans 90 days or more past due and still accruing |                               |                              |
| <b>Total non-performing loans</b>                 | <b>22,776</b>                 | <b>37,279</b>                |
| Other real estate owned                           | 290                           | 774                          |
| <b>Total non-performing assets</b>                | <b>\$ 23,066</b>              | <b>\$ 38,053</b>             |

Loans on non-accrual status totaled \$22.8 million as of September 30, 2013, compared to \$37.3 million as of December 31, 2012, representing a 38.9 percent decrease. Delinquent loans (defined as 30 days or more past due) were \$16.0 million as of September 30, 2013, compared to \$16.5 million as of December 31, 2012, representing a 2.8 percent decrease.

As of September 30, 2013, there was one other real estate owned ( OREO ) located in Washington with a carrying value of \$290,000 and no valuation adjustment. As of December 31, 2012, there were two OREOs located in Illinois and Virginia with a combined carrying value of \$774,000 and no valuation adjustment.

### **Troubled Debt Restructuring**

In April 2011, the FASB issued ASU 2011-02, *A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring*, which clarifies the guidance for evaluating whether a restructuring constitutes a TDR. This guidance is effective for the first interim or annual period beginning on or after June 15, 2011, and should be applied retrospectively to the beginning of the annual period of adoption. For the purposes of measuring impairment of loans that are newly considered impaired, the guidance should be applied prospectively for the first interim or annual period beginning on or after June 15, 2011.

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As a result of the amendments in ASU 2011-02, we reassessed all restructurings that occurred on or after the beginning of the annual period and identified certain receivables as TDRs. Upon identifying those receivables as TDRs, we considered them impaired and applied the impairment measurement guidance prospectively for those receivables newly identified as impaired.

The following table details troubled debt restructurings, disaggregated by concession type and by loan type, as of September 30, 2013 and December 31, 2012:

|                                  | Non-Accrual TDRs                      |                 |  |                 | Accrual TDRs     |                 |   |                 |                 |                  |
|----------------------------------|---------------------------------------|-----------------|--|-----------------|------------------|-----------------|---|-----------------|-----------------|------------------|
|                                  | Reduction of<br>Deferral of Principal |                 | Reduction of<br>Principal and Extension of<br>Maturity |                 | Total            |                 | Reduction of<br>Deferral of Principal<br>Principal and Extension of<br>Maturity |                 |                 |                  |
|                                  | Principal                             | Interest        | Principal  | Interest        | Principal        | Interest        | Principal   | Interest        | Principal       |                  |
| <b>September 30, 2013</b>        |                                       |                 |  |                 |                  |                 |   |                 |                 |                  |
| Real estate loans:               |                                       |                 |  |                 |                  |                 |   |                 |                 |                  |
| Commercial property              |                                       |                 |  |                 |                  |                 |   |                 |                 |                  |
| Retail                           | \$                                    | \$              | \$   | \$ 768          | \$ 768           | \$              | \$  | \$              | \$              | \$               |
| Other                            |                                       |                 |  |                 |                  | 520             |   |                 | 649             | 1,169            |
| Residential property             | 803                                   |                 |  |                 | 803              |                 |   |                 |                 |                  |
| Commercial and industrial loans: |                                       |                 |  |                 |                  |                 |   |                 |                 |                  |
| Commercial term                  |                                       |                 |  |                 |                  |                 |   |                 |                 |                  |
| Unsecured                        |                                       | 205             | 651  | 644             | 1,500            | 1,271           |   | 1,983           | 3,002           | 6,256            |
| Secured by real estate           | 2,167                                 | 993             | 263  |                 | 3,423            | 3,458           |   | 598             | 4,487           | 8,543            |
| Commercial lines of credit       | 641                                   |                 |  | 188             | 829              |                 |   |                 |                 |                  |
| SBA loans                        | 915                                   | 1,140           | 773  |                 | 2,828            | 445             |   | 70              |                 | 515              |
| International loans              |                                       |                 |  |                 |                  |                 |   | 1,180           |                 | 1,180            |
| Consumer loans                   |                                       |                 |  |                 |                  |                 |   | 149             |                 | 149              |
| <b>Total</b>                     | <b>\$ 4,526</b>                       | <b>\$ 2,338</b> | <b>\$ 1,687</b>  | <b>\$ 1,600</b> | <b>\$ 10,151</b> | <b>\$ 5,694</b> | <b>\$</b>   | <b>\$ 3,980</b> | <b>\$ 8,138</b> | <b>\$ 17,812</b> |

**December 31, 2012**

Real estate loans:

Commercial property

|        |    |    |    |          |          |        |    |    |        |        |
|--------|----|----|----|----------|----------|--------|----|----|--------|--------|
| Retail | \$ | \$ | \$ | \$ 1,080 | \$ 1,080 | \$ 357 | \$ | \$ | \$ 175 | \$ 532 |
| Other  |    |    |    |          |          | 527    |    |    |        | 527    |

|                                  |                 |                 |                 |                 |                  |                 |               |                 |                 |                  |
|----------------------------------|-----------------|-----------------|-----------------|-----------------|------------------|-----------------|---------------|-----------------|-----------------|------------------|
| Residential property             | 827             |                 |                 | 827             |                  | 572             |               | 572             |                 |                  |
| Commercial and industrial loans: |                 |                 |                 |                 |                  |                 |               |                 |                 |                  |
| Commercial term                  |                 |                 |                 |                 |                  |                 |               |                 |                 |                  |
| Unsecured                        |                 | 658             | 4,558           | 1,413           | 6,629            | 976             | 1,090         | 3,260           | 5,326           |                  |
| Secured by real estate           | 2,317           | 1,343           | 318             |                 | 3,978            | 4,444           | 448           | 4,547           | 9,439           |                  |
| Commercial lines of credit       | 673             |                 | 188             | 244             | 1,105            |                 |               |                 |                 |                  |
| SBA loans                        | 2,831           | 1,287           | 1,032           |                 | 5,150            | 484             | 100           |                 | 584             |                  |
| <b>Total</b>                     | <b>\$ 6,648</b> | <b>\$ 3,288</b> | <b>\$ 6,096</b> | <b>\$ 2,737</b> | <b>\$ 18,769</b> | <b>\$ 6,788</b> | <b>\$ 572</b> | <b>\$ 1,638</b> | <b>\$ 7,982</b> | <b>\$ 16,980</b> |

As of September 30, 2013 and December 31, 2012, total TDRs were \$28.0 million and \$35.7 million, respectively. A debt restructuring is considered a TDR if we grant a concession that we would not have otherwise considered to the borrower, for economic or legal reasons related to the borrower's financial difficulties. Loans are considered to be TDRs if they were restructured through payment structure modifications such as reducing the amount of principal and interest due monthly and/or allowing for interest only monthly payments for six months or less. All TDRs are impaired and are individually evaluated for specific impairment using one of these three criteria: (1) the present value of expected future cash flows discounted at the loan's effective interest rate; (2) the loan's observable market price; or (3) the fair value of the collateral if the loan is collateral dependent.

At September 30, 2013 and December 31, 2012, TDRs were subjected to specific impairment analysis, and \$944,000 and \$3.6 million, respectively, of reserves relating to these loans were included in the allowance for loan losses.

The following table details troubled debt restructuring, disaggregated by loan class, for the three months ended September 30, 2013 and 2012:

|   | September 30, 2013                           |                                       |                                       | September 30, 2012                           |                                       |                                       |
|---|--|---------------------------------------|---------------------------------------|--|---------------------------------------|---------------------------------------|
|   | Pre-Modification Outstanding Number of Loans | Post-Modification Recorded Investment | Post-Modification Recorded Investment | Pre-Modification Outstanding Number of Loans | Post-Modification Recorded Investment | Post-Modification Recorded Investment |
| <i>(In thousands, except number of loans)</i> |  |                                       |                                       |  |                                       |                                       |
| Real estate loans:                            |  |                                       |                                       |  |                                       |                                       |
| Commercial property                           |  |                                       |                                       |  |                                       |                                       |
| Retail <sup>(1)</sup>                         |  | \$                                    | \$                                    | 1  | \$                                    | \$                                    |
| Other <sup>(2)</sup>                          | 1  | 646                                   | 649                                   | 1  | 538                                   | 532                                   |
| Commercial and industrial loans:              |  |                                       |                                       |  |                                       |                                       |
| Commercial term                               |  |                                       |                                       |  |                                       |                                       |
| Unsecured <sup>(3)</sup>                      | 8  | 1,015                                 | 1,002                                 | 5  | 777                                   | 759                                   |
| Secured by real estate <sup>(4)</sup>         | 2  | 1,365                                 | 1,365                                 | 3  | 4,525                                 | 4,475                                 |
| SBA loans <sup>(5)</sup>                      | 1  | 107                                   | 91                                    | 3  | 78                                    | 89                                    |
| <b>Total</b>                                  | <b>12</b>                                    | <b>\$ 3,133</b>                       | <b>\$ 3,107</b>                       | <b>13</b>                                    | <b>\$ 6,049</b>                       | <b>\$ 6,032</b>                       |





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- (1) Includes a modification of \$177,000 through an extension of maturity for the three months ended September 30, 2012.
- (2) Includes a modification of \$649,000 through an extension of maturity for the three months ended September 30, 2013, and a modification of \$532,000 through a payment deferral for the three months ended September 30, 2012.
- (3) Includes modifications of \$381,000 through payment deferrals and \$621,000 through extensions of maturity for the three months ended September 30, 2013, and modifications of \$750,000 through extensions of maturity and \$9,000 through payment deferrals for the three months ended September 30, 2012.
- (4) Includes modifications of \$1.4 million through payment deferrals for the three months ended September 30, 2013, and modifications of \$3.1 million through payment deferrals and \$1.4 million through an extension of maturity for the three months ended September 30, 2012.
- (5) Includes a modification of \$91,000 through a payment deferral for the three months ended September 30, 2013, and modifications of \$48,000 through payment deferrals and \$41,000 through a reduction of principal or accrued interest for the three months ended September 30, 2012.

During the three months ended September 30, 2013, we restructured monthly payments on 12 loans, with a net carrying value of \$3.1 million as of September 30, 2013, through temporary payment structure modifications or re-amortization. For the restructured loans on accrual status, we determined that, based on the financial capabilities of the borrowers at the time of the loan restructuring and the borrowers' past performance in the payment of debt service under the previous loan terms, performance and collection under the revised terms are probable.

The following table details troubled debt restructuring, disaggregated by loan class, for the nine months ended September 30, 2013 and 2012:

|   | September 30, 2013                                    |   |   | September 30, 2012                                    |   |   |
|---|---|---|---|---|---|---|
|   | Pre-Modification<br>Outstanding<br>Number of<br>Loans | Post-<br>Modification<br>Recorded<br>Investment | Post-<br>Modification<br>Recorded<br>Investment | Pre-Modification<br>Outstanding<br>Number of<br>Loans | Post-<br>Modification<br>Recorded<br>Investment | Post-<br>Modification<br>Recorded<br>Investment |
| <i>(In thousands, except number of loans)</i> |   |   |   |   |   |   |
| Real estate loans:                            |   |   |   |   |   |   |
| Commercial property                           |   |   |   |   |   |   |
| Retail <sup>(1)</sup>                         |   | \$  | \$  | 1   | \$ 184  | \$ 177  |
| Land <sup>(2)</sup>                           |   |   |   | 1   | 547   | 532   |
| Other <sup>(3)</sup>                          | 1   | 658   | 649   |   |   |   |
| Commercial and industrial loans:              |   |   |   |   |   |   |
| Commercial term                               |   |   |   |   |   |   |
| Unsecured <sup>(4)</sup>                      | 14  | 1,780   | 1,618   | 31  | 5,362   | 4,940   |
| Secured by real estate <sup>(5)</sup>         | 2   | 1,365   | 1,365   | 5   | 5,584   | 5,307   |
| Commercial lines of credit <sup>(6)</sup>     | 1   |   |   | 1   | 202   | 188   |
| SBA loans <sup>(7)</sup>                      | 3   | 273   | 228   | 11  | 1,060   | 1,000   |
| International loans <sup>(8)</sup>            | 2   | 1,584   | 1,180   |   |   |   |
| Consumer loans <sup>(9)</sup>                 | 1   | 149   | 149   |   |   |   |

|              |           |           |              |           |              |           |           |               |           |               |
|--------------|-----------|-----------|--------------|-----------|--------------|-----------|-----------|---------------|-----------|---------------|
| <b>Total</b> | <b>24</b> | <b>\$</b> | <b>5,809</b> | <b>\$</b> | <b>5,189</b> | <b>50</b> | <b>\$</b> | <b>12,939</b> | <b>\$</b> | <b>12,144</b> |
|--------------|-----------|-----------|--------------|-----------|--------------|-----------|-----------|---------------|-----------|---------------|

- (1) *Includes a modification of \$177,000 through an extension of maturity for the nine months ended September 30, 2012.*
- (2) *Includes a modification of \$532,000 through a payment deferral for the nine months ended September 30, 2012.*
- (3) *Includes a modification of \$649,000 through an extension of maturity for the nine months ended September 30, 2013.*
- (4) *Includes modifications of \$381,000 through payment deferrals and \$1.2 million through extensions of maturity for the nine months ended September 30, 2013, and modifications of \$2.2 million through extensions of maturity, \$1.9 million through reductions of principal or accrued interest and \$884,000 through payment deferrals for the nine months ended September 30, 2012.*
- (5) *Includes modifications of \$1.4 million through payment deferrals for the nine months ended September 30, 2013, and modifications of \$3.1 million through payment deferrals, \$1.9 million through extensions of maturity and \$338,000 through a reduction of principal or accrued interest for the nine months ended September 30, 2012.*
- (6) *Includes a modification of zero through a reduction of principal or accrued interest for the three months ended September 30, 2013, and a modification of \$188,000 through a reduction of principal or accrued interest for the nine months ended September 30, 2012.*
- (7) *Includes modifications of \$98,000 through payments deferrals and \$130,000 through a reduction of principal or accrued interest for the nine months ended September 30, 2013, and modifications of \$551,000 through payment deferrals and \$449,000 through reductions of principal or accrued interest for the nine months ended September 30, 2012.*
- (8) *Includes modifications of \$1.2 million through reductions of principal or accrued interest for the nine months ended September 30, 2013.*
- (9) *Includes a modification of \$149,000 through a reduction of principal or accrued interest for the nine months ended September 30, 2013.*

During the nine months ended September 30, 2013, we restructured monthly payments on 24 loans, with a net carrying value of \$5.2 million as of September 30, 2013, through temporary payment structure modifications or re-amortization. For the restructured loans on accrual status, we determined that, based on the financial capabilities of the borrowers at the time of the loan restructuring and the borrowers' past performance in the payment of debt service under the previous loan terms, performance and collection under the revised terms are probable.

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The following table details troubled debt restructurings that defaulted subsequent to the modifications occurring within the previous twelve months, disaggregated by loan class, for the three and nine months ended September 30, 2013 and 2012, respectively:

|                                  | Three Months Ended                            |               | September 30, |               | September 30, |               | September 30, |               | September 30, |            |     |
|----------------------------------|---|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|------------|-----|
|                                  | 2013  |               | 2012          |               | 2013          |               | 2012          |               | 2012          |            |     |
|                                  | Number of                                     | Recorded      | Number of     | Recorded      | Number of     | Recorded      | Number of     | Recorded      | Number of     | Recorded   |     |
|                                  | Loans   | Investment    | Loans         | Investment    | Loans         | Investment    | Loans         | Investment    | Loans         | Investment |     |
|                                  | <i>(In thousands, except number of loans)</i> |               |               |               |               |               |               |               |               |            |     |
| Commercial and industrial loans: |   |               |               |               |               |               |               |               |               |            |     |
| Commercial term                  |   |               |               |               |               |               |               |               |               |            |     |
| Unsecured                        |   | \$            | 3             | \$            | 171           | 1             | \$            | 29            | 6             | \$         | 431 |
| Secured by real estate           |   |               |               |               |               |               |               |               |               |            |     |
| Commercial lines of credit       |   |               |               |               |               |               |               |               | 1             |            | 258 |
| SBA loans                        | 1   | 130           | 6             | 272           | 1             | 130           | 6             | 272           |               |            |     |
| <b>Total</b>                     | <b>1</b>                                      | <b>\$ 130</b> | <b>9</b>      | <b>\$ 443</b> | <b>2</b>      | <b>\$ 159</b> | <b>13</b>     | <b>\$ 961</b> |               |            |     |

**Servicing Assets**

The changes in servicing assets for the nine months ended September 30, 2013 and 2012 were as follows:

|                                 | Nine Months Ended     |                    |
|---------------------------------|-----------------------|--------------------|
|                                 | September 30, 2013    | September 30, 2012 |
|                                 | <i>(In thousands)</i> |                    |
| Balance at beginning of period  | \$ 5,542              | \$ 3,720           |
| Additions                       | 1,996                 | 2,148              |
| Amortization                    | (1,152)               | (720)              |
| <b>Balance at end of period</b> | <b>\$ 6,386</b>       | <b>\$ 5,148</b>    |

At September 30, 2013 and 2012, we serviced loans sold to unaffiliated parties in the amounts of \$332.9 million and \$277.7 million, respectively. These represented loans that have been sold for which the Bank continues to provide servicing. These loans are maintained off balance sheet and are not included in the loans receivable balance. All of the loans being serviced were SBA loans.

**Note 4 Income Taxes**

The Company's income tax expenses were \$6.6 million and \$17.1 million for the three and nine months ended September 30, 2013, respectively, compared to income tax benefits of \$644,000 and \$47.7 million for the three and nine months ended September 30, 2012, respectively. The effective income tax rate was 39.1 percent and 36.4 percent for the three and nine months ended September 30, 2013, respectively, as compared to (5.1) percent and

(166.6) percent for the three and nine months ended September 30, 2012. The change in the effective tax rate for the three and nine months ended September 30, 2013, as compared to the three and nine months ended September 30, 2012, was due primarily to a net tax benefit of \$47.7 million resulting from the reversal of \$57.9 million of valuation allowance on the Company's deferred tax asset in the nine months ended September 30, 2012. The income tax expenses for the three and nine months ended September 30, 2013 include discrete items of \$85,000 and (\$682,000), respectively, related mainly to the revision of the deferred tax estimate from stock options and state tax attributes. Management concluded that deferred tax assets were more likely than not to be realized, and therefore, maintaining a valuation allowance was not required as of September 30, 2013.

As of September 30, 2013, the Company was subject to examination by various federal and state tax authorities for the years ended December 31, 2004 through 2011. The Company was subjected to audits by the Internal Revenue Service for the 2009 tax year, by the California FTB for the 2008 and 2009 tax years. Management does not anticipate any material changes in our financial statements due to the results of those audits.

## **Note 5 Stockholders Equity**

### **Stock Warrants**

As part of the agreement dated as of July 27, 2010 with Cappello Capital Corp., the placement agent in connection with our best efforts offering and the financial advisor in connection with our completed rights offering, we issued warrants to purchase 250,000 shares of our common stock for services performed. The warrants have an exercise price of \$9.60 per share. According to the agreement, the warrants vested on October 14, 2010 and are exercisable until its expiration on October 14, 2015. The Company followed the guidance of FASB ASC Topic 815-40, *Derivatives and Hedging Contracts in Entity's Own Stock*, which establishes a framework for determining whether certain freestanding and embedded instruments are indexed to a company's own stock for purposes of evaluation of the accounting for such instruments under existing accounting literature. Under GAAP, the issuer is required to measure the fair value of the equity instruments in the transaction as of earlier of (i) the date at which a commitment for performance by the counterparty to earn the equity instruments is reached or (ii) the date at which the counterparty's performance is

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complete. The fair value of the warrants at the date of issuance totaling \$2.0 million was recorded as a liability and a cost of equity, which was determined by the Black-Scholes option pricing model. The expected stock volatility was based on historical volatility of our common stock over the expected term of the warrants. We used a weighted average expected stock volatility of 111.46 percent. The expected life assumption was based on the contract term of five years. The dividend yield of zero was based on the fact that we had no intention to pay cash dividends for the term at the grant date. The risk free rate of 2.07 percent used for the warrants was equal to the zero coupon rate in effect at the time of the grant.

Upon re-measuring the fair value of the stock warrants at September 30, 2013, the fair value decreased by \$3,000, which we have included in other operating expenses for the three months ended September 30, 2013. We used a weighted average expected stock volatility of 25.78 percent and a remaining contractual life of 1.8 years based on the contract terms. We also used a dividend yield of 1.65 percent and the risk free rate of 0.47 percent used for the warrants was equal to the zero coupon rate in effect at the end of the measurement period.

**Note 6 Regulatory Matters****Risk-Based Capital**

Federal bank regulatory agencies require bank holding companies and banks to maintain a minimum ratio of qualifying total capital to risk-weighted assets of 8.0 percent and a minimum ratio of Tier 1 capital to risk-weighted assets of 4.0 percent. In addition to the risk-based guidelines, federal bank regulatory agencies require bank holding companies and banks to maintain a minimum ratio of Tier 1 capital to average assets, referred to as the leverage ratio, of 4.0 percent.

In order for banks to be considered well capitalized, federal bank regulatory agencies require them to maintain a minimum ratio of qualifying total capital to risk-weighted assets of 10.0 percent and a minimum ratio of Tier 1 capital to risk-weighted assets of 6.0 percent. In addition to the risk-based guidelines, federal bank regulatory agencies require depository institutions to maintain a minimum ratio of Tier 1 capital to average assets, referred to as the leverage ratio, of 5.0 percent.

