HANMI FINANCIAL CORP
Form 10-K/A
March 22, 2004

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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K/A

x **Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the fiscal year ended December 31, 2003
or

o **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

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, CA 90010** (Address of principal executive offices)	**90010** (Zip Code)

(213) 382-2200
(Registrant s telephone number, including area code)
Securities registered pursuant to Section 12(b) of the Act:

(Title of each class)	**(Name of each exchange on which registered)**
NONE	NONE

Securities registered pursuant to Section 12(g) of the Act:
(Title of class)
Common Stock, $0.001 Par Value

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 x No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 or Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of the Form 10-K or any amendment to this Form 10-K. x

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes x No o

As of June 30, 2003, the aggregate market value of the common stock held by non-affiliates of the registrant was approximately $165,456,000. For purposes of the foregoing calculation only, in addition to affiliated companies, all directors and officers of the registrant have been deemed affiliates.

Number of shares of common stock of the registrant outstanding as of February 29, 2004 was approximately 14,226,000 shares.

The following documents are incorporated by reference herein:

Documents Incorporated by Reference

Registrant s Definitive Proxy Statement for its Annual Meeting of Stockholders, which will be filed within 120 days of the fiscal year ended December 31, 2003, is incorporated by reference into Part III of this report.

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FORWARD-LOOKING STATEMENTS

Some of the statements under Business, Management s Discussion and Analysis of Financial Condition and Results of Operations, and elsewhere in this Form 10-K 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. In some cases, you can identify forward-looking statements by terminology such as may, will, should, could, expects, plans, intends, anticipates, believes, estimates, predicts, potential, 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. For a discussion of some of the factors that might cause such a difference, see Item 1. Business-Factors That May Affect Future Results of Operations .

PART 1

ITEM 1. BUSINESS

General

Hanmi Financial Corporation (Hanmi Financial or the Company) is a Delaware corporation incorporated on March 14, 2000 pursuant to a Plan of Reorganization and Agreement of Merger to be the holding company for Hanmi Bank (the Bank). The Company became the holding company for the Bank in June, 2000 and is subject to the Bank Holding Company Act of 1956, as amended.

The principal office of Hanmi Financial is located at 3660 Wilshire Boulevard, Penthouse Suite A, Los Angeles, California 90010, and its telephone number is (213) 382-2200.

Hanmi Bank, the primary subsidiary of the Company, was incorporated under the laws of the State of California on August 24, 1981 and was licensed by the California Department of Financial Institutions on December 15, 1982. Hanmi Bank s deposit accounts are insured under the Federal Deposit Insurance Act up to applicable limits thereof, and the Bank is a member of the Federal Reserve System. Hanmi Bank s headquarters office is located at 3660 Wilshire Boulevard, Penthouse Suite A, Los Angeles, California 90010.

Hanmi Bank is a community bank conducting general business banking, with its primary market encompassing the multi-ethnic population of Los Angeles, Orange, Santa Clara and San Diego counties. Hanmi Bank s full-service offices are located in business areas where many of the businesses are run by immigrants and other minority groups. Hanmi Bank s client base reflects the multi-ethnic composition of these communities. Hanmi Bank currently has fifteen full-service branches. Of the fifteen branches, Hanmi Bank opened twelve as de novo branches and acquired the other three through acquisition. During 2003, Hanmi Bank opened branches in Santa Clara County and downtown Los Angeles.

The Company s revenues are derived primarily from interest on its loan and securities portfolios and service charges on deposit accounts. A summary of revenues for the years ended December 31, 2003, 2002 and 2001 follows:

	Year ended December 31,					
	2003		2002		2001	
	(dollars in thousands)					
Interest and fees on loans	$64,849	66.6%	$56,689	62.6%	$59,305	63.1%
Interest on securities and interest-bearing deposits in other financial institutions	12,410	12.7	11,363	12.6	14,776	15.7
Other interest income	502	0.5	1,555	1.7	2,863	3.1
Service charges on deposit accounts	10,339	10.6	9,195	10.2	9,222	9.8
Other income	9,339	9.6	11,718	12.9	7,765	8.3
Total revenues	$97,439	100.0%	$90,520	100.0%	$93,931	100.0%