The capital ratios of Hanmi Financial and the Bank as of September 30, 2013 and December 31, 2012 were as follows:

|   | Actual                |        | Minimum<br>Regulatory<br>Requirement |       | Minimum to Be<br>Categorized as<br>Well Capitalized |        |
|---|-----------------------|--------|--------------------------------------|-------|---|--------|
|   | Amount                | Ratio  | Amount                               | Ratio | Amount  | Ratio  |
|   | <i>(In thousands)</i> |        |                                      |       |   |        |
| <b>September 30, 2013</b>                 |                       |        |                                      |       |   |        |
| Total capital (to risk-weighted assets):  |                       |        |                                      |       |   |        |
| Hanmi Financial                           | \$ 409,551            | 17.72% | \$ 184,934                           | 8.00% | N/A   | N/A    |
| Hanmi Bank                                | \$ 392,743            | 17.02% | \$ 184,604                           | 8.00% | \$ 230,755  | 10.00% |
| Tier 1 capital (to risk-weighted assets): |                       |        |                                      |       |   |        |
| Hanmi Financial                           | \$ 380,256            | 16.45% | \$ 92,467                            | 4.00% | N/A   | N/A    |
| Hanmi Bank                                | \$ 363,527            | 15.75% | \$ 92,302                            | 4.00% | \$ 138,453  | 6.00%  |
| Tier 1 capital (to average assets):       |                       |        |                                      |       |   |        |

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|   |            |        |            |       |            |        |
|---|------------|--------|------------|-------|------------|--------|
| Hanmi Financial                           | \$ 380,256 | 13.68% | \$ 111,197 | 4.00% | N/A        | N/A    |
| Hanmi Bank                                | \$ 363,527 | 13.10% | \$ 110,995 | 4.00% | \$ 138,743 | 5.00%  |
| <b>December 31, 2012</b>                  |            |        |            |       |            |        |
| Total capital (to risk-weighted assets):  |            |        |            |       |            |        |
| Hanmi Financial                           | \$ 451,784 | 20.65% | \$ 175,050 | 8.00% | N/A        | N/A    |
| Hanmi Bank                                | \$ 433,570 | 19.85% | \$ 174,734 | 8.00% | \$ 218,418 | 10.00% |
| Tier 1 capital (to risk-weighted assets): |            |        |            |       |            |        |
| Hanmi Financial                           | \$ 423,937 | 19.37% | \$ 87,525  | 4.00% | N/A        | N/A    |
| Hanmi Bank                                | \$ 405,801 | 18.58% | \$ 87,367  | 4.00% | \$ 131,051 | 6.00%  |
| Tier 1 capital (to average assets):       |            |        |            |       |            |        |
| Hanmi Financial                           | \$ 423,937 | 14.95% | \$ 113,464 | 4.00% | N/A        | N/A    |
| Hanmi Bank                                | \$ 405,801 | 14.33% | \$ 113,278 | 4.00% | \$ 141,597 | 5.00%  |

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**Table of Contents****Regulatory Capital Rule Adjustments**

In July 2013, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation approved the Basel III regulatory capital framework and related Dodd-Frank Wall Street Reform and Consumer Protection Act changes. The rules revise minimum capital requirements and adjust prompt corrective action thresholds. The rules also revise the regulatory capital elements, add a new common equity Tier I capital ratio, and increase the minimum Tier I capital ratio requirement. The revisions permit banking organizations to retain, through a one-time election, the existing treatment for accumulated other comprehensive income. Additionally, the rules implement a new capital conservation buffer. Under the final rules, institutions are subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses if its capital level falls below the capital conservation buffer amount. The rules will become effective January 1, 2015 for smaller, non-complex banking organizations with full implementation of the capital conservation buffer and certain deductions and adjustments to regulatory capital through January 1, 2019. The Company will continue to evaluate the new changes, and expects that the Company and the Bank will meet the capital requirements.

**Note 7 Fair Value Measurements****Fair Value Measurements**

FASB ASC 820, *Fair Value Measurements and Disclosures*, defines fair value, establishes a framework for measuring fair value including a three-level valuation hierarchy, and expands disclosures about fair value measurements. Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The three-level fair value hierarchy requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The three levels of inputs that may be used to measure fair value are defined as follows:

Level 1 -Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2 -Significant other observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, and other inputs that are observable or can be corroborated by observable market data.

Level 3 -Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

Fair value is used on a recurring basis for certain assets and liabilities in which fair value is the primary basis of accounting. Additionally, fair value is used on a non-recurring basis to evaluate assets or liabilities for impairment or for disclosure purposes.

We record investment securities available-for-sale at fair value on a recurring basis. Certain other assets, such as loans held for sale, impaired loans, other real estate owned, and other intangible assets, are recorded at fair value on a non-recurring basis. Non-recurring fair value measurements typically involve assets that are periodically evaluated for impairment and for which any impairment is recorded in the period in which the re-measurement is performed.

The following methods and assumptions were used to estimate the fair value of each class of financial instrument below:

*Investment securities available-for-sale* The fair values of investment securities available-for-sale are determined by obtaining quoted prices on nationally recognized securities exchanges. If quoted prices are not available, fair values are measured using matrix pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities relationship to other benchmark quoted securities, or other model-based valuation techniques requiring observable inputs other than quoted prices such as yield curve, prepayment speeds, and default rates. Level 1 investment securities include U.S. government and agency debentures and equity securities that are traded on an active exchange or by dealers or brokers in active over-the-counter markets. The fair value of these securities is determined by quoted prices on an active exchange or over-the-counter market. Level 2 investment securities primarily include mortgage-backed securities, municipal bonds, collateralized mortgage obligations, and SBA loan pool securities. In determining the fair value of the securities categorized as Level 2, we obtain reports from nationally recognized broker-dealers detailing the fair value of each investment security held as of each reporting date. The broker-dealers use prices obtained from nationally recognized pricing services to value our fixed income securities. The fair value of the municipal bonds is determined based on a proprietary model maintained by the broker-dealers. We review the prices obtained for reasonableness based on our understanding of the marketplace, and also consider any credit issues related to the bonds. As we have not made any adjustments to the market quotes provided to us and as they are based on observable market data, they have been categorized as Level 2 within the fair value hierarchy. Level 3 investment securities are instruments that are not traded in the market. As such, no observable market data for the instrument is available, which necessitates the use of significant unobservable inputs.



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As of September 30, 2013, we had a zero coupon tax credit municipal bond of \$756,000 compared to \$779,000 as of December 31, 2012. This bond was recorded at estimated fair value using a discounted cash flow method, and was measured on a recurring basis with Level 3 inputs. Key assumptions used in measuring the fair value of the tax credit bond as of September 30, 2013 were discount rate and cash flows. The discount rate was derived from the term structure of Bank Qualified ( BQ ) A- rated municipal bonds, as the tax credit bond's guarantee had the similar credit strength. The contractual future cash flows were the tax credits to be received for a remaining life of 1.5 years. If the discount rate is adjusted down to the term structure of BQ BBB- rating municipal bonds, the tax credit bond's value would decline by 0.70 percent. We do not anticipate a significant deterioration of the tax credit bond's credit quality. Management reviews the discount rate on an ongoing basis based on current market rates.

*SBA loans held for sale* SBA loans held for sale are carried at the lower of cost or fair value. As of September 30, 2013 and December 31, 2012, we had \$5.2 million and \$7.8 million of SBA loans held for sale, respectively. Management obtains quotes, bids or pricing indication sheets on all or part of these loans directly from the purchasing financial institutions. Premiums received or to be received on the quotes, bids or pricing indication sheets are indicative of the fact that cost is lower than fair value. At September 30, 2013 and December 31, 2012, the entire balance of SBA loans held for sale was recorded at its cost. We record SBA loans held for sale on a nonrecurring basis with Level 2 inputs.

*Non-performing loans held for sale* We reclassify certain non-performing loans as held for sale when we decide to sell those loans. The fair value of non-performing loans held for sale is generally based upon the quotes, bids or sales contract prices which approximate their fair value. Non-performing loans held for sale are recorded at estimated fair value less anticipated liquidation cost. As of September 30, 2013 and December 31, 2012, we had zero and \$484,000 of non-performing loans held for sale, respectively, which are measured on a nonrecurring basis with Level 2 inputs.

*Stock warrants* The Company followed the guidance of FASB ASC Topic 815- 40, *Derivatives and Hedging Contracts in Entity's Own Stock*, which establishes a framework for determining whether certain freestanding and embedded instruments are indexed to a company's own stock for purposes of evaluation of the accounting for such instruments under existing accounting literature. Under GAAP, the issuer is required to measure the fair value of the equity instruments in the transaction as of earlier of (i) the date at which a commitment for performance by the counterparty to earn the equity instruments is reached or (ii) the date at which the counterparty's performance is complete. The fair value of the warrants was recorded as a liability and a cost of equity, which was determined by the Black-Scholes option pricing modeling and was measured on a recurring basis with Level 3 inputs.

**Table of Contents****Assets and Liabilities Measured at Fair Value on a Recurring Basis**

There were no transfers of assets between Level 1 and Level 2 of the fair value hierarchy for the three months ended September 30, 2013. As of September 30, 2013 and December 31, 2012, assets and liabilities measured at fair value on a recurring basis are as follows:

|  | Level 1<br>Quoted Prices in<br>Active Markets<br>for Identical<br>Assets | Level 2<br>Significant<br>Observable<br>Inputs with<br>No<br>Active<br>Market<br>with<br>Identical<br>Characteristics | Level 3<br>Significant<br>Unobservable<br>Inputs | Balance    |
|--|--|---|--|------------|
| <b>September 30, 2013</b>                  |  |   |  |            |
| <b>Assets:</b>                             |  |   |  |            |
| Debt securities available-for-sale:        |  |   |  |            |
| Mortgage-backed securities                 | \$   | \$ 127,085  | \$   | \$ 127,085 |
| U.S. government agency securities          | 92,878   |   |  | 92,878     |
| Collateralized mortgage obligations        |  | 85,110  |  | 85,110     |
| Municipal bonds-tax exempt                 |  | 5,730   | 756  | 6,486      |
| Municipal bonds-taxable                    |  | 34,788  |  | 34,788     |
| Corporate bonds                            |  | 20,483  |  | 20,483     |
| SBA loan pools securities                  |  | 12,921  |  | 12,921     |
| Other securities                           |  | 2,921   |  | 2,921      |
| Total debt securities available-for-sale   | 92,878   | 289,038   | 756  | 382,672    |
| Equity securities available-for-sale:      |  |   |  |            |
| Financial services industry                | 385  |   |  | 385        |
| Total equity securities available-for-sale | 385  |   |  | 385        |
| Total securities available-for-sale        | \$ 93,263  | \$ 289,038  | \$ 756   | \$ 383,057 |
| <b>Liabilities:</b>                        |  |   |  |            |
| Stock warrants                             | \$   | \$  | \$ 2   | \$ 2       |
| <b>December 31, 2012</b>                   |  |   |  |            |
| <b>Assets:</b>                             |  |   |  |            |
| Debt securities available-for-sale:        |  |   |  |            |
| Mortgage-backed securities                 | \$   | \$ 160,326  | \$   | \$ 160,326 |
| Collateralized mortgage obligations        |  | 100,487   |  | 100,487    |

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|  |           |            |        |            |
|--|-----------|------------|--------|------------|
| U.S. government agency securities          | 93,118    |            |        | 93,118     |
| Municipal bonds-tax exempt                 |           | 12,033     | 779    | 12,812     |
| Municipal bonds-taxable                    |           | 46,142     |        | 46,142     |
| Corporate bonds                            |           | 20,400     |        | 20,400     |
| SBA loan pools securities                  |           | 14,026     |        | 14,026     |
| Other securities                           |           | 3,357      |        | 3,357      |
| <br>                                       |           |            |        |            |
| Total debt securities available-for-sale   | 93,118    | 356,771    | 779    | 450,668    |
| <br>                                       |           |            |        |            |
| Equity securities available-for-sale:      |           |            |        |            |
| Financial services industry                | 392       |            |        | 392        |
| <br>                                       |           |            |        |            |
| Total equity securities available-for-sale | 392       |            |        | 392        |
| <br>                                       |           |            |        |            |
| Total securities available-for-sale        | \$ 93,510 | \$ 356,771 | \$ 779 | \$ 451,060 |
| <br>                                       |           |            |        |            |
| <b>Liabilities:</b>                        |           |            |        |            |
| Stock warrants                             | \$        | \$         | \$ 906 | \$ 906     |

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The table below presents a reconciliation and income statement classification of gains and losses for all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the nine months ended September 30, 2013:

|   | <b>Beginning<br/>Balance as of<br/>January<br/>1,<br/>2013</b> | <b>Purchases<br/>Issuances,<br/>and<br/>Settlement</b> | <b>Realized<br/>Gains or<br/>Losses<br/>In Earnings<br/>(In thousands)</b> | <b>Unrealized<br/>Gains or<br/>Losses<br/>in Other<br/>Comprehensive<br/>Income</b> | <b>Ending<br/>Balance as of<br/>September 30,<br/>2013</b> |
|---|--|--|--|---|--|
| <b>Assets:</b>                            |  |  |  |   |  |
| Municipal bonds-tax exempt <sup>(1)</sup> | \$ 779   | \$   | \$   | \$ (23)   | \$ 756   |
| <b>Liabilities:</b>                       |  |  |  |   |  |
| Stock warrants <sup>(2)</sup>             | \$ 906   | \$ (843)   | \$ (61)  | \$  | \$ 2   |

- (1) Reflects a zero coupon tax credit municipal bond. As the Company was not able to obtain a price from independent external pricing service providers, the discounted cash flow method was used to determine its fair value. The bond carried a par value of \$700,000 and an amortized value of \$699,000 with a remaining life of 1.5 years at September 30, 2013.
- (2) Reflects warrants for our common stock issued in connection with services Cappello Capital Corp. provided to us as a placement agent in connection with our best efforts public offering and as our financial adviser in connection with our completed rights offering. The warrants were immediately exercisable when issued at an exercise price of \$9.60 per share of our common stock and expire on October 14, 2015. See Note 5 Stockholders Equity for more details.

**Assets and Liabilities Measured at Fair Value on a Non-Recurring Basis**

As of September 30, 2013 and December 31, 2012, assets and liabilities measured at fair value on a non-recurring basis are as follows:

| <b>Level 1</b>  | <b>Level 2<br/>Significant<br/>Observable<br/>Inputs With</b>              | <b>Level 3</b>                                 |   |
|---|--|--|---|
| <b>Quoted Prices in<br/>Active<br/>Markets<br/>for<br/>Identical<br/>Assets</b> | <b>No<br/>Active<br/>Market<br/>With<br/>Identical<br/>Characteristics</b> | <b>Significant<br/>Unobservable<br/>Inputs</b> | <b>Loss During<br/>The<br/>Nine Months Ended<br/>September 30,<br/>2013</b> |
|   |  |  |   |

(In thousands)

**September 30, 2013****Assets:**

|  |    |        |       |       |
|--|----|--------|-------|-------|
| Non-performing loans held for sale     | \$ | \$     | \$    | \$    |
| Impaired loans <sup>(1)</sup>          |    | 30,353 | 1,099 | 1,048 |
| Other real estate owned <sup>(2)</sup> |    | 290    |       | 7     |

|  | Level 1   | Level 2<br>Significant<br>Observable                                       | Level 3                               |   |
|--|---|--|---------------------------------------|---|
|  | Quoted<br>Prices<br>in<br>Active<br>Markets<br>for<br>Identical<br>Assets | Inputs With No<br>Active<br>Market<br>With<br>Identical<br>Characteristics | Significant<br>Unobservable<br>Inputs | Loss During<br>The<br>Twelve Months Ended<br>December 31,<br>2012 |
|  |   |  |                                       |   |
|  |   |  |                                       |   |
|  |   |  |                                       |   |
|  |   |  |                                       |   |

*(In thousands)*

**December 31, 2012****Assets:**

|   |    |     |       |       |
|---|----|-----|-------|-------|
| Non-performing loans held for sale <sup>(3)</sup> | \$ | \$  | \$    | \$    |
| Impaired loans <sup>(4)</sup>                     |    | 484 | 8,888 | 3,747 |
| Other real estate owned <sup>(5)</sup>            |    | 774 |       | 301   |

- (1) Includes real estate loans of \$6.4 million, commercial and industrial loans of \$23.8 million, and consumer loans of \$1.2 million.
- (2) Includes properties from the foreclosure of a residential property loan of \$290,000.
- (3) Includes a SBA loan of \$484,000.
- (4) Includes real estate loans of \$8.7 million, commercial and industrial loans of \$27.0 million, and consumer loans of \$1.0 million.
- (5) Includes properties from the foreclosure of real estate loans of \$774,000.

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FASB ASC 825 requires disclosure of the fair value of financial assets and financial liabilities, including those financial assets and financial liabilities that are not measured and reported at fair value on a recurring basis or non-recurring basis. The methodologies for estimating the fair value of financial assets and financial liabilities that are measured at fair value on a recurring basis or non-recurring basis are discussed above.

The estimated fair value of financial instruments has been determined by using available market information and appropriate valuation methodologies. However, considerable judgment is required to interpret market data in order to develop estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts that we could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

The estimated fair values of financial instruments were as follows:

|  | <b>September 30, 2013</b>                      |                                 | <b>December 31, 2012</b>                       |                                 |
|--|--|---------------------------------|--|---------------------------------|
|  | <b>Carrying<br/>or<br/>Contract<br/>Amount</b> | <b>Estimated<br/>Fair Value</b> | <b>Carrying<br/>or<br/>Contract<br/>Amount</b> | <b>Estimated<br/>Fair Value</b> |
|  | <i>(In thousands)</i>                          |                                 |  |                                 |
| <b>Financial assets:</b>                           |  |                                 |  |                                 |
| Cash and cash equivalents                          | \$ 193,854                                     | \$ 193,854                      | \$ 268,047                                     | \$ 268,047                      |
| Restricted cash                                    |  |                                 | 5,350  | 5,350                           |
| Investment securities available-for-sale           | 383,057  | 383,057                         | 451,060  | 451,060                         |
| Loans receivable, net of allowance for loan losses | 2,102,621                                      | 2,096,928                       | 1,986,051                                      | 1,981,669                       |
| Loans held for sale                                | 5,228  | 5,228                           | 8,306  | 8,306                           |
| Accrued interest receivable                        | 6,957  | 6,957                           | 7,581  | 7,581                           |
| Investment in federal home loan bank stock         | 14,060   | 14,060                          | 17,800   | 17,800                          |
| Investment in federal reserve bank stock           | 13,200   | 13,200                          | 12,222   | 12,222                          |
| <b>Financial liabilities:</b>                      |  |                                 |  |                                 |
| Noninterest-bearing deposits                       | 778,345  | 778,345                         | 720,931  | 720,931                         |
| Interest-bearing deposits                          | 1,651,362                                      | 1,656,011                       | 1,675,032                                      | 1,680,211                       |
| Borrowings   | 2,645  | 2,674                           | 85,341   | 85,414                          |
| Accrued interest payable                           | 2,705  | 2,705                           | 11,775   | 11,775                          |
| <b>Off-balance sheet items:</b>                    |  |                                 |  |                                 |
| Commitments to extend credit                       | 225,070  | 190                             | 182,746  | 146                             |
| Standby letters of credit                          | 9,326  | 42                              | 10,588   | 24                              |

The methods and assumptions used to estimate the fair value of each class of financial instruments for which it was practicable to estimate that value are explained below:

*Cash and cash equivalents* The carrying amounts of cash and cash equivalents approximate fair value due to the short-term nature of these instruments (Level 1).

*Restricted cash* The carrying amount of restricted cash approximates its fair value (Level 1).

*Investment securities* The fair value of investment securities, consisting of investment securities available-for-sale, is generally obtained from market bids for similar or identical securities, from independent securities brokers or dealers, or from other model-based valuation techniques described above (Level 1, 2 and 3).

*Loans receivable, net of allowance for loan losses* The fair value for loans receivable is estimated based on the discounted cash flow approach. The discount rate was derived from the associated yield curve plus spreads and reflects the offering rates offered by the Bank for loans with similar financial characteristics. Yield curves are constructed by product type using the Bank's loan pricing model for like-quality credits. The discount rates used in the Bank's model represent the rates the Bank would offer to current borrowers for like-quality credits. These rates could be different from what other financial institutions could offer for these loans. No adjustments have been made for changes in credit within the loan portfolio. It is our opinion that the allowance for loan losses relating to performing and nonperforming loans results in a fair valuation of such loans. Additionally, the fair value of our loans may differ significantly from the values that would have been used had a ready market existed for such loans and may differ materially from the values that we may ultimately realize (Level 3).

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*Loans held for sale* Loans held for sale are carried at the lower of aggregate cost or fair market value, as determined based upon quotes, bids or sales contract prices, or as may be assessed based upon the fair value of the collateral which is obtained from recent real estate appraisals (Level 2). Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Such adjustment is typically significant and results in Level 3 classification of the inputs for determining fair value.

*Accrued interest receivable* The carrying amount of accrued interest receivable approximates its fair value (Level 1).

*Investment in Federal Home Loan Bank and Federal Reserve Bank stock* The carrying amounts of investment in Federal Home Loan Bank ( FHLB ) and Federal Reserve Bank ( FRB ) stock approximate fair value as such stock may be resold to the issuer at carrying value (Level 1).

*Non-interest-bearing deposits* The fair value of non-interest-bearing deposits is the amount payable on demand at the reporting date (Level 2).

*Interest-bearing deposits* The fair value of interest-bearing deposits, such as savings accounts, money market checking, and certificates of deposit, is estimated based on discounted cash flows. The cash flows for non-maturity deposits, including savings accounts and money market checking, are estimated based on their historical decaying experiences. The discount rate used for fair valuation is based on interest rates currently being offered by the Bank on comparable deposits as to amount and term (Level 3).

*Borrowings* Borrowings consist of FHLB advances, junior subordinated debentures and other borrowings. Discounted cash flows based on current market rates for borrowings with similar remaining maturities are used to estimate the fair value of borrowings (Level 3).

*Accrued interest payable* The carrying amount of accrued interest payable approximates its fair value (Level 1).

*Stock warrants* The fair value of stock warrants is determined by the Black-Scholes option pricing model. The expected stock volatility is based on historical volatility of our common stock over expected term of the warrants. The expected life assumption is based on the contract term and dividend yield is based on the company's annual dividend divided by the current share price. The risk free rate used for the warrants is equal to the zero coupon rate in effect at the time of the grant (Level 3).

*Commitments to extend credit and standby letters of credit* The fair values of commitments to extend credit and standby letters of credit are based upon the difference between the current value of similar loans and the price at which the Bank has committed to make the loans (Level 3).

**Note 8 Share-Based Compensation****Share-Based Compensation Expense**

For the three months ended September 30, 2013 and 2012, share-based compensation expense was \$197,000 and \$42,000, respectively, and the related tax benefits on non-qualified stock options were \$0 and \$18,000, respectively. For the nine months ended September 30, 2013 and 2012, share-based compensation expense was \$387,000 and \$144,000, respectively, and the related tax benefits on non-qualified stock options were \$32,000 and \$61,000, respectively.

**Unrecognized Share-Based Compensation Expense**



As of September 30, 2013, unrecognized share-based compensation expense was as follows:

|  | <b>Unrecognized<br/>Expense</b> | <b>Average Expected<br/>Recognition<br/>Period</b> |
|--|---------------------------------|--|
|  | <i>(In thousands)</i>           |  |
| Stock option awards  | \$ 2,158                        | 2.7 years  |
| Restricted stock awards  | 1,794                           | 2.9 years  |
| <b>Total unrecognized share-based compensation<br/>expense</b> | <b>\$ 3,952</b>                 | <b>2.8 years</b>                                   |

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The table below provides stock option information for the three months ended September 30, 2013:

|  | Number of<br>Shares | Weighted-<br>Average<br>Exercise<br>Price<br>Per<br>Share | Weighted<br>Average<br>Remaining<br>Contractual<br>Life | Aggregate<br>Intrinsic<br>Value of<br>In-the-<br>Money<br>Options |
|--|---------------------|---|---|---|
| <i>(In thousands, except share and per share data)</i> |                     |   |   |   |
| Options outstanding at beginning of period             | 329,970             | \$ 37.43  | 7.5 years   | \$ 1,015 <sup>(1)</sup>   |
| Options granted  | 305,000             | \$ 16.43  | 9.9 years   |   |
| Options exercised                                      | (38,437)            | \$ 11.18  | 7.7 years   |   |
| Options forfeited                                      | (16,125)            | \$ 12.46  | 9.0 years   |   |
| Options expired  | (8,750)             | \$ 45.28  | 4.7 years   |   |
| <b>Options outstanding at end of period</b>            | <b>571,658</b>      | <b>\$ 28.58</b>   | <b>8.6 years</b>  | <b>\$ 636<sup>(2)</sup></b>                                       |
| Options exercisable at end of period                   | 124,220             | \$ 76.83  | 4.9 years   | \$ 258 <sup>(2)</sup>   |

(1) Intrinsic value represents the excess of the closing stock price on the last trading day of the period, which was \$17.67 as of June 30, 2013, over the exercise price, multiplied by the number of options.

(2) Intrinsic value represents the excess of the closing stock price on the last trading day of the period, which was \$16.57 as of September 30, 2013, over the exercise price, multiplied by the number of options.

The table below provides stock option information for the nine months ended September 30, 2013:

|  | Number of<br>Shares | Weighted-<br>Average<br>Exercise<br>Price<br>Per<br>Share | Weighted<br>Average<br>Remaining<br>Contractual<br>Life | Aggregate<br>Intrinsic<br>Value of<br>In-the-<br>Money<br>Options |
|--|---------------------|---|---|---|
| <i>(In thousands, except share and per share data)</i> |                     |   |   |   |
| Options outstanding at beginning of period             | 342,950             | \$ 37.44  | 8.0 years   | \$ 359 <sup>(1)</sup>   |
| Options granted  | 305,000             | \$ 16.43  | 9.9 years   |   |
| Options exercised                                      | (40,678)            | \$ 11.25  | 7.7 years   |   |
| Options forfeited                                      | (22,501)            | \$ 12.48  | 9.1 years   |   |
| Options expired  | (13,113)            | \$ 59.36  | 4.3 years   |   |
| <b>Options outstanding at end of period</b>            | <b>571,658</b>      | <b>\$ 28.58</b>   | <b>8.6 years</b>  | <b>\$ 636<sup>(2)</sup></b>                                       |
| Options exercisable at end of period                   | 124,220             | \$ 76.83  | 4.9 years   | \$ 258 <sup>(2)</sup>   |

- (1) *Intrinsic value represents the excess of the closing stock price on the last trading day of the period, which was \$13.59 as of December 31, 2012, over the exercise price, multiplied by the number of options.*
- (2) *Intrinsic value represents the excess of the closing stock price on the last trading day of the period, which was \$16.57 as of September 30, 2013, over the exercise price, multiplied by the number of options.*

There were 38,437 and 40,678 stock options exercised during the three and nine months ended September 30, 2013, respectively, compared to none during the same periods in 2012.

### **Restricted Stock Awards**

Restricted stock awards under the 2013 Plan generally become fully vested after three to five years of continued employment from the date of grant. Hanmi Financial becomes entitled to an income tax deduction in an amount equal to the taxable income reported by the holders of the restricted stock awards when the restrictions are released and the shares are issued. Restricted stock awards are forfeited if officers and employees terminate prior to the lapsing of restrictions. Forfeitures of restricted stock awards are treated as cancelled shares.

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The table below provides information for restricted stock awards for the three and nine months ended September 30, 2013:

|  | Three Months Ended |  | Nine Months Ended |  |
|--|--------------------|--|-------------------|--|
|  | Number of Shares   | Weighted-Average Grant Date Fair Value Per Share | Number of Shares  | Weighted-Average Grant Date Fair Value Per Share |
| Restricted stock at beginning of period  | 3,500              | \$ 10.99   | 10,500            | \$ 10.83   |
| Restricted stock granted                 | 111,332            | \$ 16.43   | 111,332           | \$ 16.43   |
| Restricted stock vested                  |                    |  | (7,000)           | \$ 10.75   |
| Restricted stock forfeited               | (750)              | \$ 10.80   | (750)             | \$ 10.80   |
| <b>Restricted stock at end of period</b> | <b>114,082</b>     | <b>\$ 16.30</b>                                  | <b>114,082</b>    | <b>\$ 16.30</b>                                  |

**Note 9 Earnings Per Share**

Earnings per share ( EPS ) is calculated on both a basic and a diluted basis. Basic EPS excludes dilution and is computed by dividing income available to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted from the issuance of common stock that then shared in earnings, excluding common shares in treasury. Unvested restricted stock is excluded from the calculation of weighted-average common shares for basic EPS. For diluted EPS, weighted-average common shares include the impact of restricted stock under the treasury method.

The following table is a reconciliation of the components used to derive basic and diluted EPS for the periods indicated:

|   | 2013       |                         |                  | 2012       |                         |                  |
|---|------------|-------------------------|------------------|------------|-------------------------|------------------|
|   | Net Income | Weighted-Average Shares | Per Share Amount | Net Income | Weighted-Average Shares | Per Share Amount |
| <b>Three months ended September 30:</b>                                       |            |                         |                  |            |                         |                  |
| Basic EPS   | \$ 10,250  | 31,621,049              | \$ 0.32          | \$ 13,279  | 31,475,976              | \$ 0.42          |
| Effect of dilutive securities options, warrants and unvested restricted stock |            | 111,955                 |                  |            | 69,135                  |                  |
| Diluted EPS   | \$ 10,250  | 31,733,004              | \$ 0.32          | \$ 13,279  | 31,545,111              | \$ 0.42          |
| <b>Nine months ended September 30:</b>  |            |                         |                  |            |                         |                  |

|  |           |            |         |           |            |         |
|--|-----------|------------|---------|-----------|------------|---------|
| Basic EPS  | \$ 29,879 | 31,583,897 | \$ 0.95 | \$ 76,395 | 31,474,042 | \$ 2.43 |
| Effect of dilutive securities options,<br>warrants and unvested restricted stock |           | 68,898     | (0.01)  |           | 32,725     | (0.01)  |
| Diluted EPS  | \$ 29,879 | 31,652,795 | \$ 0.94 | \$ 76,395 | 31,506,767 | \$ 2.42 |

For the three months ended September 30, 2013 and 2012, there were 65,525 and 80,825 options, warrants and shares of unvested restricted stock outstanding, respectively, that were not included in the computation of diluted EPS because their effect would be anti-dilutive. For the nine months ended September 30, 2013 and 2012, there were 370,525 and 122,525 options, warrants and shares of unvested restricted stock outstanding, respectively, that were not included in the computation of diluted EPS because their effect would be anti-dilutive.

#### **Note 10 Off-Balance Sheet Commitments**

The Bank is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of our customers. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk similar to the risk involved with on-balance sheet items recognized in the Consolidated Balance Sheets.

The Bank's exposure to credit losses in the event of non-performance by the other party to commitments to extend credit and standby letters of credit is represented by the contractual notional amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for extending loan facilities to customers. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, was based on management's credit evaluation of the counterparty.

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Collateral held varies but may include accounts receivable, inventory, premises and equipment, and income-producing or borrower-occupied properties. The following table shows the distribution of undisbursed loan commitments as of the dates indicated:

|   | <b>September 30,<br/>2013</b> | <b>December 31,<br/>2012</b> |
|---|-------------------------------|------------------------------|
|   | <i>(In thousands)</i>         |                              |
| Commitments to extend credit              | \$ 225,070                    | \$ 182,746                   |
| Standby letters of credit                 | 9,326                         | 10,588                       |
| Commercial letters of credit              | 4,149                         | 6,092                        |
| Unused credit card lines                  | 11,934                        | 13,459                       |
| <b>Total undisbursed loan commitments</b> | <b>\$ 250,479</b>             | <b>\$ 212,885</b>            |

**Note 11 Liquidity****Hanmi Financial**

Management believes that Hanmi Financial, on a stand-alone basis, has adequate liquid assets to meet its operating cash needs through September 30, 2014. Hanmi Financial redeemed \$30.9 million of trust preferred securities ( TPS ) in March 2013, and fully paid the remaining \$51.5 million of TPS in April 2013.

**Hanmi Bank**

The principal objective of our liquidity management program is to maintain the Bank's ability to meet the day-to-day cash flow requirements of our customers who either wish to withdraw funds or to draw upon credit facilities to meet their cash needs. Management believes that the Bank, on a stand-alone basis, has adequate liquid assets to meet its current obligations. The Bank's primary funding source will continue to be deposits originating from its branch platform. The Bank's wholesale funds historically consisted of FHLB advances and brokered deposits. As of September 30, 2013, the Bank had no brokered deposits, and had a FHLB advance of \$2.6 million compared to \$2.9 million as of December 31, 2012.

We monitor the sources and uses of funds on a regular basis to maintain an acceptable liquidity position. The Bank's primary source of borrowings is the FHLB, from which the Bank is eligible to borrow up to 30 percent of its total assets. As of September 30, 2013, the total borrowing capacity available based on pledged collateral and the remaining available borrowing capacity were \$366.2 million and \$363.5 million, respectively, compared to \$275.1 million and \$272.2 million, respectively, as of December 31, 2012. The Bank's FHLB borrowings as of September 30, 2013 and December 31, 2012 totaled \$2.6 million and \$2.9 million, respectively, which represented 0.09 percent of total assets as of both dates.

The amount that the FHLB is willing to advance differs based on the quality and character of qualifying collateral pledged by the Bank, and the advance rates for qualifying collateral may be adjusted upwards or downwards by the FHLB from time to time. To the extent deposit renewals and deposit growth are not sufficient to fund maturing and withdrawable deposits, repay maturing borrowings, fund existing and future loans and investment securities and otherwise fund working capital needs and capital expenditures, the Bank may utilize the remaining borrowing capacity from its FHLB borrowing arrangement.

As a means of augmenting its liquidity, the Bank had an available borrowing source of \$91.8 million from the Federal Reserve Discount Window (the Fed Discount Window), to which the Bank pledged loans with a carrying value of \$126.8 million, and had no borrowings as of September 30, 2013. In December 2012, the Bank established a line of credit with Raymond James & Associates, Inc. for repurchase agreements up to a maximum of \$100.0 million.

The Bank has Contingency Funding Plans (CFPs) designed to ensure that liquidity sources are sufficient to meet its ongoing obligations and commitments, particularly in the event of a liquidity contraction. The CFPs are designed to examine and quantify its liquidity under various stress scenarios. Furthermore, the CFPs provide a framework for management and other critical personnel to follow in the event of a liquidity contraction or in anticipation of such an event. The CFPs address authority for activation and decision making, liquidity options and the responsibilities of key departments in the event of a liquidity contraction.

## **Note 12 Segment Reporting**

Through our branch network and lending units, we provide a broad range of financial services to individuals and companies located primarily in Southern California. These services include demand, time and savings deposits; and commercial and industrial, real estate and consumer lending. While our chief decision makers monitor the revenue streams of our various products and services, operations are managed and financial performance is evaluated on a company-wide basis. Accordingly, we consider all of our operations to be aggregated in one reportable operating segment.

Table of Contents**Note 13 Accumulated Other Comprehensive Income**

Activity in accumulated other comprehensive income for the three months periods ended September 30, 2013 and 2012 was as follows:

|   | <b>Unrealized<br/>Gains<br/>and Losses on<br/>Available-for-Sale<br/>Securities</b> | <b>Unrealized Gains<br/>and Losses on<br/>Interest<br/>Rate<br/>Swap</b> | <b>Unrealized Gains<br/>and Losses on<br/>Interest-Only<br/>Strip<br/><i>(In thousands)</i></b> | <b>Unrealized Gains<br/>and Losses on<br/>Tax (Expense)<br/>Benefit</b> | <b>Total</b>      |
|---|---|--|---|---|-------------------|
| <b>For the three months ended<br/>September 30 2013:</b>        |   |  |   |   |                   |
| Balance at beginning of period                                  | \$ 915  | \$   | \$ 17   | \$ 702  | \$ 1,634          |
| Other comprehensive (loss) income<br>before reclassification    | (10,020)  |  |   | 4,528   | (5,492)           |
| Reclassification from accumulated<br>other comprehensive income | (611)   |  |   |   | (611)             |
| <b>Period change</b>  | <b>(10,631)</b>   |  |   | <b>4,528</b>  | <b>(6,103)</b>    |
| <b>Balance at end of period</b>                                 | <b>\$ (9,716)</b>   | <b>\$</b>  | <b>\$ 17</b>  | <b>\$ 5,230</b>   | <b>\$ (4,469)</b> |
| <b>For the three months ended<br/>September 30, 2012:</b>       |   |  |   |   |                   |
| Balance at beginning of period                                  | \$ 3,442  | \$   | \$ 14   | \$ (302)  | \$ 3,154          |
| Other comprehensive income (loss)<br>before reclassification    | 3,623   |  | 2   | (1,581)   | 2,044             |
| Reclassification from accumulated<br>other comprehensive income | 166   |  |   |   | 166               |
| <b>Period change</b>  | <b>3,789</b>  |  | <b>2</b>  | <b>(1,581)</b>  | <b>2,210</b>      |
| <b>Balance at end of period</b>                                 | <b>\$ 7,231</b>   | <b>\$</b>  | <b>\$ 16</b>  | <b>\$ (1,883)</b>   | <b>\$ 5,364</b>   |

For the three months ended September 30, 2013, there was a \$611,000 reclassification from accumulated other comprehensive income to gains in earnings resulting from the sale of available-for-sale securities. The \$611,000 reclassification adjustment out of accumulated other comprehensive income was included in net gain on sales of investment securities under non-interest income. The securities were previously recorded as unrealized gains of \$899,000 in accumulated other comprehensive income.

For the three months ended September 30, 2012, there was a \$10,000 reclassification from accumulated other comprehensive income to gains in earnings, which resulted from the redemption of available-for-sale securities, and a \$176,000 reclassification from other comprehensive loss to OTTI charge in earnings, which resulted from a write-down of the value of investment securities to its fair value. The reclassification adjustments of a \$10,000 gain



and a \$176,000 loss out of accumulated other comprehensive income were included in net gain on sales of investment securities and impairment loss on investment securities, respectively, under non-interest income. The securities with the \$10,000 gain from reclassification adjustments were previously recorded as unrealized gains of \$4,000 in accumulated other comprehensive income.

Activity in accumulated other comprehensive income for the nine months periods ended September 30, 2013 and 2012 was as follows:

|   | <b>Unrealized<br/>Gains<br/>and Losses on<br/>Available-for-Sale<br/>Securities</b> | <b>Unrealized Gains<br/>and Losses on<br/>Interest<br/>Rate<br/>Swap</b> | <b>Unrealized Gains<br/>and Losses on<br/>Interest-Only<br/>Strip<br/>(In thousands)</b> | <b>Tax (Expense)<br/>Benefit</b> | <b>Total</b>      |
|---|---|--|--|----------------------------------|-------------------|
| <b>For the nine months ended<br/>September 30 2013:</b>         |   |  |  |                                  |                   |
| Balance at beginning of period                                  | \$ 7,348  | \$   | \$ 16  | \$ (1,946)                       | \$ 5,418          |
| Other comprehensive (loss) income<br>before reclassification    | (16,141)  |  | 1  | 7,176                            | (8,964)           |
| Reclassification from accumulated<br>other comprehensive income | (923)   |  |  |                                  | (923)             |
| Period change   | (17,064)  |  | 1  | 7,176                            | (9,887)           |
| <b>Balance at end of period</b>                                 | <b>\$ (9,716)</b>   | <b>\$</b>  | <b>\$ 17</b>   | <b>\$ 5,230</b>                  | <b>\$ (4,469)</b> |
| <b>For the nine months ended<br/>September 30, 2012:</b>        |   |  |  |                                  |                   |
| Balance at beginning of period                                  | \$ 4,115  | \$ (9)   | \$ 20  | \$ (602)                         | \$ 3,524          |
| Other comprehensive income (loss)<br>before reclassification    | 4,216   | 9  | (4)  | (1,281)                          | 2,940             |
| Reclassification from accumulated<br>other comprehensive income | (1,100)   |  |  |                                  | (1,100)           |
| Period change   | 3,116   | 9  | (4)  | (1,281)                          | 1,840             |
| <b>Balance at end of period</b>                                 | <b>\$ 7,231</b>   | <b>\$</b>  | <b>\$ 16</b>   | <b>\$ (1,883)</b>                | <b>\$ 5,364</b>   |

For the nine months ended September 30, 2013, there was a \$923,000 reclassification from accumulated other comprehensive income to gains in earnings resulting from the redemption and sale of available-for-sale securities. The \$923,000 reclassification adjustment out of accumulated other comprehensive income was included in net gain on sales of investment securities under non-interest income. The securities were previously recorded as unrealized gains of \$2.4 million in accumulated other comprehensive income.

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For the nine months ended September 30, 2012, there was a \$1.3 million reclassification from accumulated other comprehensive income to gains in earnings, which resulted from the redemption and sale of available-for-sale securities, and a \$176,000 reclassification from other comprehensive loss to OTTI charge in earnings, which resulted from write-down of the value of investment securities to its fair value. The reclassification adjustments of a \$1.3 million gain and a \$176,000 loss out of accumulated other comprehensive income were included in net gain on sales of investment securities and impairment loss on investment securities, respectively, under non-interest income. The securities with the \$1.3 million gain from reclassification adjustments were previously recorded as an unrealized gain of \$1.7 million in accumulated other comprehensive income.

**Note 14 Subsequent Events**

Management has evaluated subsequent events through the date of issuance of the financial data included herein. There have been no subsequent events that occurred during such period that would require disclosure in this Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2013, or would be required to be recognized in the Consolidated Financial Statements (Unaudited) as of September 30, 2013.

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### **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following is management's discussion and analysis of the major factors that influenced our results of operations and financial condition as of and for the three and nine months ended September 30, 2013. This analysis should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2012 (the 2012 Annual Report on Form 10-K ) and with the unaudited consolidated financial statements and notes thereto set forth in this Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2013 (this Report ).

#### **Forward-Looking Statements**

Some of the statements under *Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations* and elsewhere in this Report constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act ). All statements in this Report other than statements of historical fact are forward looking statements for purposes of federal and state securities laws, including, but not limited to, statements about anticipated future operating and financial performance, financial position and liquidity, business strategies, regulatory and competitive outlook, investment and expenditure plans, capital and financing needs, plan and availability, plans and objectives of management for future operations, and other similar forecasts and statements of expectation and statements of assumption underlying any of the foregoing. In some cases, you can identify forward-looking statements by terminology such as may, will, should, could, expects, plans, intends, anticipates, believes, estimates, potential, or continue, or the negative of such terms and other comparable terminology. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. These statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievements to differ from those expressed or implied by the forward-looking statement. These factors include the following:

failure to maintain adequate levels of capital to support our operations;

a significant number of customers failing to perform under their loans or other extensions of credit;

fluctuations in interest rates and a decline in the level of our interest rate spread;

failure to attract or retain deposits and restrictions on taking brokered deposits;

sources of liquidity available to us and to Hanmi Bank becoming limited or our potential inability to access sufficient sources of liquidity when needed or the requirement that we obtain government waivers to do so;

adverse changes in domestic or global financial markets, economic conditions or business conditions;

regulatory restrictions on Hanmi Bank's ability to pay dividends to us and on our ability to make payments on our obligations;

significant reliance on loans secured by real estate and the associated vulnerability to downturns in the local real estate market, natural disasters and other variables impacting the value of real estate;

our use of appraisals in deciding whether to make loans secured by real property, which does not ensure that the value of the real property collateral will be sufficient to pay our loans;

failure to attract or retain our key employees;

credit quality and the effect of credit quality on our provision for credit losses and allowance for loan losses;

volatility and disruption in financial, credit and securities markets, and the price of our common stock;

deterioration in financial markets that may result in impairment charges relating to our securities portfolio;

competition and demographic changes in our primary market areas;

global hostilities, acts of war or terrorism, including but not limited to, conflict between North Korea and South Korea;

the effects of litigation against us;

significant government regulations, legislation and potential changes thereto, including as a result of the Dodd-Frank Act; and

other risks described herein and in the other reports we file with the Securities and Exchange Commission; For a discussion of some of the other factors that might cause such a difference, see the discussion contained in this Report under the heading Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations. Also see Item 1A. Risk Factors, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations-Interest Rate Risk Management and Capital Resources and Liquidity in our 2012 Annual Report on Form 10-K, as well as other factors we identify from time to time in our periodic reports, including our Quarterly Reports on Form 10-Q, filed pursuant to the Exchange Act. We undertake no obligation to update these forward-looking statements to reflect events or circumstances that occur after the date, on which such statements were made, except as required by law.