Business Combination

On December 22, 2003, the Company entered into a definitive agreement to acquire Pacific Union Bank (PUB), a commercial bank with assets of approximately $1.1 billion, for an aggregate purchase price estimated at $295 million. Under the agreement, the Company will acquire all the outstanding shares of PUB for $164.5 million cash plus a quantity of Hanmi Financial shares specified in the agreement. The number of shares to be exchanged is subject to a collar set forth in the agreement and is based upon the volume weighted market value of Hanmi Financial shares for the five business days prior to the closing date, which is expected to take place in the second quarter of 2004.

The number of shares to be exchanged is as follows:

Hanmi Financial Share Price	Number of shares
$26.50 or more	5,773,672 shares
$25.01 $26.49	Shares with an aggregate market value of $153,002,325
$19.00 $25.00	6,120,093 shares
$17.51 $18.99	Shares with an aggregate market value of $116,281,767
$17.50 or less	6,644,672 shares

The acquisition has been structured to qualify as a tax-free exchange under the Federal Internal Revenue Code, which requires that aggregate cash consideration paid not exceed 58% of the transaction value.

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Notwithstanding the formula above, the amount of cash consideration to be paid will be reduced to a level that will allow the transaction to qualify as a tax-free exchange should the market price of Hanmi Financial stock drop to a level where this becomes necessary.

Financing for the cash portion of the transaction will be obtained through (1) a $75 million private placement of common stock to be completed concurrently with the closing of the acquisition, (2) the issuance of $60 million trust preferred securities, of which $30 million was issued January 8, 2004 and the remaining $30 million will be issued subsequently, and (3) funds obtained from the Company s cash and investment portfolio aggregating approximately $30 million.

The acquisition is subject to approval by the shareholders and regulators of both Hanmi Financial and PUB.

PUB commenced its operations in September, 1974 and is a California state-chartered commercial bank headquartered in the Koreatown area of Los Angeles, with twelve branches in Koreatown, downtown Los Angeles, Cerritos, Garden Grove, Gardena, Rowland Heights, San Francisco, San Jose and Torrance, California, as well as a loan production office in Seattle, Washington. It operates a general business bank, offering services similar to those offered by Hanmi Bank.

Market Area

Hanmi Bank historically has provided its banking services through its branch network, located primarily in the Koreatown area of Los Angeles, to a wide variety of small to medium-sized businesses. In recent years, it has expanded its service areas to Orange County, Santa Clara in Northern California, and San Diego in Southern California. Throughout Hanmi Bank s service area, competition is intense for both loans and deposits. While the market is dominated by a few nationwide banks with many offices operating over a wide geographic area, savings banks, thrift and loan associations, credit unions, mortgage companies, insurance companies, and other lending institutions, Hanmi Bank s primary competitors are relatively smaller community banks that focus their marketing efforts on Korean-American businesses in Hanmi Bank s service areas. Substantially all of the Company s assets are located in and substantially all of the company s revenues are derived from the state of California.

Lending Activities

Hanmi Bank originates loans for its own portfolio and for sale in the secondary market. Lending activities include commercial loans, Small Business Administration (SBA) guaranteed loans, commercial mortgage loans, real estate construction loans, residential mortgage loans, and consumer loans.