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**Critical Accounting Policies**

We have established various accounting policies that govern the application of GAAP in the preparation of our financial statements. Our significant accounting policies are described in the Notes to Consolidated Financial Statements in our 2012 Annual Report on Form 10-K. Certain accounting policies require us to make significant estimates and assumptions that have a material impact on the carrying value of certain assets and liabilities, and we consider these critical accounting policies. For a description of these critical accounting policies, see Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies in our 2012 Annual Report on Form 10-K. We use estimates and assumptions based on historical experience and other factors that we believe to be reasonable under the circumstances. Actual results could differ significantly from these estimates and assumptions, which could have a material impact on the carrying value of assets and liabilities at the balance sheet dates and our results of operations for the reporting periods. Management has discussed the development and selection of these critical accounting policies with the Audit Committee of Hanmi Financial's Board of Directors.

**Table of Contents****Selected Financial Data**

The following tables set forth certain selected financial data for the periods indicated:

|   | <b>As of and For the</b>  |              |                          |              |
|---|---------------------------|--------------|--------------------------|--------------|
|   | <b>Three Months Ended</b> |              | <b>Nine Months Ended</b> |              |
|   | <b>September 30,</b>      |              | <b>September 30,</b>     |              |
|   | <b>2013</b>               | <b>2012</b>  | <b>2013</b>              | <b>2012</b>  |
| <i>(In thousands, except share and per share data)</i>        |                           |              |                          |              |
| <b>Average balances:</b>                                      |                           |              |                          |              |
| Average gross loans, net of deferred loan fees <sup>(1)</sup> | \$ 2,186,884              | \$ 1,958,819 | \$ 2,142,462             | \$ 1,982,369 |
| Average investment securities                                 | 385,961                   | 386,513      | 417,290                  | 409,544      |
| Average interest-earning assets                               | 2,644,844                 | 2,694,571    | 2,665,087                | 2,671,300    |
| Average total assets  | 2,789,741                 | 2,829,778    | 2,804,224                | 2,765,308    |
| Average deposits  | 2,374,847                 | 2,361,534    | 2,363,272                | 2,335,771    |
| Average borrowings  | 5,587                     | 85,482       | 34,308                   | 85,884       |
| Average interest-bearing liabilities                          | 1,630,637                 | 1,766,709    | 1,673,559                | 1,754,943    |
| Average stockholders equity                                   | 395,274                   | 352,980      | 390,700                  | 313,816      |
| <b>Per share data:</b>  |                           |              |                          |              |
| Earnings per share basic                                      | \$ 0.32                   | \$ 0.42      | \$ 0.95                  | \$ 2.43      |
| Earnings per share diluted                                    | \$ 0.32                   | \$ 0.42      | \$ 0.94                  | \$ 2.42      |
| Common shares outstanding                                     | 31,754,115                | 31,489,201   | 31,754,115               | 31,489,201   |
| Book value per share <sup>(2)</sup>                           | \$ 12.53                  | \$ 11.56     | \$ 12.53                 | \$ 11.56     |
| <b>Performance ratios:</b>                                    |                           |              |                          |              |
| Return on average assets <sup>(3) (4)</sup>                   | 1.46%                     | 1.87%        | 1.42%                    | 3.69%        |
| Return on average stockholders equity <sup>(3) (5)</sup>      | 10.29%                    | 14.97%       | 10.22%                   | 32.52%       |
| Efficiency ratio <sup>(6)</sup>                               | 52.98%                    | 59.81%       | 55.30%                   | 63.62%       |
| Net interest spread <sup>(7)</sup>                            | 3.98%                     | 3.34%        | 3.78%                    | 3.35%        |
| Net interest margin <sup>(8)</sup>                            | 4.28%                     | 3.69%        | 4.08%                    | 3.74%        |
| Average stockholders equity to average total assets           | 14.17%                    | 12.47%       | 13.93%                   | 11.35%       |
| <b>Selected capital ratios: <sup>(9)</sup></b>                |                           |              |                          |              |
| <b>Total risk-based capital ratio:</b>                        |                           |              |                          |              |
| Hanmi Financial   | 17.72%                    | 20.79%       | 17.72%                   | 20.79%       |
| Hanmi Bank  | 17.02%                    | 19.91%       | 17.02%                   | 19.91%       |
| <b>Tier 1 risk-based capital ratio:</b>                       |                           |              |                          |              |
| Hanmi Financial   | 16.45%                    | 19.52%       | 16.45%                   | 19.52%       |
| Hanmi Bank  | 15.75%                    | 18.63%       | 15.75%                   | 18.63%       |
| <b>Tier 1 leverage ratio:</b>                                 |                           |              |                          |              |
| Hanmi Financial   | 13.68%                    | 14.71%       | 13.68%                   | 14.71%       |
| Hanmi Bank  | 13.10%                    | 14.05%       | 13.10%                   | 14.05%       |
| <b>Asset quality ratios:</b>                                  |                           |              |                          |              |
| Non-performing loans to gross loans <sup>(10)</sup>           | 1.05%                     | 2.28%        | 1.05%                    | 2.28%        |
| Non-performing assets to total assets <sup>(11)</sup>         | 0.81%                     | 1.59%        | 0.81%                    | 1.59%        |

|   |         |         |         |         |
|---|---------|---------|---------|---------|
| Net loan charge-offs to average gross loans <sup>(12)</sup> | 0.41%   | 1.21%   | 0.38%   | 2.06%   |
| Allowance for loan losses to gross loans                    | 2.67%   | 3.38%   | 2.67%   | 3.38%   |
| Allowance for loan losses to total non-performing loans     | 253.07% | 147.92% | 253.07% | 147.92% |

- (1) Loans are net of deferred fees and related direct costs
- (2) Total stockholders' equity divided by common shares outstanding
- (3) Calculation based on annualized net income
- (4) Net income divided by average total assets
- (5) Net income divided by average stockholders' equity
- (6) Total non-interest expenses divided by the sum of net interest income before provision for credit losses and total non-interest income
- (7) Average yield earned on interest-earning assets less average rate paid on interest-bearing liabilities. Computed on a tax-equivalent basis using an effective marginal rate of 35 percent
- (8) Net interest income before provision for credit losses divided by average interest-earning assets. Computed on a tax-equivalent basis using an effective marginal rate of 35 percent
- (9) The required ratios for a well-capitalized institution, as defined by regulations of the Board of Governors of the Federal Reserve System, are 10 percent for the Total Risk-Based Capital Ratio (total capital divided by total risk-weighted assets); 6 percent for the Tier 1 Risk-Based Capital Ratio (Tier 1 capital divided by total risk-weighted assets); and 5 percent for the Tier 1 Leverage Ratio (Tier 1 capital divided by average total assets)
- (10) Non-performing loans consist of non-accrual loans and loans past due 90 days or more and still accruing interest
- (11) Non-performing assets consist of non-performing loans (see footnote (10) above) and other real estate owned
- (12) Calculation based on annualized net loan charge-offs

**Table of Contents****Non-GAAP Financial Measures****Tangible Stockholders' Equity to Tangible Assets Ratio**

Tangible common equity to tangible assets ratio is supplemental financial information determined by a method other than in accordance with U.S. generally accepted accounting principles ( GAAP ). This non-GAAP measure is used by management in analyzing Hanmi Financial's capital strength. Tangible equity is calculated by subtracting goodwill and other intangible assets from total stockholders' equity. Banking and financial institution regulators also exclude goodwill and other intangible assets from total stockholders' equity when assessing the capital adequacy of a financial institution. Management believes the presentation of this financial measure excluding the impact of these items provides useful supplemental information that is essential to a proper understanding of the capital strength of Hanmi Financial. This disclosure should not be viewed as a substitution for results determined in accordance with GAAP, nor is it necessarily comparable to non-GAAP performance measures that may be presented by other companies.

The following table reconciles this non-GAAP performance measure to the GAAP performance measure as of the dates indicated:

|  | <b>As of September 30,</b>                             |              |
|--|--|--------------|
|  | <b>2013</b>  | <b>2012</b>  |
|  | <i>(In thousands, except share and per share data)</i> |              |
| <b>Hanmi Financial Corporation</b>         |  |              |
| Total assets                               | \$ 2,845,137   | \$ 2,841,857 |
| Less other intangible assets               | (1,212)  | (1,376)      |
| Tangible assets                            | \$ 2,843,925   | \$ 2,840,481 |
| Total stockholders' equity                 | \$ 397,956   | \$ 363,987   |
| Less other intangible assets               | (1,212)  | (1,376)      |
| Tangible stockholders' equity              | \$ 396,744   | \$ 362,611   |
| Total stockholders' equity to total assets | 13.99%   | 12.81%       |
| Tangible common equity to tangible assets  | 13.95%   | 12.77%       |
| Common shares outstanding                  | 31,754,115   | 31,489,201   |
| Tangible common equity per common share    | \$ 12.49   | \$ 11.52     |



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### **Executive Overview**

The financial highlights for the third quarter ended September 30, 2013 are as follows:

Third quarter net income was \$10.3 million, or \$0.32 per diluted share, compared to \$9.5 million, or \$0.30 per diluted share, in the second quarter of 2013, and \$13.3 million, or \$0.42 per diluted share, in the third quarter of 2012.

Net interest margin increased 18 basis points to 4.28 percent, from 4.10 percent in the second quarter of 2013, and increased 59 basis points from 3.69 percent in the third quarter of 2012.

Efficiency ratio continued to improve to 52.98 percent for this quarter from 56.55 percent for the second quarter of 2013 and 59.81 percent for the same quarter a year ago.

New loan production totaled \$136.0 million, mainly consisting of \$84.6 million of commercial real estate loans, \$22.8 million of commercial and industrial loans, and \$27.9 million of SBA loans.

Average gross loans were up 11.7 percent year-over-year.

Asset quality improved, with non-performing assets declining to 0.81 percent of total assets.

A cash dividend of \$0.07 per share of common stock was paid on September 17, 2013.

### **Results of Operations**

#### **Net Interest Income**

Our primary source of revenue is net interest income, which is the difference between interest and fees derived from earning assets, and interest paid on liabilities obtained to fund those assets. Our net interest income is affected by changes in the level and mix of interest-earning assets and interest-bearing liabilities, referred to as volume changes. Net interest income is also affected by changes in the yields earned on assets and rates paid on liabilities, referred to as rate changes. Interest rates charged on our loans are affected principally by changes to interest rates, the demand for such loans, the supply of money available for lending purposes, and other competitive factors. Those factors are, in turn, affected by general economic conditions and other factors beyond our control, such as federal economic policies, the general supply of money in the economy, legislative tax policies, governmental budgetary matters, and the actions of the Federal Reserve Board.

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The following table shows the average balances of assets, liabilities and stockholders' equity; the amount of interest income and interest expense; the average yield or rate for each category of interest-earning assets and interest-bearing liabilities; and the net interest spread and the net interest margin for the periods indicated. All average balances are daily average balances.

|   | <b>Three Months Ended</b>  |  |                                     |                            |  |                                     |
|---|----------------------------|--|-------------------------------------|----------------------------|--|-------------------------------------|
|   | <b>September 30, 2013</b>  |  |                                     | <b>September 30, 2012</b>  |  |                                     |
|   | <b>Average<br/>Balance</b> | <b>Interest<br/>Income<br/>/<br/>Expense</b> | <b>Average<br/>Yield /<br/>Rate</b> | <b>Average<br/>Balance</b> | <b>Interest<br/>Income<br/>/<br/>Expense</b> | <b>Average<br/>Yield /<br/>Rate</b> |
| <i>(In thousands)</i>                                 |                            |  |                                     |                            |  |                                     |
| <b>Assets</b>   |                            |  |                                     |                            |  |                                     |
| Interest-earning assets:                              |                            |  |                                     |                            |  |                                     |
| Gross loans, net of deferred loan fees <sup>(1)</sup> | \$ 2,186,884               | \$ 29,098                                    | 5.28%                               | \$ 1,958,819               | \$ 26,781                                    | 5.44%                               |
| Municipal securities-taxable                          | 43,259                     | 442  | 4.09%                               | 44,887                     | 452  | 4.03%                               |
| Municipal securities-tax exempt <sup>(2)</sup>        | 10,088                     | 106  | 4.21%                               | 12,587                     | 151  | 4.79%                               |
| Obligations of other U.S. government agencies         | 94,350                     | 455  | 1.93%                               | 74,345                     | 280  | 1.51%                               |
| Other debt securities                                 | 238,264                    | 1,143  | 1.92%                               | 254,694                    | 1,260  | 1.98%                               |
| Equity securities                                     | 28,058                     | 392  | 5.59%                               | 30,886                     | 178  | 2.31%                               |
| Federal funds sold                                    |                            |  | 0.00%                               | 17,925                     | 20   | 0.44%                               |
| Term federal funds sold                               |                            |  | 0.00%                               | 78,967                     | 191  | 0.96%                               |
| Interest-bearing deposits in other banks              | 43,941                     | 28   | 0.25%                               | 221,461                    | 142  | 0.26%                               |
| <b>Total interest-earning assets</b>                  | <b>2,644,844</b>           | <b>31,664</b>                                | <b>4.75%</b>                        | <b>2,694,571</b>           | <b>29,455</b>                                | <b>4.35%</b>                        |
| Noninterest-earning assets:                           |                            |  |                                     |                            |  |                                     |
| Cash and cash equivalents                             | 66,808                     |  |                                     | 70,591                     |  |                                     |
| Allowance for loan losses                             | (58,991)                   |  |                                     | (71,481)                   |  |                                     |
| Other assets  | 137,080                    |  |                                     | 136,097                    |  |                                     |
| <b>Total noninterest-earning assets</b>               | <b>144,897</b>             |  |                                     | <b>135,207</b>             |  |                                     |
| <b>Total assets</b>                                   | <b>\$ 2,789,741</b>        |  |                                     | <b>\$ 2,829,778</b>        |  |                                     |
| <b>Liabilities and Stockholders' Equity</b>           |                            |  |                                     |                            |  |                                     |
| Interest-bearing liabilities:                         |                            |  |                                     |                            |  |                                     |
| Deposits:   |                            |  |                                     |                            |  |                                     |
| Savings   | \$ 115,058                 | \$ 454                                       | 1.57%                               | \$ 111,432                 | \$ 516                                       | 1.84%                               |
| Money market checking and NOW accounts                | 546,413                    | 691  | 0.50%                               | 555,454                    | 859  | 0.62%                               |
| Time deposits of \$100,000 or more                    | 522,664                    | 942  | 0.72%                               | 660,036                    | 1,467  | 0.88%                               |
| Other time deposits                                   | 440,915                    | 1,030  | 0.93%                               | 354,305                    | 797  | 0.89%                               |
| FHLB advances   | 5,587                      | 36   | 2.56%                               | 3,076                      | 40   | 5.17%                               |
| Junior subordinated debentures                        |                            |  | 0.00%                               | 82,406                     | 804  | 3.88%                               |

|  |                     |                  |              |                     |                  |              |
|--|---------------------|------------------|--------------|---------------------|------------------|--------------|
| Total interest-bearing liabilities               | 1,630,637           | 3,153            | 0.77%        | 1,766,709           | 4,483            | 1.01%        |
| <b>Noninterest-bearing liabilities:</b>          |                     |                  |              |                     |                  |              |
| Demand deposits                                  | 749,797             |                  |              | 680,307             |                  |              |
| Other liabilities                                | 14,033              |                  |              | 29,782              |                  |              |
| Total noninterest-bearing liabilities            | 763,830             |                  |              | 710,089             |                  |              |
| Total liabilities                                | 2,394,467           |                  |              | 2,476,798           |                  |              |
| Stockholders equity                              | 395,274             |                  |              | 352,980             |                  |              |
| <b>Total liabilities and stockholders equity</b> | <b>\$ 2,789,741</b> |                  |              | <b>\$ 2,829,778</b> |                  |              |
| <b>Net interest income</b>                       |                     | <b>\$ 28,511</b> |              |                     | <b>\$ 24,972</b> |              |
| <b>Cost of deposits</b>                          |                     |                  | <b>0.52%</b> |                     |                  | <b>0.61%</b> |
| <b>Net interest spread <sup>(3)</sup></b>        |                     |                  | <b>3.98%</b> |                     |                  | <b>3.34%</b> |
| <b>Net interest margin <sup>(4)</sup></b>        |                     |                  | <b>4.28%</b> |                     |                  | <b>3.69%</b> |

(1) Loans are net of deferred fees and related direct costs, but exclude the allowance for loan losses. Non-accrual loans are included in the average loan balance. Loan fees have been included in the calculation of interest income. Loan fees were \$510,000 and \$282,000 for the three months ended September 30, 2013 and 2012, respectively.

(2) Computed on a tax-equivalent basis using an effective marginal rate of 35 percent.

(3) Represents the average rate earned on interest-earning assets less the average rate paid on interest-bearing liabilities.

(4) Represents annualized net interest income as a percentage of average interest-earning assets.

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The table below shows changes in interest income and interest expense and the amounts attributable to variations in interest rates and volumes for the periods indicated. The variances attributable to simultaneous volume and rate changes have been allocated to the change due to volume and the change due to rate categories in proportion to the relationship of the absolute dollar amount attributable solely to the change in volume and to the change in rate.

|   | <b>Three Months Ended September 30, 2013 vs.<br/>Three Months Ended September 30, 2012<br/>Increases (Decreases) Due to Change</b> |                    |                   |
|---|--|--------------------|-------------------|
|   | <b>Volume</b>  | <b>In<br/>Rate</b> | <b>Total</b>      |
|   | <i>(In thousands)</i>  |                    |                   |
| <b>Interest and dividend income:</b>          |  |                    |                   |
| Gross loans, net of deferred loan fees        | \$ 3,115   | \$ (798)           | \$ 2,317          |
| Municipal securities-taxable                  | (17)   | 7                  | (10)              |
| Municipal securities-tax exempt               | (28)   | (17)               | (45)              |
| Obligations of other U.S. government agencies | 86   | 89                 | 175               |
| Other debt securities                         | (79)   | (38)               | (117)             |
| Equity securities                             | (17)   | 231                | 214               |
| Federal funds sold                            | (10)   | (10)               | (20)              |
| Term federal funds sold                       | (95)   | (96)               | (191)             |
| Interest-bearing deposits in other banks      | (110)  | (4)                | (114)             |
| <b>Total interest and dividend income</b>     | <b>\$ 2,845</b>  | <b>\$ (636)</b>    | <b>\$ 2,209</b>   |
| <b>Interest expense:</b>                      |  |                    |                   |
| Savings                                       | \$ 17  | \$ (79)            | \$ (62)           |
| Money market checking and NOW accounts        | (13)   | (155)              | (168)             |
| Time deposits of \$100,000 or more            | (274)  | (251)              | (525)             |
| Other time deposits                           | 199  | 34                 | 233               |
| FHLB advances                                 | 23   | (27)               | (4)               |
| Junior subordinated debentures                | (402)  | (402)              | (804)             |
| <b>Total interest expense</b>                 | <b>\$ (450)</b>  | <b>\$ (880)</b>    | <b>\$ (1,330)</b> |
| <b>Change in net interest income</b>          | <b>\$ 3,295</b>  | <b>\$ 244</b>      | <b>\$ 3,539</b>   |

Interest income increased \$2.2 million, or 7.5 percent, to \$31.7 million for the three months ended September 30, 2013 from \$29.5 million for the same period in 2012. Interest expense decreased \$1.3 million, or 29.7 percent, to \$3.2 million for the three months ended September 30, 2013 compared to \$4.5 million for the same period in 2012. For the three months ended September 30, 2013 and 2012, net interest income before credit losses on a tax-equivalent basis was \$28.5 million and \$25.0 million, respectively. The increase in net interest income before credit losses was primarily attributable to increased interest income from average gross loan increases, lower deposit costs resulting from the replacement of high-cost time deposits with low-cost deposits and a decrease in interest expense from the redemption of \$80 million of TPS. The net interest spread and net interest margin for the three months ended September 30, 2013 were 3.98 percent and 4.28 percent, respectively, compared to 3.34 percent and 3.69 percent, respectively, for the three months ended September 30, 2012.

Average gross loans increased \$228.1 million, or 11.6 percent, to \$2.19 billion for the three months ended September 30, 2013 from \$1.96 billion for the same period in 2012. Average investment securities decreased \$552,000, or 0.1 percent, to \$386.0 million for the three months ended September 30, 2013 from \$386.5 million for the same period in 2012. Average interest-earning assets decreased \$49.7 million, or 1.8 percent, to \$2.64 billion for the three months ended September 30, 2013 from \$2.69 billion for the same period in 2012. The decrease in average interest-earning assets was due mainly to a decrease in excess liquidity utilized for reduction of interest-bearing liabilities. Average interest-bearing liabilities decreased \$136.1 million to \$1.63 billion for the three months ended September 30, 2013, compared to \$1.77 billion for the same period in 2012. The decrease in average interest-bearing liabilities resulted primarily from the redemption of \$80 million of TPS and the reduction of high-cost time deposits.

The average yield on loans decreased to 5.28 percent for the three months ended September 30, 2013 from 5.44 percent for the same period in 2012. The average yield on investment securities remained the same at 2.22 percent for the three months ended September 30, 2013 and the same period in 2012. The average yield on interest-earning assets increased 40 basis points to 4.75 percent for the three months ended September 30, 2013 from 4.35 percent for the same period in 2012, due primarily to on-going investment of funds to higher yielding loans. The average cost on interest-bearing liabilities decreased 24 basis points to 0.77 percent for the three months ended September 30, 2013 from 1.01 percent for the same period in 2012. This decrease was due primarily to a continued shift in funding sources toward lower-cost funds through disciplined deposit pricing, while completely redeeming TPS and reducing rate sensitive deposits.

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The following table shows the average balances of assets, liabilities and stockholders' equity; the amount of interest income and interest expense; the average yield or rate for each category of interest-earning assets and interest-bearing liabilities; and the net interest spread and the net interest margin for the periods indicated. All average balances are daily average balances.

|   | Nine Months Ended     |               |              |                     |               |              |
|---|-----------------------|---------------|--------------|---------------------|---------------|--------------|
|   | September 30, 2013    |               |              | September 30, 2012  |               |              |
|   | Average               | Interest      | Average      | Average             | Interest      | Average      |
|   | Balance               | Income        | Yield /      | Balance             | Income        | Yield /      |
|   |                       | Expense       | Rate         |                     | Expense       | Rate         |
|   | <i>(In thousands)</i> |               |              |                     |               |              |
| <b>Assets</b>   |                       |               |              |                     |               |              |
| Interest-earning assets:                              |                       |               |              |                     |               |              |
| Gross loans, net of deferred loan fees <sup>(1)</sup> | \$ 2,142,462          | \$ 83,736     | 5.23%        | \$ 1,982,369        | \$ 81,564     | 5.50%        |
| Municipal securities-taxable                          | 45,141                | 1,350         | 3.99%        | 44,881              | 1,340         | 3.98%        |
| Municipal securities-tax exempt <sup>(2)</sup>        | 11,188                | 365           | 4.35%        | 12,959              | 460           | 4.73%        |
| Obligations of other U.S. government agencies         | 92,262                | 1,309         | 1.89%        | 75,058              | 985           | 1.75%        |
| Other debt securities                                 | 268,699               | 3,597         | 1.78%        | 276,646             | 3,955         | 1.91%        |
| Equity securities                                     | 29,032                | 1,026         | 4.71%        | 31,486              | 512           | 2.17%        |
| Federal funds sold                                    | 2,079                 | 6             | 0.39%        | 16,545              | 53            | 0.43%        |
| Term federal funds sold                               |                       |               | 0.00%        | 91,898              | 684           | 0.99%        |
| Interest-bearing deposits in other banks              | 74,224                | 140           | 0.25%        | 139,458             | 269           | 0.26%        |
| <b>Total interest-earning assets</b>                  | <b>2,665,087</b>      | <b>91,529</b> | <b>4.59%</b> | <b>2,671,300</b>    | <b>89,822</b> | <b>4.49%</b> |
| Noninterest-earning assets:                           |                       |               |              |                     |               |              |
| Cash and cash equivalents                             | 66,542                |               |              | 70,303              |               |              |
| Allowance for loan losses                             | (60,872)              |               |              | (79,502)            |               |              |
| Other assets  | 133,467               |               |              | 103,207             |               |              |
| <b>Total noninterest-earning assets</b>               | <b>139,137</b>        |               |              | <b>94,008</b>       |               |              |
| <b>Total assets</b>                                   | <b>\$ 2,804,224</b>   |               |              | <b>\$ 2,765,308</b> |               |              |
| <b>Liabilities and Stockholders' Equity</b>           |                       |               |              |                     |               |              |
| Interest-bearing liabilities:                         |                       |               |              |                     |               |              |
| Deposits:   |                       |               |              |                     |               |              |
| Savings   | \$ 114,978            | \$ 1,377      | 1.60%        | \$ 109,605          | \$ 1,675      | 2.04%        |
| Money market checking and NOW accounts                | 568,490               | 2,180         | 0.51%        | 512,086             | 2,313         | 0.60%        |
| Time deposits of \$100,000 or more                    | 560,999               | 3,174         | 0.76%        | 700,443             | 5,978         | 1.14%        |
| Other time deposits                                   | 394,784               | 2,645         | 0.90%        | 346,925             | 2,545         | 0.98%        |
| FHLB advances   | 5,898                 | 115           | 2.61%        | 3,478               | 126           | 4.84%        |
| Junior subordinated debentures                        | 28,410                | 678           | 3.19%        | 82,406              | 2,400         | 3.89%        |

|  |                     |                  |              |                     |                  |              |
|--|---------------------|------------------|--------------|---------------------|------------------|--------------|
| Total interest-bearing liabilities               | 1,673,559           | 10,169           | 0.81%        | 1,754,943           | 15,037           | 1.14%        |
| <b>Noninterest-bearing liabilities:</b>          |                     |                  |              |                     |                  |              |
| Demand deposits                                  | 724,021             |                  |              | 666,712             |                  |              |
| Other liabilities                                | 15,944              |                  |              | 29,837              |                  |              |
| Total noninterest-bearing liabilities            | 739,965             |                  |              | 696,549             |                  |              |
| Total liabilities                                | 2,413,524           |                  |              | 2,451,492           |                  |              |
| Stockholders equity                              | 390,700             |                  |              | 313,816             |                  |              |
| <b>Total liabilities and stockholders equity</b> | <b>\$ 2,804,224</b> |                  |              | <b>\$ 2,765,308</b> |                  |              |
| <b>Net interest income</b>                       |                     | <b>\$ 81,360</b> |              |                     | <b>\$ 74,785</b> |              |
| <b>Cost of deposits</b>                          |                     |                  | <b>0.53%</b> |                     |                  | <b>0.72%</b> |
| <b>Net interest spread <sup>(3)</sup></b>        |                     |                  | <b>3.78%</b> |                     |                  | <b>3.35%</b> |
| <b>Net interest margin <sup>(4)</sup></b>        |                     |                  | <b>4.08%</b> |                     |                  | <b>3.74%</b> |

(1) Loans are net of deferred fees and related direct costs, but exclude the allowance for loan losses. Non-accrual loans are included in the average loan balance. Loan fees have been included in the calculation of interest income. Loan fees were \$937,000 and \$1.0 million for the nine months ended September 30, 2013 and 2012, respectively.

(2) Computed on a tax-equivalent basis using an effective marginal rate of 35 percent.

(3) Represents the average rate earned on interest-earning assets less the average rate paid on interest-bearing liabilities.

(4) Represents annualized net interest income as a percentage of average interest-earning assets.

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The table below shows changes in interest income and interest expense and the amounts attributable to variations in interest rates and volumes for the periods indicated. The variances attributable to simultaneous volume and rate changes have been allocated to the change due to volume and the change due to rate categories in proportion to the relationship of the absolute dollar amount attributable solely to the change in volume and to the change in rate.

|   | <b>Nine Months Ended September 30, 2013 vs.<br/>Nine Months Ended September 30, 2012<br/>Increases (Decreases) Due to Change In</b> |                   |                   |
|---|---|-------------------|-------------------|
|   | <b>Volume</b>   | <b>Rate</b>       | <b>Total</b>      |
|   | <i>(In thousands)</i>   |                   |                   |
| <b>Interest and dividend income:</b>          |   |                   |                   |
| Gross loans, net of deferred loan fees        | \$ 6,392  | \$ (4,220)        | \$ 2,172          |
| Municipal securities-taxable                  | 8   | 2                 | 10                |
| Municipal securities-tax exempt               | (60)  | (35)              | (95)              |
| Obligations of other U.S. government agencies | 239   | 85                | 324               |
| Other debt securities                         | (109)   | (249)             | (358)             |
| Equity securities                             | (43)  | 557               | 514               |
| Federal funds sold                            | (42)  | (5)               | (47)              |
| Term federal funds sold                       | (342)   | (342)             | (684)             |
| Interest-bearing deposits in other banks      | (121)   | (8)               | (129)             |
| <b>Total interest and dividend income</b>     | <b>\$ 5,922</b>   | <b>\$ (4,215)</b> | <b>\$ 1,707</b>   |
| <b>Interest expense:</b>                      |   |                   |                   |
| Savings                                       | \$ (10)   | \$ (288)          | \$ (298)          |
| Money market checking and NOW accounts        | 40  | (173)             | (133)             |
| Time deposits of \$100,000 or more            | (1,043)   | (1,761)           | (2,804)           |
| Other time deposits                           | 152   | (52)              | 100               |
| FHLB advances                                 | 17  | (28)              | (11)              |
| Junior subordinated debentures                | (1,351)   | (371)             | (1,722)           |
| <b>Total interest expense</b>                 | <b>\$ (2,195)</b>   | <b>\$ (2,673)</b> | <b>\$ (4,868)</b> |
| <b>Change in net interest income</b>          | <b>\$ 8,117</b>   | <b>\$ (1,542)</b> | <b>\$ 6,575</b>   |

Interest income increased \$1.7 million, or 1.9 percent, to \$91.5 million for the nine months ended September 30, 2013 from \$89.8 million for the same period in 2012. Interest expense decreased \$4.9 million, or 32.4 percent, to \$10.2 million for the nine months ended September 30, 2013 compared to \$15.0 million for the same period in 2012. For the nine months ended September 30, 2013 and 2012, net interest income before credit losses on a tax-equivalent basis was \$81.4 million and \$74.8 million, respectively. The increase in net interest income before credit losses was primarily attributable to lower deposit costs resulting from the replacement of high-cost time deposits with low-cost deposit and a decrease in interest expense from the full redemption of \$80 million of TPS. The net interest spread and net interest margin for the nine months ended September 30, 2013 were 3.78 percent and 4.08 percent, respectively, compared to 3.35 percent and 3.74 percent, respectively, for the nine months ended September 30, 2012.



Average gross loans increased \$160.1 million, or 8.1 percent, to \$2.14 billion for the nine months ended September 30, 2013 from \$1.98 billion for the same period in 2012. Average investment securities increased \$7.7 million, or 1.9 percent, to \$417.3 million for the nine months ended September 30, 2013 from \$409.5 million for the same period in 2012. Average interest-earning assets decreased \$6.2 million, or 0.2 percent, to \$2.665 billion for the nine months ended September 30, 2013 from \$2.671 billion for the same period in 2012. The decrease in average interest-earning assets was due mainly to decrease in excess liquidity utilized for reduction of interest-bearing liabilities. Average interest bearing liabilities decreased \$81.4 million to \$1.67 billion for the nine months ended September 30, 2013, compared to \$1.75 billion for the same period in 2012. The decrease in average interest-bearing liabilities resulted primarily from the full redemption of \$80 million of TPS and the reduction of high-cost time deposits.

The average yield on loans decreased to 5.23 percent for the nine months ended September 30, 2013 from 5.50 percent for the same period in 2012. The average yield on investment securities decreased to 2.12 percent for the nine months ended September 30, 2013 from 2.19 percent for the same period in 2012. The average yield on interest-earning assets increased 10 basis points to 4.59 percent for the nine months ended September 30, 2013 from 4.49 percent for the same period in 2012 due primarily to deployment of lower yielding funds to higher yielding loans, partially offset by new securities purchased with lower rates. The average cost on interest-bearing liabilities decreased 33 basis points to 0.81 percent for the nine months ended September 30, 2013 from 1.14 percent for the same period in 2012. This decrease was due primarily to a continued shift in funding sources toward lower-cost funds through disciplined deposit pricing, while reducing wholesale funds and rate sensitive deposits.

**Table of Contents****Provision for Credit Losses**

No provisions for credit losses were recorded for the three months ended September 30, 2013 and 2012. For the nine months ended September 30, 2013 and 2012, the provisions for credit losses were zero and \$6.0 million, respectively. Net charge-offs decreased by \$3.7 million, or 62.3 percent, to \$2.2 million for the three months ended September 30, 2013 from \$5.9 million for the same period in 2012. Net charge-offs decreased by \$24.4 million, or 79.9 percent, to \$6.2 million for the nine months ended September 30, 2013 from \$30.6 million for the same period in 2012.

Non-performing loans decreased to \$22.8 million at September 30, 2013 from \$44.7 million at September 30, 2012, representing 1.05 percent and 2.28 percent of gross loans, respectively. See [Financial Condition Non-Performing Assets](#) and [Financial Condition Allowance for Loan Losses and Allowance for Off-Balance Sheet Items](#) for further details.

**Non-Interest Income**

The following table sets forth the various components of non-interest income for the periods indicated:

|   | <b>Three Months Ended</b> |                 | <b>Increase (Decrease)</b> |                   |
|---|---------------------------|-----------------|----------------------------|-------------------|
|   | <b>September 30, 2013</b> | <b>2012</b>     | <b>Amount</b>              | <b>Percentage</b> |
|   | <i>(In thousands)</i>     |                 |                            |                   |
| Service charges on deposit accounts                           | \$ 2,730                  | \$ 2,851        | \$ (121)                   | -4.24%            |
| Insurance commissions   | 1,273                     | 1,092           | 181                        | 16.58%            |
| Remittance fees   | 481                       | 476             | 5                          | 1.05%             |
| Trade finance fees  | 248                       | 274             | (26)                       | -9.49%            |
| Other service charges and fees                                | 349                       | 361             | (12)                       | -3.32%            |
| Bank-owned life insurance income                              | 230                       | 235             | (5)                        | -2.13%            |
| Gain on sales of SBA loans guaranteed portion                 | 994                       | 1,772           | (778)                      | -43.91%           |
| Net loss on sales of other loans                              |                           | (515)           | 515                        | -100.00%          |
| Net gain on sales of investment securities                    | 611                       | 10              | 601                        | 6010.00%          |
| Other-than-temporary impairment loss on investment securities |                           | (176)           | 176                        | -100.00%          |
| Other operating income  | 410                       | 140             | 270                        | 192.86%           |
| <b>Total non-interest income</b>                              | <b>\$ 7,326</b>           | <b>\$ 6,520</b> | <b>\$ 806</b>              | <b>12.36%</b>     |

|                                     | <b>Nine Months Ended</b>  |             | <b>Increase (Decrease)</b> |                   |
|-------------------------------------|---------------------------|-------------|----------------------------|-------------------|
|                                     | <b>September 30, 2013</b> | <b>2012</b> | <b>Amount</b>              | <b>Percentage</b> |
|                                     | <i>(In thousands)</i>     |             |                            |                   |
| Service charges on deposit accounts | \$ 8,662                  | \$ 8,955    | \$ (293)                   | -3.27%            |
| Insurance commissions               | 3,904                     | 3,622       | 282                        | 7.79%             |
| Remittance fees                     | 1,519                     | 1,417       | 102                        | 7.20%             |
| Trade finance fees                  | 801                       | 858         | (57)                       | -6.64%            |
| Other service charges and fees      | 1,082                     | 1,105       | (23)                       | -2.08%            |

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|   |                  |                  |                 |               |
|---|------------------|------------------|-----------------|---------------|
| Bank-owned life insurance income                              | 693              | 872              | (179)           | -20.53%       |
| Gain on sales of SBA loans guaranteed portion                 | 6,064            | 7,245            | (1,181)         | -16.30%       |
| Net loss on sales of other loans                              | (557)            | (8,234)          | 7,677           | -93.24%       |
| Net gain on sales of investment securities                    | 923              | 1,392            | (469)           | -33.69%       |
| Other-than-temporary impairment loss on investment securities |                  | (292)            | 292             | -100.00%      |
| Other operating income  | 742              | 402              | 340             | 84.58%        |
| <b>Total non-interest income</b>                              | <b>\$ 23,833</b> | <b>\$ 17,342</b> | <b>\$ 6,491</b> | <b>37.43%</b> |

Non-interest income increased to \$7.3 million for the three months ended September 30, 2013, compared to \$6.5 million for the same period in 2012. The increase was primarily attributable to a \$601,000 increase in net gain on sales of investment securities and a \$515,000 decrease in net loss on sales of other loans. Non-interest income as a percentage of average assets was 1.04 percent for the three months ended September 30, 2013, up from 0.92 percent of average assets for the same period in 2012. Non-interest income increased to \$23.8 million for the nine months ended September 30, 2013, compared to \$17.3 million for the same period in 2012. The increase was due mainly to a \$7.7 million decrease in net loss on sales of other loans. Non-interest income as a percentage of average assets was 1.14 percent for the nine months ended September 30, 2013, up from 0.84 percent of average assets for the same period in 2012.

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For the three months ended September 30, 2013, a net gain from selling the guaranteed portions of SBA loans totaled \$994,000, or 13.6 percent of total non-interest income, compared to \$1.8 million, or 27.2 percent of total non-interest income for the same period in 2012. The Company sold \$15.6 million and \$21.3 million of the guaranteed portions of SBA loans during the three months ended September 30, 2013 and 2012, respectively. Net gain on sales of investment securities was \$611,000 for the three months ended September 30, 2013, compared to \$10,000 for the same period in 2012. Net loss on sales of other loans, which includes the valuation adjustment to loans held for sale, was zero for the three months ended September 30, 2013, compared to \$515,000 for the same period in 2012. The decrease in net loss on sales of other loans was due to continuing improvement in asset quality. Net gain from selling the guaranteed portions of SBA loans for the nine months ended September 30, 2013 totaled \$6.1 million compared to \$7.2 million for the same period in 2012. The Company sold \$69.2 million and \$86.5 million of the guaranteed portions of SBA loans during the nine months ended September 30, 2013 and 2012, respectively. Net loss on sales of other loans, which includes the valuation adjustment to loans held for sale, decreased to \$557,000 for the nine months ended September 30, 2013 from \$8.2 million for the same period in 2012. The sale of other loans decreased significantly to \$5.9 million for the nine months ended September 30, 2013 from \$96.6 million for the same period in 2012. The decrease in net loss on sales of other loans was due primarily to a direct result of our management's effort to reduce problem and non-performing assets and continuing improvement in asset quality.

**Non-Interest Expense**

The following table sets forth the breakdown of non-interest expense for the periods indicated:

|   | <b>Three Months<br/>Ended<br/>September 30,</b> |                  | <b>Increase (Decrease)</b> |                   |
|---|---|------------------|----------------------------|-------------------|
|   | <b>2013</b>                                     | <b>2012</b>      | <b>Amount</b>              | <b>Percentage</b> |
|   | <i>(In thousands)</i>                           |                  |                            |                   |
| Salaries and employee benefits                        | \$ 9,926  | \$ 9,148         | \$ 778                     | 8.50%             |
| Occupancy and equipment                               | 2,634   | 2,623            | 11                         | 0.42%             |
| Deposit insurance premiums and regulatory assessments | 308   | 283              | 25                         | 8.83%             |
| Data processing                                       | 1,158   | 1,211            | (53)                       | -4.38%            |
| Other real estate owned expense                       | (59)  | 352              | (411)                      | -116.76%          |
| Professional fees                                     | 907   | 1,112            | (205)                      | -18.44%           |
| Directors and officers liability insurance            | 219   | 296              | (77)                       | -26.01%           |
| Supplies and communications                           | 562   | 669              | (107)                      | -15.99%           |
| Advertising and promotion                             | 1,140   | 1,023            | 117                        | 11.44%            |
| Loan-related expense                                  | 91  | 164              | (73)                       | -44.51%           |
| Amortization of other intangible assets               | 41  | 41               |                            | 0.00%             |
| Other operating expenses                              | 2,039   | 1,882            | 157                        | 8.34%             |
| <b>Total non-interest expense</b>                     | <b>\$ 18,966</b>                                | <b>\$ 18,804</b> | <b>\$ 162</b>              | <b>0.86%</b>      |

|  | <b>Nine Months Ended<br/>September 30,</b> |             | <b>Increase (Decrease)</b> |                   |
|--|--|-------------|----------------------------|-------------------|
|  | <b>2013</b>                                | <b>2012</b> | <b>Amount</b>              | <b>Percentage</b> |

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|   | <i>(In thousands)</i> |                  |               |              |
|---|-----------------------|------------------|---------------|--------------|
| Salaries and employee benefits                        | \$ 28,692             | \$ 27,707        | \$ 985        | 3.56%        |
| Occupancy and equipment                               | 7,745                 | 7,839            | (94)          | -1.20%       |
| Deposit insurance premiums and regulatory assessments | 1,059                 | 3,182            | (2,123)       | -66.72%      |
| Data processing                                       | 3,470                 | 3,762            | (292)         | -7.76%       |
| Other real estate owned expense                       | (47)                  | 377              | (424)         | -112.47%     |
| Professional fees                                     | 5,428                 | 2,950            | 2,478         | 84.00%       |
| Directors and officers liability insurance            | 658                   | 888              | (230)         | -25.90%      |
| Supplies and communications                           | 1,687                 | 1,803            | (116)         | -6.43%       |
| Advertising and promotion                             | 2,817                 | 2,633            | 184           | 6.99%        |
| Loan-related expense                                  | 328                   | 452              | (124)         | -27.43%      |
| Amortization of other intangible assets               | 123                   | 157              | (34)          | -21.66%      |
| Other operating expenses                              | 6,137                 | 5,563            | 574           | 10.32%       |
| <b>Total non-interest expense</b>                     | <b>\$ 58,097</b>      | <b>\$ 57,313</b> | <b>\$ 784</b> | <b>1.37%</b> |

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Non-interest expense increased to \$19.0 million for the three months ended September 30, 2013, compared to \$18.8 million for the same period in 2012. Non-interest expense as a percentage of average assets was 2.70 percent for the three months ended September 30, 2013, up from 2.64 percent of average assets for the same period in 2012. Non-interest expense increased to \$58.1 million for the nine months ended September 30, 2013, compared to \$57.3 million for the same period in 2012. Non-interest expense as a percentage of average assets was 2.77 percent both for the nine months ended September 30, 2013 and for the same period in 2012.