Commercial Loans

Hanmi Bank offers commercial loans for intermediate and short-term credit. Commercial loans may be unsecured, partially secured or fully secured. The majority of the origination of commercial loans is in Los Angeles County and Orange County. Loan maturities are normally twelve months to 60 months. Hanmi Bank requires a complete re-analysis before considering any extension of loans. The Bank finances primarily small and middle market businesses in a wide spectrum of industries. Short-term business loans generally are intended to finance current transactions and typically provide for periodic principal payments, with interest payable monthly. Term loans normally provide for floating interest rates, with monthly payments of both principal and interest. In general, it is the intent of Hanmi Bank to take collateral whenever possible, regardless of the loan purpose(s). Collateral may include liens on inventory, accounts receivable, fixtures and equipment and, in some cases, leasehold improvements and real estate. As a matter of policy, Hanmi Bank requires all principals of a business to be co-obligors on all loan instruments and all significant stockholders of corporations to execute a specific debt guaranty. All borrowers must demonstrate the ability to service and repay not only Hanmi Bank debt, but also all outstanding business debt, without liquidating the collateral, on the basis of historical earnings or reliable projections.

Commercial and industrial loans consist of credit lines for operating needs, loans for equipment purchases and working capital, and various other business purposes.

As compared to consumer lending, commercial lending entails significant additional risks. These loans typically involve larger loan balances and are generally dependent on the business s cash flow and, thus, may be subject to adverse conditions in the general economy or in a specific industry.

Small Business Administration Guaranteed Loans

Hanmi Bank originates loans qualifying for guarantees issued by the United States SBA, an independent agency of the Federal government. The SBA guarantees on such loans currently range from 75% to 85% of the principal and accrued interest. Under certain circumstances, the guarantee of principal and interest may be less than 75%. In general, the guaranteed percentage is less than 75% for loans over $1.3 million. As of December 31, 2003, Hanmi Bank had 19 SBA loans totaling $27.7 million that exceeded $1.3 million individually.

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Hanmi Bank typically requires that SBA loans be secured by business assets and by a first or second deed of trust on any available real property. SBA loans have terms ranging from seven to 25 years depending on the use of the proceeds. To qualify for a SBA loan, a borrower must demonstrate the capacity to service and repay the loan, without liquidating the collateral, on the basis of historical earnings or reliable projections.

Hanmi Bank generally sells to unrelated third parties a substantial amount of the guaranteed portion of the SBA guaranteed loans that it originates. When Hanmi Bank sells a SBA loan, it may be obligated to repurchase the loan (for a period of 90 days after the sale) if the loan fails to comply with certain representations and warranties given by the Bank. Hanmi Bank retains the obligation to service the SBA loans, for which it receives servicing fees. Those unsold portions of the SBA loans that remain owned by Hanmi Bank are included in its assets. As of December 31, 2003, Hanmi Bank had $101.1 million in SBA loans remaining on its balance sheet, and was servicing $83.2 million of sold SBA loans.

Loans Secured by Real Estate

Real estate lending involves risks associated with the potential decline in the value of the underlying real estate collateral and the cash flow from income producing properties. Declines in real estate values and cash flows can be caused by a number of factors, including adversity in general economic conditions, rising interest rates, changes in tax and other laws and regulations affecting the holding of real estate, environmental conditions, governmental and other use restrictions, development of competitive properties and increasing vacancy rates. Hanmi Bank s real estate dependence increases the risk of loss both in Hanmi Bank s loan portfolio and any holdings of other real estate owned when real estate values decline.

Commercial Mortgage Loans Hanmi Bank offers commercial real estate loans. These loans are collateralized by first deeds of trust. When real estate collateral is owner-occupied, to support the value of the real estate collateral, the bank obtains formal appraisals in accordance with applicable regulations. Hanmi Bank also considers the cash flow from the business. The majority of the properties securing these loans are located in Los Angeles and Orange counties.

Hanmi Bank s commercial real estate loans are principally secured by owner-occupied commercial and industrial buildings. Generally, these types of loans are made for a period of up to seven years, with monthly payments based upon a portion of the principal plus interest, and with a loan-to-value ratio of 65% or less, using an adjustable rate indexed to the prime rate appearing in the West Coast edition of *The Wall Street Journal* or Hanmi Bank s prime rate, as adjusted from time to time. Hanmi Bank also offers fixed-rate loans. Amortization schedules for commercial loans generally do not exceed 25 years.