Salaries and employee benefits increased by \$778,000, or 8.50 percent, to \$9.9 million for the three months ended September 30, 2013, compared to \$9.1 million for the same period in 2012, due mainly to the addition of new personnel. Professional fees decreased by \$205,000, or 18.44 percent, to \$907,000 for the three months ended September 30, 2013, compared to \$1.1 million for the same period in 2012, due mainly to no further costs incurred in connection with a lawsuit in which the Bank prevailed. For the nine months ended September 30, 2013, professional fees increased by \$2.5 million, or 84.0 percent, to \$5.4 million, compared to \$3.0 million for the same period in 2012, due mainly to legal expenses incurred in defending lawsuits in the ordinary course of business, as well as professional and legal expenses related to reviews of potential strategic transactions. Reflecting lower premium and assessment rates as a result of overall improvement in our financial condition, deposit insurance premiums and regulatory assessments decreased by \$2.1 million, or 66.7 percent, to \$1.1 million for the nine months ended September 30, 2013 compared to \$3.2 million for the same period in 2012.

**Provision for Income Taxes**

For the nine months ended September 30, 2013, income tax expenses of \$17.1 million were recognized on pre-tax income of \$47.0 million, representing an effective tax rate of 36.4 percent, compared to income tax benefit of \$47.7 million on pre-tax income of \$28.7 million, representing an effective tax rate of (166.6) percent, for the same period in 2012.

**Financial Conditions****Investment Portfolio**

Investment securities are classified as held-to-maturity or available-for-sale in accordance with GAAP. Those securities that we have the ability and the intent to hold to maturity are classified as held-to-maturity. All other securities are classified as available-for-sale. There were no trading or held-to-maturity securities as of September 30, 2013 and December 31, 2012. Securities classified as held-to-maturity are stated at cost, adjusted for amortization of premiums and accretion of discounts, and available-for-sale securities are stated at fair value. The composition of our investment portfolio reflects our investment strategy of providing a relatively stable source of interest income while maintaining an appropriate level of liquidity. The investment portfolio also provides a source of liquidity by pledging as collateral or through repurchase agreement and collateral for certain public funds deposits.

As of September 30, 2013, the investment portfolio was composed primarily of mortgage-backed securities, U.S. government agency securities, and collateralized mortgage obligations. Investment securities available-for-sale were 100 percent of the investment portfolio as of September 30, 2013 and December 31, 2012. Most of the securities carried fixed interest rates. Other than holdings of U.S. government agency securities, there were no investments in securities of any one issuer exceeding 10 percent of stockholders' equity as of September 30, 2013 and December 31, 2012.

As of September 30, 2013, securities available-for-sale were \$383.1 million, or 13.5 percent of assets, compared to \$451.1 million, or 15.6 percent of assets, as of December 31, 2012. For the nine months ended September 30, 2013,

securities available-for-sale decreased by \$68.0 million, or 15.1 percent, from \$451.1 million as of December 31, 2012, in the form of sales, calls, prepayments and scheduled amortization.

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The following table summarizes the amortized cost, estimated fair value and unrealized gain (loss) on investment securities as of the dates indicated:

|  | September 30, 2013 |                            |                              | December 31, 2012 |                            |                              |
|--|--------------------|----------------------------|------------------------------|-------------------|----------------------------|------------------------------|
|  | Amortized<br>Cost  | Estimated<br>Fair<br>Value | Unrealized<br>Gain<br>(Loss) | Amortized<br>Cost | Estimated<br>Fair<br>Value | Unrealized<br>Gain<br>(Loss) |
| <i>(In thousands)</i>                              |                    |                            |                              |                   |                            |                              |
| <b>Securities available-for-sale:</b>              |                    |                            |                              |                   |                            |                              |
| Mortgage-backed securities <sup>(1)</sup>          | \$ 129,463         | \$ 127,085                 | \$ (2,378)                   | \$ 157,185        | \$ 160,326                 | \$ 3,141                     |
| U.S. government agency securities                  | 98,844             | 92,878                     | (5,966)                      | 92,990            | 93,118                     | 128                          |
| Collateralized mortgage obligations <sup>(1)</sup> | 85,191             | 85,110                     | (81)                         | 98,821            | 100,487                    | 1,666                        |
| Municipal bonds-tax exempt                         | 6,438              | 6,486                      | 48                           | 12,209            | 12,812                     | 603                          |
| Municipal bonds-taxable                            | 35,290             | 34,788                     | (502)                        | 44,248            | 46,142                     | 1,894                        |
| Corporate bonds                                    | 20,478             | 20,483                     | 5                            | 20,470            | 20,400                     | (70)                         |
| SBA loan pool securities                           | 13,826             | 12,921                     | (905)                        | 14,104            | 14,026                     | (78)                         |
| Other securities                                   | 3,025              | 2,921                      | (104)                        | 3,331             | 3,357                      | 26                           |
| Equity securities                                  | 218                | 385                        | 167                          | 354               | 392                        | 38                           |
| <b>Total securities available-for-sale:</b>        | <b>\$ 392,773</b>  | <b>\$ 383,057</b>          | <b>\$ (9,716)</b>            | <b>\$ 443,712</b> | <b>\$ 451,060</b>          | <b>\$ 7,348</b>              |

(1) Collateralized by residential mortgages and guaranteed by U.S. government sponsored entities.

The amortized cost and estimated fair value of investment securities as of September 30, 2013, by contractual maturity, are shown below. Although mortgage-backed securities and collateralized mortgage obligations have contractual maturities through 2063, expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

|                                     | Available-for-Sale |                            |
|-------------------------------------|--------------------|----------------------------|
|                                     | Amortized<br>Cost  | Estimated<br>Fair<br>Value |
| <i>(In thousands)</i>               |                    |                            |
| Within one year                     | \$                 | \$                         |
| Over one year through five years    | 33,325             | 33,315                     |
| Over five years through ten years   | 105,186            | 100,320                    |
| Over ten years                      | 39,390             | 36,842                     |
| Mortgage-backed securities          | 129,463            | 127,085                    |
| Collateralized mortgage obligations | 85,191             | 85,110                     |
| Equity securities                   | 218                | 385                        |
| <b>Total</b>                        | <b>\$ 392,773</b>  | <b>\$ 383,057</b>          |



FASB ASC 320, *Investments Debt and Equity Securities*, requires us to periodically evaluate our investments for other-than-temporary impairment ( OTTI ). There was no OTTI charge during the nine months ended September 30, 2013.

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Gross unrealized losses on investment securities available-for-sale, the estimated fair value of the related securities and the number of securities aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, were as follows as of September 30, 2013 and December 31, 2012:

|                                     | <b>Holding Period</b>        |                             |                             |                              |                             |                             |                              |                             |                             |  |
|-------------------------------------|------------------------------|-----------------------------|-----------------------------|------------------------------|-----------------------------|-----------------------------|------------------------------|-----------------------------|-----------------------------|--|
|                                     | <b>Less Than 12 Months</b>   |                             |                             | <b>12 Months or More</b>     |                             |                             | <b>Total</b>                 |                             |                             |  |
|                                     | <b>Gross Unrealized Loss</b> | <b>Estimated Fair Value</b> | <b>Number of Securities</b> | <b>Gross Unrealized Loss</b> | <b>Estimated Fair Value</b> | <b>Number of Securities</b> | <b>Gross Unrealized Loss</b> | <b>Estimated Fair Value</b> | <b>Number of Securities</b> |  |
| <b>September 30, 2013</b>           |                              |                             |                             |                              |                             |                             |                              |                             |                             |  |
| Mortgage-backed securities          | \$ 1,552                     | \$ 64,931                   | 21                          | \$ 1,619                     | \$ 22,774                   | 9                           | \$ 3,171                     | \$ 87,705                   | 30                          |  |
| U.S. government agency securities   | 4,577                        | 70,263                      | 26                          | 1,393                        | 19,603                      | 7                           | 5,970                        | 89,866                      | 33                          |  |
| Collateralized mortgage obligations | 500                          | 24,478                      | 12                          | 354                          | 9,610                       | 4                           | 854                          | 34,088                      | 16                          |  |
| Municipal bonds-tax exempt          | 13                           | 4,065                       | 2                           |                              |                             |                             | 13                           | 4,065                       | 2                           |  |
| Municipal bonds-taxable             | 479                          | 19,783                      | 14                          | 242                          | 3,876                       | 4                           | 721                          | 23,659                      | 18                          |  |
| Corporate bonds                     | 91                           | 4,899                       | 1                           | 114                          | 6,874                       | 2                           | 205                          | 11,773                      | 3                           |  |
| SBA loan pool securities            | 229                          | 2,714                       | 1                           | 676                          | 10,207                      | 3                           | 905                          | 12,921                      | 4                           |  |
| Other securities                    | 18                           | 1,994                       | 3                           | 86                           | 927                         | 2                           | 104                          | 2,921                       | 5                           |  |
| <b>Total</b>                        | <b>\$ 7,459</b>              | <b>\$ 193,127</b>           | <b>80</b>                   | <b>\$ 4,484</b>              | <b>\$ 73,871</b>            | <b>31</b>                   | <b>\$ 11,943</b>             | <b>\$ 266,998</b>           | <b>111</b>                  |  |
| <b>December 31, 2012</b>            |                              |                             |                             |                              |                             |                             |                              |                             |                             |  |
| Mortgage-backed securities          | \$ 186                       | \$ 28,354                   | 10                          | \$                           | \$                          |                             | \$ 186                       | \$ 28,354                   | 10                          |  |
| U.S. government agency securities   | 94                           | 26,894                      | 9                           |                              |                             |                             | 94                           | 26,894                      | 9                           |  |
| Collateralized mortgage obligations | 109                          | 14,344                      | 5                           |                              |                             |                             | 109                          | 14,344                      | 5                           |  |
| Municipal bonds-taxable             | 126                          | 4,587                       | 4                           | 9                            | 1,964                       | 3                           | 135                          | 6,551                       | 7                           |  |
| Corporate bonds                     |                              |                             |                             | 246                          | 10,738                      | 3                           | 246                          | 10,738                      | 3                           |  |
| SBA loan pool securities            | 82                           | 11,004                      | 3                           |                              |                             |                             | 82                           | 11,004                      | 3                           |  |
| Other securities                    | 1                            | 12                          | 1                           | 46                           | 953                         | 1                           | 47                           | 965                         | 2                           |  |
| Equity securities                   | 40                           | 96                          | 1                           |                              |                             |                             | 40                           | 96                          | 1                           |  |
| <b>Total</b>                        | <b>\$ 638</b>                | <b>\$ 85,291</b>            | <b>33</b>                   | <b>\$ 301</b>                | <b>\$ 13,655</b>            | <b>7</b>                    | <b>\$ 939</b>                | <b>\$ 98,946</b>            | <b>40</b>                   |  |

All individual securities that have been in a continuous unrealized loss position for 12 months or longer as of September 30, 2013 and December 31, 2012 had investment grade ratings upon purchase. The issuers of these securities have not established any cause for default on these securities and the various rating agencies have reaffirmed these securities long-term investment grade status as of September 30, 2013. These securities have fluctuated in value since their purchase dates as market interest rates have fluctuated.

FASB ASC 320 requires other-than-temporarily impaired investment securities to be written down when fair value is below amortized cost in circumstances where: (1) an entity has the intent to sell a security; (2) it is more likely than not that an entity will be required to sell the security before recovery of its amortized cost basis; or (3) an entity does not expect to recover the entire amortized cost basis of the security. If an entity intends to sell a security or if it is more likely than not the entity will be required to sell the security before recovery, an OTTI write-down is recognized in earnings equal to the entire difference between the security's amortized cost basis and its fair value. If an entity does not intend to sell the security or it is not more likely than not that it will be required to sell the security before recovery, the OTTI write-down is separated into an amount representing credit loss, which is recognized in earnings, and the amount related to all other factors, which is recognized in other comprehensive income.

The Company does not intend to sell these securities and it is not more likely than not that we will be required to sell the investments before the recovery of its amortized cost basis. In addition, the unrealized losses on municipal and corporate bonds are not considered other-than-temporarily impaired as the bonds are rated investment grade and there are no credit quality concerns with the issuers. Interest payments have been made as scheduled, and management believes this will continue in the future and that the bonds will be repaid in full as scheduled. Therefore, in management's opinion, all securities that have been in a continuous unrealized loss position for the past 12 months or longer as of September 30, 2013 and December 31, 2012 were not other-than-temporarily impaired, and therefore, no impairment charges as of September 30, 2013 and December 31, 2012 were warranted.

Investment securities available-for-sale with carrying values of \$50.5 million and \$18.2 million as of September 30, 2013 and December 31, 2012, respectively, were pledged to secure FHLB advances, public deposits and for other purposes as required or permitted by law.

**Table of Contents****Loan Portfolio**

The following table shows the loan composition by type as of the dates indicated:

|  | September 30,<br>2013 | December 31,<br>2012 | Increase (Decrease) |             |
|--|-----------------------|----------------------|---------------------|-------------|
|  |                       |                      | Amount              | Percentage  |
|  | <i>(In thousands)</i> |                      |                     |             |
| <b>Real estate loans:</b>                    |                       |                      |                     |             |
| Commercial property                          | \$ 887,576            | \$ 787,094           | \$ 100,482          | 12.8%       |
| Residential property                         | 82,519                | 101,778              | (19,259)            | -18.9%      |
| <b>Total real estate loans</b>               | <b>970,095</b>        | <b>888,872</b>       | <b>81,223</b>       | <b>9.1%</b> |
| <b>Commercial and Industrial loans:</b>      |                       |                      |                     |             |
| Commercial term                              | 913,021               | 884,364              | 28,657              | 3.2%        |
| Commercial lines of credit                   | 54,374                | 56,121               | (1,747)             | -3.1%       |
| SBA loans                                    | 153,990               | 148,306              | 5,684               | 3.8%        |
| International loans                          | 33,726                | 34,221               | (495)               | -1.4%       |
| <b>Total commercial and industrial loans</b> | <b>1,155,111</b>      | <b>1,123,012</b>     | <b>32,099</b>       | <b>2.9%</b> |
| Consumer loans <sup>(1)</sup>                | 34,065                | 36,676               | (2,611)             | -7.1%       |
| <b>Total gross loans</b>                     | <b>2,159,271</b>      | <b>2,048,560</b>     | <b>110,711</b>      | <b>5.4%</b> |
| Allowance for loans losses                   | (57,639)              | (63,305)             | 5,666               | -9.0%       |
| Deferred loan fees                           | 989                   | 796                  | 193                 | 24.2%       |
| <b>Loans receivable, net</b>                 | <b>\$ 2,102,621</b>   | <b>\$ 1,986,051</b>  | <b>\$ 116,570</b>   | <b>5.9%</b> |

(1) Consumer loans include home equity line of credit.

As of September 30, 2013 and December 31, 2012, loans receivable, net of deferred loan fees and allowance for loan losses, totaled \$2.10 billion and \$1.99 billion, respectively, representing an increase of \$116.6 million, or 5.9 percent. Gross loans increased by \$110.7 million, or 5.4 percent, to \$2.16 billion as of September 30, 2013, from \$2.05 billion as of December 31, 2012. The increase was attributable to increases in real estate loans by 9.1 percent, commercial term loans by 3.2 percent, and SBA loans by 3.8 percent from the year ended December 31, 2012. The increase was partially offset by a decline in commercial lines of credit by 3.1 percent and consumer loans by 7.1 percent.

During the nine months ended September 30, 2013, total loan disbursement consisted of \$342.2 million in commercial real estate loans, \$95.2 million in SBA loans and \$38.9 million in commercial and industrial loans. The increase was offset by decreases in loans resulting from \$69.5 million of transfers to loans held for sale, \$11.1 million of gross charge-offs, \$287.0 million of pay-offs and other net amortizations.

As of September 30, 2013, our loan portfolio included the following concentrations of loans to one type of industry that were greater than 10 percent of gross loans outstanding:

| <b>Industry</b>                     | <b>Balance<br/>as of<br/>September 30, 2013</b> | <b>Percentage of<br/>Gross<br/>Loans<br/>Outstanding</b> |
|-------------------------------------|---|--|
|                                     | <i>(In thousands)</i>                           |  |
| Lessor of non-residential buildings | \$ 561,391                                      | 25.94%   |
| Accommodation/hospitality           | \$ 344,682                                      | 15.92%   |
| Gasoline stations                   | \$ 303,273                                      | 14.01%   |

There was no other concentration of loans to any one type of industry exceeding 10 percent of gross loans outstanding.

### **Non-Performing Assets**

Non-performing loans consist of loans on non-accrual status and loans 90 days or more past due and still accruing interest. Non-performing assets consist of non-performing loans and other real estate owned ( OREO ). Loans are placed on non-accrual status when, in the opinion of management, the full timely collection of principal or interest is in doubt. Generally, the accrual of interest is discontinued when principal or interest payments become more than 90 days past due, unless management believes the loan is adequately collateralized and in the process of collection. However, in certain instances, we may place a particular loan on non-accrual status earlier, depending upon the individual circumstances surrounding the loan's delinquency. When an asset is placed on non-accrual status, previously accrued but unpaid interest is reversed against current income. Subsequent collections of cash are applied as principal reductions when received, except when the ultimate collectability of principal is probable, in which case interest payments are credited to income. Non-accrual assets may be restored to accrual status when principal and interest become current and full repayment is expected. Interest income is recognized on the accrual basis for impaired loans not meeting the criteria for non-accrual. OREO consists of properties acquired by foreclosure or similar means that management intends to offer for sale.

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Except for non-performing loans set forth below, management is not aware of any loans as of September 30, 2013 and December 31, 2012 for which known credit problems of the borrower would cause serious doubts as to the ability of such borrowers to comply with their present loan repayment terms, or any known events that would result in the loan being designated as non-performing at some future date. Management cannot, however, predict the extent to which a deterioration in general economic conditions, real estate values, increases in general rates of interest, or changes in the financial condition or business of borrower may adversely affect a borrower's ability to pay.

The following table provides information with respect to the components of non-performing assets as of the dates indicated:

|  | September 30,<br>2013 | December 31,<br>2012 | Increase (Decrease) |               |
|--|-----------------------|----------------------|---------------------|---------------|
|  |                       |                      | Amount              | Percentage    |
|  | <i>(In thousands)</i> |                      |                     |               |
| <b>Non-performing loans:</b>                                     |                       |                      |                     |               |
| <b>Real estate loans:</b>  |                       |                      |                     |               |
| <b>Commercial property</b>                                       |                       |                      |                     |               |
| Retail   | \$ 768                | \$ 1,079             | \$ (311)            | -28.8%        |
| Land   |                       | 2,097                | (2,097)             | -100.0%       |
| Residential property   | 1,659                 | 1,270                | 389                 | 30.6%         |
| <b>Commercial and industrial loans:</b>                          |                       |                      |                     |               |
| <b>Commercial term</b>   |                       |                      |                     |               |
| Unsecured  | 2,490                 | 8,311                | (5,821)             | -70.0%        |
| Secured by real estate   | 5,591                 | 8,679                | (3,088)             | -35.6%        |
| Commercial lines of credit                                       | 830                   | 1,521                | (691)               | -45.4%        |
| SBA loans  | 9,959                 | 12,563               | (2,604)             | -20.7%        |
| Consumer loans   | 1,479                 | 1,759                | (280)               | -15.9%        |
| <b>Total non-accrual loans</b>                                   | <b>22,776</b>         | <b>37,279</b>        | <b>(14,503)</b>     | <b>-38.9%</b> |
| <b>Loans 90 days or more past due and still accruing</b>         |                       |                      |                     | <b>0.0%</b>   |
| <b>Total non-performing loans <sup>(1)</sup></b>                 | <b>22,776</b>         | <b>37,279</b>        | <b>(14,503)</b>     | <b>-38.9%</b> |
| <b>Other real estate owned</b>                                   | <b>290</b>            | <b>774</b>           | <b>(484)</b>        | <b>-62.5%</b> |
| <b>Total non-performing assets</b>                               | <b>\$ 23,066</b>      | <b>\$ 38,053</b>     | <b>\$ (14,987)</b>  | <b>-39.4%</b> |
| <b>Non-performing loans as a percentage of total gross loans</b> |                       |                      |                     |               |
|  | 1.05%                 | 1.82%                |                     |               |
| <b>Non-performing assets as a percentage of total assets</b>     |                       |                      |                     |               |
|  | 0.81%                 | 1.32%                |                     |               |
| <b>Total debt restructured performing loans</b>                  | <b>\$ 17,812</b>      | <b>\$ 16,980</b>     |                     |               |

(1) Includes non-performing troubled debt restructured loans of \$10.2 million and \$18.8 million as of September 30, 2013 and December 31, 2012, respectively

Non-accrual loans totaled \$22.8 million as of September 30, 2013, compared to \$37.3 million as of December 31, 2012, representing a 38.9 percent decrease. Delinquent loans (defined as 30 days or more past due) were \$16.0 million as of September 30, 2013, compared to \$16.5 million as of December 31, 2012, representing a 2.8 percent decrease. As of September 30, 2013, delinquent loans of \$9.2 million were included in non-performing loans. The \$14.1 million of delinquent loans as of December 31, 2012 was included in non-performing loans. During the nine months ended September 30, 2013, loans totaling \$8.9 million were placed on non-accrual status. The additions to non-accrual loans were offset by \$5.7 million in transfers to loans held for sale, \$8.1 million in charge-offs, \$6.1 million in principal paydowns and payoffs, \$1.4 million in upgrades to accrual, \$1.2 million in note sales, and \$919,000 in SBA guaranteed portions received.