Payments on loans secured by such properties are often dependent upon successful operation or management of the properties. Repayment of such loans may be subject to a greater extent to adverse conditions in the real estate market or the economy. Hanmi Bank seeks to minimize these risks in a variety of ways, including limiting the size of such loans and strictly scrutinizing the property securing the loan. When possible, Hanmi Bank also obtains corporate or individual guarantees from financially capable parties. Hanmi Bank s lending personnel inspect substantially all of the properties securing Hanmi Bank s real estate loans before loans are approved. Hanmi Bank requires title insurance insuring the status of its lien on all of the real estate secured loans when a first trust deed on the real estate is taken as collateral. Hanmi Bank also requires the borrower to maintain fire insurance, extended coverage casualty insurance and, if the property is in a flood zone, flood insurance, in an amount equal to the outstanding loan balance, subject to applicable laws that may limit the amount of hazard insurance a lender can require to replace such improvements. Hanmi Financial cannot assure that these procedures will protect against losses on loans secured by real property.

Real Estate Construction Loans Hanmi Bank finances the construction of residential, commercial and industrial properties within its market area. The future condition of the local economy could negatively affect the collateral values of such loans.

Hanmi Bank s construction loans typically have the following characteristics:

- maturities of two years or less;
- a floating rate of interest based on the Bank s base lending rate;
- minimum cash equity of 35% of project cost;
- advance of anticipated interest costs during construction; advance of fees;
- first lien position on the underlying real estate;

loan-to-value ratios generally not exceeding 65%; and

recourse against the borrower or a guarantor in the event of default.

Hanmi Bank does not typically commit to making permanent loans on the property unless the permanent loan is a government guaranteed loan. Hanmi Bank does not participate in joint ventures or take an equity interest in connection with its construction lending.

Construction loans involve additional risks compared to loans secured by existing improved real property. These include the following:

the uncertain value of the project prior to completion;

the inherent uncertainty in estimating construction costs, which are often beyond the control of the borrower;

construction delays and cost overruns;

possible difficulties encountered in connection with municipal or other governmental regulation during construction; and

the difficulty in accurately evaluating the market value of the completed project.

As a result of these uncertainties, construction lending often involves the disbursement of substantial funds with repayment dependent, in part, on the success of the ultimate project rather than the ability of the borrower or guarantor to repay principal and interest. If Hanmi Bank is forced to foreclose on a project prior to or at completion due to a default, there can be no assurance that Hanmi Bank will be able to recover all of the unpaid balance of, and accrued interest on, the loans as well as the related foreclosure and holding costs. In addition, Hanmi Bank may be required to fund additional amounts to complete a project and may have to hold the property for an indeterminable period of time. Hanmi Bank has underwriting procedures designed to identify what it believes to be acceptable levels of risk in construction lending. Among other things, qualified and bonded third parties are engaged to provide progress reports and recommendations for construction disbursements. No assurance can be given that these procedures will prevent losses arising from the risks described above.

Residential Mortgage Loans Hanmi Bank originates fixed rate and variable rate mortgage loans secured by one- to four-family properties with amortization schedules of 15 to 30 years and maturities of up to 30 years. The loan fees charged, interest rates and other provisions of Hanmi Bank s residential loans are determined by an analysis of Hanmi Bank s cost of funds, cost of origination, cost of servicing, risk factors and portfolio needs.

Consumer Loans

Consumer loans are extended for a variety of purposes. Most are for the purchase of automobiles. Other consumer loans include secured and unsecured personal loans, home improvement loans, equity lines, overdraft protection loans, and unsecured lines of credit. Management assesses the borrower s creditworthiness and ability to repay the debt through a review of credit history and ratings, verification of employment and other income, review of debt-to-income ratios and other measures of repayment ability. Although creditworthiness of the applicant is of primary importance, the underwriting process also includes a comparison of the value of the collateral, if any, to the proposed loan amount. An appraisal is obtained from a qualified real estate appraiser for substantially all loans secured by real estate. Most of Hanmi Bank s loans to individuals are repayable on an installment basis.

Any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment of the outstanding loan balance, because the collateral is more likely to suffer damage, loss or depreciation. The remaining deficiency often does not warrant further collection efforts against the borrower beyond obtaining a deficiency judgment. In addition, the collection of loans to individuals is dependent on the borrower s continuing financial stability, and thus is more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy. Furthermore, various Federal and state laws, including bankruptcy and insolvency laws, often limit the amount which the lender can recover on loans to individuals. Loans to individuals may also give rise to claims and defenses by a consumer borrower against the lender on these loans, and a borrower may be able to assert against any assignee of the note these claims and defenses that the borrower has against the seller of the underlying collateral.

Off-Balance Sheet Commitments

As part of its service to its small to medium-sized business customers, Hanmi Bank from time to time issues formal commitments and lines of credit. These commitments can be either secured or unsecured. They may be in the form of revolving lines of credit for seasonal working capital needs or may take the form of commercial letters of credit and standby letters of credit. Commercial letters of credit facilitate

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import trade. Standby letters of credit are conditional commitments issued by Hanmi Bank to guarantee the performance of a customer to a third party.

The following table shows the distribution of the Hanmi Bank s undisbursed loan commitments as of the dates indicated:

	December 31, 2003	December 31, 2002
	(dollars in thousands)	
Commitments to extend credit	$253,722	$197,257
Standby letters of credit	34,434	22,122
Commercial letters of credit	34,261	21,316
Guaranteed credit cards	3,801	3,465
Total	$326,218	$244,160

Lending Procedures and Loan Approval Process

Loan applications may be approved by the board of directors Loan Committee, or by Hanmi Bank s management or lending officers to the extent of their loan authority. Individual lending authority is granted to the Chief Executive Officer, the Chief Credit Officer, and branch and department managers. Loans for which direct and indirect borrower liability would exceed an individual s lending authority are referred to Hanmi Bank s Management Credit Committee and, for those in excess of the Management Credit Committee s approval limits, to the Loan Committee.

At December 31, 2003, Hanmi Bank s authorized legal lending limits were $22.6 million for unsecured loans plus an additional $15.1 million for specific secured loans. Legal lending limits are calculated in conformance with California law, which prohibits a bank from lending to any one individual or entity or its related interests an aggregate amount which exceeds 15% of primary capital plus the allowance for loan losses on an unsecured basis, plus an additional 10% on a secured basis. Hanmi Bank s primary capital plus allowance for loan losses at December 31, 2003 totaled $151.3 million.

The highest management lending authority at Hanmi Bank is the combined administrative lending authority for unsecured and secured lending of $3 million, which requires the approval and signatures of the Management Credit Committee, composed of the Chief Executive Officer and Chief Credit Officer. The next highest lending authority is $500,000 for the Chief Credit Officer. All other individual lending authority is substantially less.

Lending limits are authorized for the Management Credit Committee, Chief Executive Officer and other officers by the board of directors of Hanmi Bank. The Chief Credit Officer is responsible for evaluating the authority limits for individual credit officers and recommending lending limits for all other officers to the board of directors for approval.

Hanmi Bank seeks to mitigate the risks inherent in its loan portfolio by adhering to certain underwriting practices. The review of each loan application includes analysis of the applicant s prior credit history, income level, cash flow and financial condition, tax returns, cash flow projections, and the value of any collateral to secure the loan, based upon reports of independent appraisers and audits of accounts receivable or inventory pledged as security. In the case of real estate loans over a specified amount, the review of collateral value includes an appraisal report prepared by an independent Bank-approved appraiser.

Asset Quality

Nonperforming assets Nonperforming assets include nonperforming loans and other real estate owned.

Nonperforming loans Nonperforming loans are those that are not earning income, and (1) full payment of principal and interest is no longer anticipated, (2) principal or interest is 90 days or more delinquent, or (3) the maturity date has passed and payment in full has not been made.