The ratio of non-performing loans to gross loans also decreased to 1.05 percent at September 30, 2013 from 1.82 percent at December 31, 2012. During the same period, allowance for loan losses decreased by \$5.7 million, or 9.0 percent, to \$57.6 million from \$63.3 million. Of the \$22.8 million non-performing loans, approximately \$18.8 million were impaired based on the definition contained in FASB ASC 310, *Receivables*, which resulted in aggregate impairment reserve of \$1.8 million as of September 30, 2013. The allowance for collateral-dependent loans is calculated as the difference between the outstanding loan balance and the value of the collateral as determined by recent appraisals less estimated costs to sell. The allowance for collateral-dependent loans varies from loan to loan based on the collateral coverage of the loan at the time of designation as non-performing. We continue to monitor the collateral coverage, based on recent appraisals, on these loans on a quarterly basis and adjust the allowance accordingly.

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As of September 30, 2013, there was one other real estate owned ( OREO ) located in Washington with a carrying value of \$290,000 and no valuation adjustment. As of December 31, 2012, there were two OREOs located in Illinois and Virginia with a combined carrying value of \$774,000 and no valuation adjustment.

We evaluate loan impairment in accordance with applicable GAAP. Loans are considered impaired when it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement, including scheduled interest payments. Impaired loans are measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or, as an expedient, at the loan's observable market price or the fair value of the collateral if the loan is collateral dependent, less costs to sell. If the measure of the impaired loan is less than the recorded investment in the loan, the deficiency will be charged off against the allowance for loan losses or, alternatively, a specific allocation will be established. Additionally, impaired loans are specifically excluded from the quarterly migration analysis when determining the amount of the allowance for loan losses required for the period.

The following table provides information on impaired loans as of the dates indicated:

|                                  | <b>Recorded Investment</b> | <b>Unpaid Principal Balance</b> | <b>With No Related Allowance Recorded</b> | <b>With an Allowance Recorded</b> | <b>Related Allowance</b> |
|----------------------------------|----------------------------|---------------------------------|---|-----------------------------------|--------------------------|
|                                  | <i>(In thousands)</i>      |                                 |   |                                   |                          |
| <b>September 30, 2013</b>        |                            |                                 |   |                                   |                          |
| Real estate loans:               |                            |                                 |   |                                   |                          |
| Commercial property              |                            |                                 |   |                                   |                          |
| Retail                           | \$ 2,234                   | \$ 2,309                        | \$ 2,234                                  | \$                                | \$                       |
| Land                             |                            |                                 |   |                                   |                          |
| Other                            | 1,169                      | 1,169                           | 649                                       | 520                               | 25                       |
| Residential property             | 2,982                      | 3,072                           | 2,982                                     |                                   |                          |
| Commercial and industrial loans: |                            |                                 |   |                                   |                          |
| Commercial term                  |                            |                                 |   |                                   |                          |
| Unsecured                        | 10,072                     | 10,361                          | 1,743                                     | 8,329                             | 1,371                    |
| Secured by real estate           | 17,948                     | 19,181                          | 17,193                                    | 755                               | 163                      |
| Commercial lines of credit       | 830                        | 1,055                           | 830                                       |                                   | 471                      |
| SBA loans                        | 5,477                      | 8,785                           | 4,112                                     | 1,365                             | 9                        |
| International loans              | 1,180                      | 1,180                           | 608                                       | 572                               | 330                      |
| Consumer loans                   | 1,574                      | 1,662                           | 399                                       | 1,175                             |                          |
| <b>Total gross loans</b>         | <b>\$ 43,466</b>           | <b>\$ 48,774</b>                | <b>\$ 30,750</b>                          | <b>\$ 12,716</b>                  | <b>\$ 2,369</b>          |
| <b>December 31, 2012</b>         |                            |                                 |   |                                   |                          |
| Real estate loans:               |                            |                                 |   |                                   |                          |
| Commercial property              |                            |                                 |   |                                   |                          |
| Retail                           | \$ 2,930                   | \$ 3,024                        | \$ 2,930                                  | \$                                | \$                       |
| Land                             |                            |                                 |   |                                   |                          |
| Other                            | 527                        | 527                             |   | 527                               | 67                       |
| Residential property             | 3,265                      | 3,308                           | 1,866                                     | 1,399                             | 94                       |
| Commercial and industrial loans: |                            |                                 |   |                                   |                          |



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|                            |                  |                  |                  |                  |                 |
|----------------------------|------------------|------------------|------------------|------------------|-----------------|
| <b>Commercial term</b>     |                  |                  |                  |                  |                 |
| Unsecured                  | 14,532           | 15,515           | 6,826            | 7,706            | 2,144           |
| Secured by real estate     | 22,050           | 23,221           | 9,520            | 12,530           | 2,319           |
| Commercial lines of credit | 1,521            | 1,704            | 848              | 673              | 230             |
| SBA loans                  | 6,170            | 10,244           | 4,294            | 1,876            | 762             |
| <b>International loans</b> |                  |                  |                  |                  |                 |
| Consumer loans             | 1,652            | 1,711            | 449              | 1,203            | 615             |
| <b>Total gross loans</b>   | <b>\$ 54,744</b> | <b>\$ 61,561</b> | <b>\$ 28,830</b> | <b>\$ 25,914</b> | <b>\$ 6,231</b> |

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|                                  | Average<br>Recorded<br>Investment for<br>the<br>Three<br>Months Ended | Interest Income<br>Recognized<br>for<br>the Three<br>Months<br>Ended | Average<br>Recorded<br>Investment for<br>the Nine<br>Months Ended | Interest Income<br>Recognized<br>for<br>the Nine<br>Months<br>Ended |
|----------------------------------|---|--|---|---|
| <i>(In thousands)</i>            |   |  |   |   |
| <b>September 30, 2013</b>        |   |  |   |   |
| Real estate loans:               |   |  |   |   |
| Commercial property              |   |  |   |   |
| Retail                           | \$ 2,243  | \$ 21  | \$ 2,287  | \$ 65   |
| Land                             |   |  | 1,116   | 80  |
| Other                            | 1,170   | 13   | 740   | 23  |
| Residential property             | 2,992   | 33   | 3,026   | 92  |
| Commercial and industrial loans: |   |  |   |   |
| Commercial term                  |   |  |   |   |
| Unsecured                        | 10,179  | 148  | 12,122  | 555   |
| Secured by real estate           | 18,023  | 336  | 17,358  | 954   |
| Commercial lines of credit       | 840   | 23   | 1,137   | 48  |
| SBA loans                        | 5,542   | 299  | 5,870   | 851   |
| International loans              | 1,197   |  | 1,342   |   |
| Consumer loans                   | 1,581   | 27   | 1,624   | 54  |
| <b>Total gross loans</b>         | <b>\$ 43,767</b>  | <b>\$ 900</b>  | <b>\$ 46,622</b>  | <b>\$ 2,722</b>   |
| <b>September 30, 2012</b>        |   |  |   |   |
| Real estate loans:               |   |  |   |   |
| Commercial property              |   |  |   |   |
| Retail                           | \$ 2,597  | \$ 47  | \$ 2,162  | \$ 95   |
| Land                             | 2,054   | 45   | 2,134   | 136   |
| Other                            | 534   | 5  | 937   | 38  |
| Construction                     | 7,868   | 29   | 8,016   | 207   |
| Residential property             | 3,279   | 34   | 3,265   | 118   |
| Commercial and industrial loans: |   |  |   |   |
| Commercial term                  |   |  |   |   |
| Unsecured                        | 13,723  | 214  | 14,079  | 644   |
| Secured by real estate           | 19,990  | 342  | 21,834  | 1,300   |
| Commercial lines of credit       | 1,555   | 16   | 1,742   | 46  |
| SBA loans                        | 6,168   | 330  | 7,489   | 813   |
| Consumer loans                   | 1,257   | 49   | 1,021   | 59  |
| <b>Total gross loans</b>         | <b>\$ 59,025</b>  | <b>\$ 1,111</b>  | <b>\$ 62,679</b>  | <b>\$ 3,456</b>   |

The following is a summary of interest foregone on impaired loans for the periods indicated:

**Three Months Ended**

**Nine Months Ended**

|  | September 30,<br>2013 | September 30,<br>2012 | September 30,<br>2013 | September 30,<br>2012 |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
|  | <i>(In thousands)</i> |                       |                       |                       |
| Interest income that would have been recognized had impaired loans performed in accordance with their original terms | \$ 1,058              | \$ 1,382              | \$ 3,183              | \$ 4,315              |
| Less: Interest income recognized on impaired loans   | (900)                 | (1,111)               | (2,722)               | (3,456)               |
| <b>Interest foregone on impaired loans</b>   | <b>\$ 158</b>         | <b>\$ 271</b>         | <b>\$ 461</b>         | <b>\$ 859</b>         |

For the nine months ended September 30, 2013, we restructured monthly payments for 24 loans, with a net carrying value of \$5.8 million at the time of modification, which we subsequently classified as troubled debt restructured loans. Temporary payment structure modifications included, but were not limited to, extending the maturity date, reducing the amount of principal and/or interest due monthly, and/or allowing for interest only monthly payments for nine months or less. As of September 30, 2013, troubled debt restructurings on accrual status totaled \$17.8 million, all of which were temporary interest rate and payment reductions and extensions of maturity, and a \$391,000 reserve relating to these loans is included in the allowance for loan losses. For the restructured loans on

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accrual status, we determined that, based on the financial capabilities of the borrowers at the time of the loan restructuring and the borrowers' past performance in the payment of debt service under the previous loan terms, performance and collection under the revised terms is probable. As of September 30, 2013, troubled debt restructuring on non-accrual status totaled \$10.2 million, and a \$554,000 reserve relating to these loans is included in the allowance for loan losses.

As of December 31, 2012, troubled debt restructurings on accrual status totaled \$17.0 million, all of which were temporary interest rate and payment reductions, and a \$1.5 million reserve relating to these loans was included in the allowance for loan losses. As of December 31, 2012, troubled debt restructuring on non-accrual status totaled \$18.8 million, and a \$2.1 million reserve relating to these loans was included in the allowance for loan losses.

**Allowance for Loan Losses and Allowance for Off-Balance Sheet Items**

Provisions to allowance for loan losses are made quarterly to recognize probable loan losses. The quarterly provision is based on the allowance need, which is determined through analysis involving quantitative calculations based on historic loss rates for general reserves and individual impairment calculations for specific allocations to impaired loans as well as qualitative adjustments.

In the first quarter of 2010, the look-back period was reduced from twelve quarters to eight quarters, with 60 percent weighting given to the most recent four quarters and 40 percent to the oldest four quarters, to place greater emphasis on losses taken by the Bank during the economic downturn. In the second quarter of 2013, management reevaluated the look-back period and restored the twelve quarter look-back period in order to capture a period of higher losses that would have otherwise been excluded. Risk factor calculations are weighted at 50 percent for the most recent four quarters, 33 percent for the next four quarters, and 17 percent for the oldest four quarters. As homogenous loans are bulk graded, the risk grade is not factored into the historical loss analysis. The change in methodology maintained the Bank's allowance at a level consistent with the prior quarter. Under the previous methodology, the Bank would have recognized a negative provision of \$5.9 million in the second quarter of 2013, which the Bank did not consider to be prudent, given the uncertainty in the economy.

To determine general reserve requirements, existing loans are divided into 11 general loan pools of risk-rated loans as well as three homogenous loan pools. For risk-rated loans, migration analysis allocates historical losses by loan pool and risk grade to determine risk factors for potential loss inherent in the current outstanding loan portfolio. In addition, specific reserves are allocated for loans deemed impaired.

When determining the appropriate level for allowance for loan losses, management considers qualitative adjustments for any factors that are likely to cause estimated credit losses associated with the Bank's current portfolio to differ from historical loss experience, including, but not limited to, national and local economic and business conditions, volume and geographic concentrations, and problem loan trends.

To systematically quantify the credit risk impact of trends and changes within the loan portfolio, a credit risk matrix is utilized. The qualitative factors are considered on a loan pool by loan pool basis subsequent to, and in conjunction with, a loss migration analysis. The credit risk matrix provides various scenarios with positive or negative impact on the portfolio along with corresponding basis points for qualitative adjustments.

The following table reflects our allocation of allowance for loan losses by loan category as well as the loans receivable for each loan type:

|                                 | September 30, 2013    |                     | December 31, 2012 |                     |
|---------------------------------|-----------------------|---------------------|-------------------|---------------------|
|                                 | Allowance             | Loans               | Allowance         | Loans               |
|                                 | Amount                | Receivable          | Amount            | Receivable          |
|                                 | <i>(In thousands)</i> |                     |                   |                     |
| Real estate loans:              |                       |                     |                   |                     |
| Commercial property             | \$ 19,088             | \$ 887,576          | \$ 17,109         | \$ 787,094          |
| Residential property            |                       | 82,519              | 1,071             | 101,778             |
| Total real estate loans         | 19,088                | 970,095             | 18,180            | 888,872             |
| Commercial and industrial loans | 34,805                | 1,155,111           | 41,928            | 1,123,012           |
| Consumer loans                  | 1,639                 | 34,065              | 2,280             | 36,676              |
| Unallocated                     | 2,107                 |                     | 917               |                     |
| <b>Total</b>                    | <b>\$ 57,639</b>      | <b>\$ 2,159,271</b> | <b>\$ 63,305</b>  | <b>\$ 2,048,560</b> |

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The following table sets forth certain information regarding allowance for loan losses and allowance for off-balance sheet items for the periods presented. Allowance for off-balance sheet items is determined by applying reserve factors according to loan pool and grade as well as actual current commitment usage figures by loan type to existing contingent liabilities.

|  | As of and for the<br>Three Months Ended |                  |                       | As of and for the<br>Nine Months Ended |                       |
|--|---|------------------|-----------------------|--|-----------------------|
|  | September 30,<br>2013                   | June 30,<br>2013 | September 30,<br>2012 | September 30,<br>2013                  | September 30,<br>2012 |
| <i>(In thousands)</i>  |   |                  |                       |  |                       |
| <b>Allowance for loan losses:</b>                                |   |                  |                       |  |                       |
| Balance at beginning of period                                   | \$ 59,876                               | \$ 61,191        | \$ 71,893             | \$ 63,305                              | \$ 89,936             |
| Actual charge-offs   | (4,610)                                 | (3,490)          | (7,223)               | (11,124)                               | (34,260)              |
| Recoveries on loans previously charged cff                       | 2,383                                   | 1,867            | 1,320                 | 4,964                                  | 3,681                 |
| Net loan charge-offs   | (2,227)                                 | (1,623)          | (5,903)               | (6,160)                                | (30,579)              |
| Provision charged to operating expense                           | (10)                                    | 308              | 117                   | 494                                    | 6,750                 |
| <b>Balance at end of period</b>                                  | <b>\$ 57,639</b>                        | <b>\$ 59,876</b> | <b>\$ 66,107</b>      | <b>\$ 57,639</b>                       | <b>\$ 66,107</b>      |
| <b>Allowance for off-balance sheet items:</b>                    |   |                  |                       |  |                       |
| Balance at beginning of period                                   | \$ 1,320                                | \$ 1,628         | \$ 2,348              | \$ 1,824                               | \$ 2,981              |
| Provision charged to operating expense                           | 10                                      | (308)            | (117)                 | (494)                                  | (750)                 |
| <b>Balance at end of period</b>                                  | <b>\$ 1,330</b>                         | <b>\$ 1,320</b>  | <b>\$ 2,231</b>       | <b>\$ 1,330</b>                        | <b>\$ 2,231</b>       |
| <b>Ratios:</b>   |   |                  |                       |  |                       |
| Net loan charge-offs to average gross loans <sup>(1)</sup>       | 0.41%                                   | 0.30%            | 1.21%                 | 0.38%                                  | 2.06%                 |
| Net loan charge-offs to gross loans <sup>(1)</sup>               | 0.41%                                   | 0.30%            | 1.21%                 | 0.38%                                  | 2.08%                 |
| Allowance for loan losses to average gross loans                 | 2.64%                                   | 2.76%            | 3.37%                 | 2.69%                                  | 3.33%                 |
| Allowance for loan losses to gross loans                         | 2.67%                                   | 2.74%            | 3.38%                 | 2.67%                                  | 3.38%                 |
| Net loan charge-offs to allowance for loan losses <sup>(1)</sup> | 15.45%                                  | 10.84%           | 35.72%                | 14.29%                                 | 61.68%                |
| Net loan charge-offs to provision charged to operating expenses  | -22270.00%                              | 526.95%          | 5045.30%              | 1246.96%                               | 453.02%               |
| Allowance for loan losses to non-performing loans                | 253.07%                                 | 214.03%          | 147.92%               | 253.07%                                | 147.92%               |
| <b>Balance:</b>  |   |                  |                       |  |                       |
| Average gross loans during period                                | \$ 2,186,884                            | \$ 2,165,741     | \$ 1,958,819          | \$ 2,142,462                           | \$ 1,982,369          |
| Gross loans at end of period                                     | \$ 2,159,271                            | \$ 2,187,389     | \$ 1,958,290          | \$ 2,159,271                           | \$ 1,958,290          |
| Non-performing loans at end of period                            | \$ 22,776                               | \$ 27,975        | \$ 44,692             | \$ 22,776                              | \$ 44,692             |

(1) Net loan charge-offs are annualized to calculate the ratios.

Allowance for loan losses decreased by \$5.7 million, or 9.0 percent, to \$57.6 million as of September 30, 2013, compared to \$63.3 million as of December 31, 2012. Allowance for loan losses as a percentage of gross loans decreased to 2.67 percent as of September 30, 2013 from 3.09 percent as of December 31, 2012. Provision for credit losses decreased by \$6.0 million to zero for the nine months ended September 30, 2013 from \$6.0 million for the nine

months ended September 30, 2012. The \$494,000 provision for credit losses was offset by the reversal in provision for off-balance sheet items, resulting in a zero provision for credit losses for the nine months ended September 30, 2013. The \$6.8 million provision for credit losses was offset by the \$750,000 reversal in provision for off-balance sheet items, resulting in a \$6.0 million provision for credit losses for the nine months ended September 30, 2012.

The decrease in allowance for loan losses as of September 30, 2013 was due primarily to decreases in historical loss rates and classified assets. Due to these factors, the general and impaired loan reserves decreased by \$6.8 million, or 23.5 percent, to \$22.2 million and by \$3.9 million, or 62.0 percent, to \$2.4 million, respectively, as of September 30, 2013 as compared to \$29.1 million and \$6.2 million, respectively, at December 31, 2012.

Total impaired loans decreased by \$11.3 million, or 20.6 percent, to \$43.5 million as of September 30, 2013 as compared to \$54.7 million at December 31, 2012. Accordingly, specific reserve allocations associated with impaired loans decreased by \$3.9 million, or 62.0 percent, to \$2.4 million as of September 30, 2013, as compared to \$6.2 million as of December 31, 2012.

The Bank recorded, in other liabilities, an allowance for off-balance sheet exposure, primarily unfunded loan commitments, of \$1.3 million and \$1.8 million as of September 30, 2013 and December 31, 2012, respectively. The decrease was due primarily to lower reserve factors based on historical loss rates. The Bank closely monitors the borrower's repayment capabilities while funding existing commitments to ensure losses are minimized. Based on management's evaluation and analysis of portfolio credit quality and prevailing economic conditions, we believe these reserves are adequate for losses inherent in the loan portfolio and off-balance sheet exposure as of September 30, 2013 and December 31, 2012.

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The following table shows a summary of net charge-offs for the periods presented:

|                            | As of and for the<br>Three Months Ended |                       | As of and for the<br>Nine Months Ended |                       |
|----------------------------|---|-----------------------|--|-----------------------|
|                            | September 30,<br>2013                   | September 30,<br>2012 | September 30,<br>2013                  | September 30,<br>2012 |
|                            | <i>(In thousands)</i>                   |                       |  |                       |
| <b>Charge-offs:</b>        |   |                       |  |                       |
| Real estate loans          | \$                                      | \$ 1,321              | \$ 359                                 | \$ 9,406              |
| Commercial term            | 3,610                                   | 4,576                 | 8,509                                  | 22,190                |
| Commercial lines of credit | 507                                     | 201                   | 507                                    | 203                   |
| SBA loans                  | 475                                     | 794                   | 1,531                                  | 1,686                 |
| International loans        |   |                       |  |                       |
| Consumer loans             | 18                                      | 331                   | 218                                    | 775                   |
| <b>Total charge-offs</b>   | <b>4,610</b>                            | <b>7,223</b>          | <b>11,124</b>                          | <b>34,260</b>         |
| <b>Recoveries:</b>         |   |                       |  |                       |
| Real estate loans          | 726                                     | 58                    | 1,776                                  | 575                   |
| Commercial term            | 182                                     | 913                   | 974                                    | 2,470                 |
| Commercial lines of credit | 312                                     | 269                   | 388                                    | 291                   |
| SBA loans                  | 1,156                                   | 64                    | 1,761                                  | 284                   |
| International loans        | 2                                       | 5                     | 5                                      | 8                     |
| Consumer loans             | 5                                       | 11                    | 60                                     | 53                    |
| <b>Total recoveries</b>    | <b>2,383</b>                            | <b>1,320</b>          | <b>4,964</b>                           | <b>3,681</b>          |
| <b>Net charge-offs</b>     | <b>\$ 2,227</b>                         | <b>\$ 5,903</b>       | <b>\$ 6,160</b>                        | <b>\$ 30,579</b>      |

For the nine months ended September 30, 2013, total charge-offs were \$11.1 million, a decrease of \$23.1 million, or 67.5 percent, from \$34.3 million for the nine months ended September 30, 2012. The decrease in the nine months ended September 30, 2013 from the same period in 2012 was due mainly to decreases in charge-offs of commercial term loans by \$13.7 million and real estate loans by \$9.0 million.

**Deposits**

The following table shows the composition of deposits by type as of the dates indicated:

|                            | September 30,<br>2013 | December 31,<br>2012 | Increase (Decrease) |            |
|----------------------------|-----------------------|----------------------|---------------------|------------|
|                            |                       |                      | Amount              | Percentage |
|                            | <i>(In thousands)</i> |                      |                     |            |
| Demand noninterest-bearing | \$ 778,345            | \$ 720,931           | \$ 57,414           | 7.96%      |
| Interest-bearing:          |                       |                      |                     |            |
| Savings                    | 113,892               | 114,302              | (410)               | -0.36%     |
|                            | 539,130               | 575,744              | (36,614)            | -6.36%     |



Money market checking and NOW  
accounts

|                                    |                     |                     |                  |              |
|------------------------------------|---------------------|---------------------|------------------|--------------|
| Time deposits of \$100,000 or more | 493,532             | 616,187             | (122,655)        | -19.91%      |
| Other time deposits                | 504,808             | 368,799             | 136,009          | 36.88%       |
| <b>Total deposits</b>              | <b>\$ 2,429,707</b> | <b>\$ 2,395,963</b> | <b>\$ 33,744</b> | <b>1.41%</b> |

Total deposits increased by \$33.7 million, or 1.4 percent, to \$2.43 billion as of September 30, 2013 from \$2.40 billion as of December 31, 2012. The increase in total deposits was attributable mainly to increases in non-interest-bearing deposit and other time deposits, offset by decreases in jumbo CDs.

Core deposits (defined as demand, savings, money market checking, NOW accounts and other time deposits) increased by \$156.4 million, or 8.8 percent, to \$1.94 billion at September 30, 2013 from \$1.78 billion at December 31, 2012. Time deposits of \$250,000 or more decreased by \$12.5 million, or 5.2 percent, to \$225.8 million from \$238.2 million at December 31, 2012. However, noninterest-bearing demand deposits as a percentage of deposits grew to 32.0 percent at September 30, 2013 from 30.1 percent at December 31, 2012. We had no brokered deposits as of September 30, 2013 and December 31, 2012.

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**Federal Home Loan Bank Advances and Other Borrowings**

FHLB advances and other borrowings mostly take the form of advances from the FHLB of San Francisco and overnight federal funds. At September 30, 2013, advances from the FHLB were \$2.6 million, a decrease of \$290,000 from \$2.9 million at December 31, 2012, with a remaining maturity of 0.63 years at 5.27 percent.

**Junior Subordinated Debentures**

During the second half of 2004, we issued two junior subordinated notes bearing interest at the three-month London Interbank Offered Rate ( LIBOR ) plus 2.90 percent totaling \$61.8 million and one junior subordinated note bearing interest at the three-month LIBOR plus 2.63 percent totaling \$20.6 million. The outstanding subordinated debentures related to these offerings, the proceeds of which were used to finance the purchase of Pacific Union Bank, totaled zero and \$82.4 million at September 30, 2013 and December 31, 2012, respectively. Hanmi Financial redeemed its TPS II for \$30.9 million in March 2013, and fully paid the remaining TPS I and III in the aggregate amount of \$51.5 million in April 2013.

**Table of Contents****Interest Rate Risk Management**

Interest rate risk indicates our exposure to market interest rate fluctuations. The movement of interest rates directly and inversely affects the economic value of fixed-income assets, which is the present value of future cash flow discounted by the current interest rate; under the same conditions, the higher the current interest rate, the higher the denominator of discounting. Interest rate risk management is intended to decrease or increase the level of our exposure to market interest rates. The level of interest rate risk can be managed through such means as the changing of gap positions and the volume of fixed-income assets. For successful management of interest rate risk, we use various methods to measure existing and future interest rate risk exposures, giving effect to historical attrition rates of core deposits. In addition to regular reports used in business operations, repricing gap analysis, stress testing and simulation modeling are the main measurement techniques used to quantify interest rate risk exposure.

The following table shows the status of our gap position as of September 30, 2013:

|   | Less<br>Than<br>Three<br>Months | More<br>Than<br>Three<br>Months<br>But<br>Less<br>Than<br>One Year | More<br>Than<br>One<br>Year<br>But<br>Less Than<br>Five Years | More<br>Than<br>Five Years | Non-<br>Interest-<br>Sensitive | Total               |
|---|---------------------------------|--|---|----------------------------|--------------------------------|---------------------|
| <i>(In thousands)</i>   |                                 |  |   |                            |                                |                     |
| <b>Assets</b>   |                                 |  |   |                            |                                |                     |
| Cash and due from banks   | \$                              | \$   | \$  | \$                         | \$ 78,810                      | \$ 78,810           |
| Interest-bearing deposits<br>in other banks                       | 115,044                         |  |   |                            |                                | 115,044             |
| Investment securities:  |                                 |  |   |                            |                                |                     |
| Fixed rate  | 28,791                          | 33,814   | 167,203   | 93,011                     | (1,362)                        | 321,457             |
| Floating rate   | 53,044                          | 3,030  | 5,588   |                            | (62)                           | 61,600              |
| Loans:  |                                 |  |   |                            |                                |                     |
| Fixed rate  | 65,659                          | 149,706  | 281,724   | 2,304                      |                                | 499,393             |
| Floating rate   | 1,064,527                       | 135,980  | 450,835   | 41                         |                                | 1,651,383           |
| Non-accrual   |                                 |  |   |                            | 22,776                         | 22,776              |
| Deferred loan fees,<br>discount, and allowance<br>for loan losses |                                 |  |   |                            | (65,703)                       | (65,703)            |
| Federal home loan bank<br>and federal reserve bank<br>stock       |                                 |  |   | 27,260                     |                                | 27,260              |
| Other assets  |                                 | 29,468   |   | 4,595                      | 99,054                         | 133,117             |
| <b>Total assets</b>   | <b>\$ 1,327,065</b>             | <b>\$ 351,998</b>  | <b>\$ 905,350</b>   | <b>\$ 127,211</b>          | <b>\$ 133,513</b>              | <b>\$ 2,845,137</b> |

**Liabilities and  
Stockholders Equity**

## Liabilities:

## Deposits:

## Demand

|  |    |         |         |         |         |         |    |         |
|--|----|---------|---------|---------|---------|---------|----|---------|
| noninterest-bearing                    | \$ | \$      | \$      | \$      | \$      | 778,345 | \$ | 778,345 |
| Savings                                |    | 22,645  | 29,782  | 30,426  | 31,039  |         |    | 113,892 |
| Money market checking and NOW accounts |    | 28,225  | 139,626 | 183,920 | 187,359 |         |    | 539,130 |
| Time deposits                          |    |         |         |         |         |         |    |         |
| Fixed rate                             |    | 130,071 | 761,549 | 106,661 |         |         |    | 998,281 |
| Floating rate                          |    | 59      |         |         |         |         |    | 59      |
| Federal home loan bank advances        |    | 99      | 2,546   |         |         |         |    | 2,645   |
| Other liabilities                      |    |         |         |         |         | 14,829  |    | 14,829  |
| Stockholders equity                    |    |         |         |         |         | 397,956 |    | 397,956 |

|  |           |                |           |                |           |                |           |                |           |                  |           |                  |
|--|-----------|----------------|-----------|----------------|-----------|----------------|-----------|----------------|-----------|------------------|-----------|------------------|
| <b>Total liabilities and stockholders equity</b> | <b>\$</b> | <b>181,099</b> | <b>\$</b> | <b>933,503</b> | <b>\$</b> | <b>321,007</b> | <b>\$</b> | <b>218,398</b> | <b>\$</b> | <b>1,191,130</b> | <b>\$</b> | <b>2,845,137</b> |
|--|-----------|----------------|-----------|----------------|-----------|----------------|-----------|----------------|-----------|------------------|-----------|------------------|

|   |  |           |           |           |           |             |  |                     |
|---|--|-----------|-----------|-----------|-----------|-------------|--|---------------------|
| Repricing gap   |  | 1,145,966 | (581,505) | 584,343   | (91,187)  | (1,057,617) |  |                     |
| Cumulative repricing gap  |  | 1,145,966 | 564,461   | 1,148,804 | 1,057,617 |             |  |                     |
| Cumulative repricing gap as a percentage of total assets            |  | 40.28%    | 19.84%    | 40.38%    | 37.17%    | 0.00%       |  |                     |
| Cumulative repricing gap as a percentage of interest-earning assets |  | 42.81%    | 21.08%    | 42.91%    | 39.51%    | 0.00%       |  |                     |
| Interest-earning assets   |  |           |           |           |           |             |  | <b>\$ 2,677,126</b> |

The repricing gap analysis measures the static timing of repricing risk of assets and liabilities (i.e., a point-in-time analysis measuring the difference between assets maturing or repricing in a period and liabilities maturing or repricing within the same period). Assets are assigned to maturity and repricing categories based on their expected repayment or repricing dates, and liabilities are assigned based on their repricing or maturity dates. Core deposits that have no maturity dates (demand deposits, savings, money market checking and NOW accounts) are assigned to categories based on expected decay rates.

As of September 30, 2013, the cumulative repricing gap for the three-month period was at an asset-sensitive position and was 42.81 percent of interest-earning assets, which increased from 34.96 percent as of December 31, 2012. The increase was due mainly to a \$139.1 million decrease in fixed rate time deposits and an \$82.4 million decrease in junior subordinated debentures, offset by a \$60.7 million decrease in interest-bearing deposits in other banks.

The cumulative repricing gap for the twelve-month period was at an asset-sensitive position and was 21.08 percent of interest-earning assets as of September 30, 2013, which decreased from 22.32 percent as of December 31, 2012. The decrease was due mainly to a \$60.7 million decrease in interest-bearing deposits in other banks and a \$146.5 million increase in fixed rate time deposits, offset by an \$83.5 million decrease in money market checking and NOW accounts and an \$82.4 million decrease in junior subordinated debentures.

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The following table summarizes the status of the cumulative gap position as of the dates indicated:

|                                       | Less Than Three Months |                      | Less Than Twelve Months |                      |
|---------------------------------------|------------------------|----------------------|-------------------------|----------------------|
|                                       | September 30,<br>2013  | December 31,<br>2012 | September 30,<br>2013   | December 31,<br>2012 |
|                                       | <i>(In thousands)</i>  |                      |                         |                      |
| Cumulative repricing gap              | \$ 1,145,966           | \$ 926,923           | \$ 564,461              | \$ 591,748           |
| Percentage of total assets            | 40.28%                 | 32.16%               | 19.84%                  | 20.53%               |
| Percentage of interest-earning assets | 42.81%                 | 34.96%               | 21.08%                  | 22.32%               |

The spread between interest income on interest-earning assets and interest expense on interest-bearing liabilities is the principal component of net interest income, and interest rate changes substantially affect our financial performance. We emphasize capital protection through stable earnings rather than maximizing yield. In order to achieve stable earnings, we prudently manage our assets and liabilities and closely monitor the percentage changes in net interest income and equity value in relation to limits established within our guidelines.

To supplement traditional gap analysis, we perform simulation modeling to estimate the potential effects of interest rate changes. The following table summarizes one of the stress simulations performed to forecast the impact of changing interest rates on net interest income and the market value of interest-earning assets and interest-bearing liabilities reflected on our balance sheet (i.e., an instantaneous parallel shift in the yield curve of the magnitude indicated below). This sensitivity analysis is compared to policy limits, which specify the maximum tolerance level for net interest income exposure over a one-year horizon, given the basis point adjustment in interest rates reflected below.

| Change in<br>Interest<br>Rate | Percentage Changes        |                                | Change in Amount          |                                |
|-------------------------------|---------------------------|--------------------------------|---------------------------|--------------------------------|
|                               | Net<br>Interest<br>Income | Economic<br>Value of<br>Equity | Net<br>Interest<br>Income | Economic<br>Value of<br>Equity |
|                               | <i>(In thousands)</i>     |                                |                           |                                |
| 200%                          | 11.97%                    | 2.86%                          | \$ 13,766                 | \$ 15,439                      |
| 100%                          | 5.73%                     | 1.94%                          | \$ 6,590                  | \$ 10,477                      |
| -100%                         | -10.19%                   | -4.10%                         | \$ (11,723)               | \$ (22,144)                    |
| -200%                         | -20.36%                   | -9.07%                         | \$ (23,415)               | \$ (49,050)                    |

The estimated sensitivity does not necessarily represent our forecast, and the results may not be indicative of actual changes to our net interest income. These estimates are based upon a number of assumptions including the nature and timing of interest rate levels including yield curve shape, prepayments on loans and securities, pricing strategies on loans and deposits, and replacement of asset and liability cash flows. While the assumptions used are based on current economic and local market conditions, there is no assurance as to the predictive nature of these conditions, including how customer preferences or competitor influences might change.

**Capital Resources and Liquidity****Capital Resources**

Historically, our primary source of capital has been the retention of operating earnings. In order to ensure adequate levels of capital, the Board continually assesses projected sources and uses of capital in conjunction with projected increases in assets and levels of risk. Management considers, among other things, earnings generated from operations, and access to capital from financial markets through the issuance of additional securities, including common stock or notes, to meet our capital needs.

At September 30, 2013, the Bank's Tier 1 risk-based capital ratio of 16.45 percent, total risk-based capital ratio of 17.72 percent, and Tier 1 leverage capital ratio of 13.68 percent, placed the Bank in the "well capitalized" category, which is defined as institutions with Tier 1 risk-based capital ratio equal to or greater than 6.00 percent, total risk-based capital ratio equal to or greater than 10.00 percent, and Tier 1 leverage capital ratio equal to or greater than 5.00 percent.

For a discussion of recently implemented changes to the capital adequacy framework prompted by Basel III and the Dodd-Frank Wall Street Reform and Consumer Protection Act, see Note 6 "Regulatory Matters" of Notes to Consolidated Financial Statements (Unaudited) in this Quarterly Report on Form 10-Q.

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**Table of Contents****Liquidity Hanmi Financial**

Currently, management believes that Hanmi Financial, on a stand-alone basis, has adequate liquid assets to meet its operating cash needs through September 30, 2014. Hanmi Financial redeemed \$30.9 million of its TPS in March 2013, and fully paid the remaining \$51.5 million of TPS in April 2013.

**Liquidity Hanmi Bank**

Management believes that the Bank, on a stand-alone basis, has adequate liquid assets to meet its current obligations. The Bank's primary funding source will continue to be deposits originating from its branch platform. The Bank's wholesale funds historically consisted of FHLB advances and brokered deposits. As of September 30, 2013, the Bank had a FHLB advance of \$2.6 million compared to \$2.9 million as of December 31, 2012. The Bank had no brokered deposits at September 30, 2013 and December 31, 2012.

The Bank's primary source of borrowings is the FHLB, from which the Bank is eligible to borrow up to 30 percent of its total assets. As of September 30, 2013, the total borrowing capacity available based on pledged collateral and the remaining available borrowing capacity were \$366.2 million and \$363.5 million, respectively. The Bank's FHLB borrowings as of September 30, 2013 totaled \$2.6 million, representing 0.09 percent of total assets.

The amount that the FHLB is willing to advance differs based on the quality and character of qualifying collateral pledged by the Bank, and the advance rates for qualifying collateral may be adjusted upwards or downwards by the FHLB from time to time. To the extent deposit renewals and deposit growth are not sufficient to fund maturing and withdrawable deposits, repay maturing borrowings, fund existing and future loans and investment securities and otherwise fund working capital needs and capital expenditures, the Bank may utilize the remaining borrowing capacity from its FHLB borrowing arrangement.

As a means of augmenting its liquidity, the Bank had an available borrowing source of \$91.8 million from the Federal Reserve Discount Window (the Fed Discount Window), to which the Bank pledged loans with a carrying value of \$126.8 million, and had no borrowings as of September 30, 2013. Additionally, the Bank is currently in the primary credit program of the Fed Discount Window. Primary credit is available to depository institutions in sound overall condition to meet short-term (typically overnight), backup funding needs. Generally, primary credit will be granted on a no-questions-asked, minimal administered basis with no restrictions. Furthermore, on December 31, 2012, the Bank established a line of credit with Raymond James & Associates, Inc. for repurchase agreements up to a maximum of \$100.0 million.

The Bank has Contingency Funding Plans (CFPs) designed to ensure that liquidity sources are sufficient to meet its ongoing obligations and commitments, particularly in the event of a liquidity contraction. The CFPs are designed to examine and quantify its liquidity under various stress scenarios. Furthermore, the CFPs provide a framework for management and other critical personnel to follow in the event of a liquidity contraction or in anticipation of such an event. The CFPs address authority for activation and decision making, liquidity options and the responsibilities of key departments in the event of a liquidity contraction.

**Off-Balance Sheet Arrangements**

For a discussion of off-balance sheet arrangements, see Note 10 Off-Balance Sheet Commitments of Notes to Consolidated Financial Statements (Unaudited) in this Quarterly Report on Form 10-Q and Item 1. Business Off-Balance Sheet Commitments in our 2012 Annual Report on Form 10-K.

## **Contractual Obligations**

There have been no material changes to the contractual obligations described in our 2012 Annual Report on Form 10-K.

## **Recently Issued Accounting Standards**

*FASB ASU 2013-11 Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists (Topic 740)* was issued to improve the reporting for unrecognized tax benefits when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. The pronouncement is expected to reduce diversity in practice by providing guidance on the presentation of unrecognized tax benefits and will better reflect the manner in which an entity would settle at the reporting date any additional income taxes that would result from the disallowance of a tax position when net operating loss carryforwards, similar tax losses, or tax credit carryforwards exist. The pronouncement is effective prospectively for fiscal years, and interim periods within those years, beginning after December 15, 2013. The adoption of this pronouncement is not expected to have a material impact on our consolidated financial statements.



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***FASB ASU 2013-02 Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income (Topic 220)*** was issued to address concerns raised in the initial issuance of ASU 2011-05, *Presentation of Comprehensive Income*. For items reclassified out of accumulated other comprehensive income into net income in their entirety, entities must disclose the effect of the reclassification on each affected net income line item. For accumulated other comprehensive income reclassification items that are not reclassified in their entirety into net income, entities must provide a cross reference to other required U.S. GAAP disclosures. This information may be provided either in the notes or parenthetically on the face of the statement that reports net income as long as all the information is disclosed in a single location. However, an entity is prohibited from providing this information parenthetically on the face of the statement that reports net income if it has items that are not reclassified in their entirety into net income. The amendments are effective for annual reporting periods beginning after December 15, 2012 and interim periods within those years. The adoption of FASB ASU 2013-02 did not have a significant impact on our financial condition or result of operations.

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**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

For quantitative and qualitative disclosures regarding market risks in Hanmi Bank's portfolio, see Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations - Interest Rate Risk Management and Capital Resources and Liquidity.

**Item 4. Controls and Procedures**

**Disclosure Controls and Procedures**

As of September 30, 2013, we conducted an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended (the Exchange Act). Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective as of September 30, 2013.

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

**Internal Controls**

During our most recent fiscal quarter, there have been no changes in our internal control over financial reporting that has materially affected or is reasonably likely to materially affect our internal control over financial reporting.

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**Part II Other Information**

**Item 1. Legal Proceedings**

From time to time, Hanmi Financial and its subsidiaries are parties to litigation that arises in the ordinary course of business, such as claims to enforce liens, claims involving the origination and servicing of loans, and other issues related to the business of Hanmi Financial and its subsidiaries. In the opinion of management, the resolution of any such issues would not have a material adverse impact on the financial condition, results of operations, or liquidity of Hanmi Financial or its subsidiaries.

**Item 1A. Risk Factors**

The following are changes to two risk factors previously disclosed in our 2012 Annual Report on Form 10-K, and our Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2013. Events or circumstances arising from one or more of these risks could adversely affect our business, financial condition, operating results, prospects and the price of our common stock. These risks are not intended to be a comprehensive list of all risks we face and additional risks that we may currently view as not material may also adversely impact our financial condition, business operations and results of operations.

***Increases in the level of non-performing loans could adversely affect our business, profitability, and financial condition.*** Increase in non-performing loans could have an adverse effect on our earnings as a result of related increases in our provisions for loan losses, charge-offs, and other losses related to non-performing loans. An increase in non-performing loans could potentially lead to a decline in earnings and could deplete our capital, leaving the Company undercapitalized. Non-performing loans as of September 30, 2013 decreased to \$28.0 million from \$37.3 million as of December 31, 2012.

***We are dependent on key personnel and the loss of one or more of those key personnel may materially and adversely affect our prospects.*** Our success depends in large part on our ability to attract key people who are qualified and have knowledge and experience in the banking industry in our markets and to retain those people to successfully implement our business objectives. Competition for qualified employees and personnel in the banking industry is intense and there are a limited number of qualified persons with knowledge of, and experience in, our banking space. The process of recruiting personnel with the combination of skills and attributes required to carry out our strategies is often lengthy. In addition, legislation and regulations which impose restrictions on executive compensation may make it more difficult for us to retain and recruit key personnel. Our success depends to a significant degree upon our ability to attract and retain qualified management, loan origination, finance, administrative, marketing and technical personnel and upon the continued contributions of our management and personnel. The unexpected loss of services of one or more of our key personnel or failure to attract or retain such employees could have a material adverse effect on our financial condition and results of operations.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

None.

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. Mine Safety Disclosures**

Not applicable.

**Item 5. Other Information**

None.

**Item 6. Exhibits**

**Exhibit**

**Number**

**Document**

|      |   |
|------|---|
| 31.1 | Certification of Chief Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended         |
| 31.2 | Certification of Chief Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended         |
| 32.1 | Certification of Chief Executive Officer Pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 32.2 | Certification of Chief Financial Officer Pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |

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|         |  |
|---------|--|
| 101.INS | XBRL Instance Document *                                 |
| 101.SCH | XBRL Taxonomy Extension Schema Document *                |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document *  |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document *        |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document * |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document *   |

\* Attached as Exhibit 101 to this report are documents formatted in XBRL (Extensible Business Reporting Language).

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**Signatures**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned thereunto duly authorized.

**Hanmi Financial Corporation**

Date: November 12, 2013

By: */s/ C. G. Kum*  
C. G. Kum  
*President and Chief Executive Officer*

By: */s/ Shick (Mark) Yoon*  
Shick (Mark) Yoon  
*Executive Vice President and Chief Financial Officer*