Non-accrual loans Hanmi Bank generally places loans on non-accrual status when interest or principal payments become 90 days or more past due unless the outstanding principal and interest is adequately secured and, in the opinion of management, is deemed to be in the process of collection. When loans are placed on non-accrual status, accrued but unpaid interest is reversed against the current year s income, and interest income on non-accrual loans is recorded on a cash basis. Hanmi Bank may treat payments as interest income or return of principal depending upon management s opinion of the ultimate risk of loss on the individual loan. Cash payments are treated as interest income where management believes the remaining principal balance is fully collectible. Additionally, Hanmi Bank may place loans that are not 90 days past due on nonaccrual status, if management reasonably believes the borrower will not be able to comply with the contractual loan repayment terms and collection of principal or interest is in question.

Loans 90 days or more past due Hanmi Bank classifies a loan in this category when the borrower is more than 90 days late in making a payment of principal or interest.

Restructured loans These are loans on which interest accrues at a below market rate or upon which a portion of the principal has been forgiven so as to aid the borrower in the final repayment of the loan, with any interest previously accrued, but not yet collected, being reversed against current income. Interest is reported on a cash basis until the borrower s ability to service the restructured loan in accordance with its terms is established.

Other real estate owned (OREO) This category of non-performing assets consists of real estate to which Hanmi Bank has taken title by foreclosure or by taking a deed in lieu of foreclosure from the borrower. Before Hanmi Bank takes title to OREO, it generally obtains an environmental review.

Substandard and doubtful loans Hanmi Bank monitors all loans in the loan portfolio to identify problem credits. Additionally, as an integral part of the credit review process of Hanmi Bank, credit reviews are performed by inside loan review officers throughout the year to assure accuracy of documentation and the identification of problem credits. The State of California Department of Financial Institutions and the Federal Reserve Bank of San Francisco also review Hanmi Bank and its loans during an annual safety and soundness examination.

Hanmi Bank has three classifications for problem loans:

Substandard An asset is classified as substandard if it is inadequately protected by the current net worth and paying capacity of the borrower, or of the collateral pledged, if any. Credits in this category have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the possibility that Hanmi Bank will sustain some loss if the deficiencies are not corrected.

Doubtful An asset is classified as doubtful if it has all the weaknesses inherent in an asset classified substandard, and has the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The possibility of loss is extremely high, but because of important and reasonably specific pending factors which may work to the advantage and strengthening of the assets, its classification as an estimated loss is deferred until its more exact status may be determined.

Loss An asset is classified as a loss if it is considered uncollectible and of such little value that its continuance as a bankable asset is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be effected in the future. Any potential recovery is considered too small and the realization too distant in the future to justify retention as an asset on Hanmi Bank s books.

Another category, designated as special mention, is maintained for loans which do not currently expose Hanmi Bank to so significant a degree of risk as to warrant classification in a substandard, doubtful or loss category, but do possess credit deficiencies or potential weaknesses deserving management s close attention.

Hanmi Bank had $14.6 million and $18.6 million of substandard loans, and $ 4.8 million and $ 2.5 million of doubtful loans as of December 31, 2003 and 2002, respectively.

Impaired loans Hanmi Bank defines impaired loans, regardless of past-due status, as those on which principal and interest are not expected to be collected under the original contractual repayment terms. Hanmi Bank charges off an impaired loan at the time management believes the collection process has been exhausted. Hanmi Bank measures impaired loans based on the present value of future cash flows discounted at the loan s effective rate, and the loan s observable market price or the fair value of collateral if the loan is collateral-dependent. At December 31, 2003, $6.3 million of loans were impaired, most of which were also on nonaccrual status. The allowance for loan losses related to impaired loans was $3 million at December 31, 2003.

Except as disclosed above, as of December 31, 2003, management was not aware of any material credit problems of borrowers that would cause it to have serious doubts about the ability of a borrower to comply with the present loan repayment terms. However, no assurance can be given that current credit problems may exist that may not have been brought to the attention of management. See Allowance and Provision for Loan Losses.

Allowance and Provision for Loan Losses

Hanmi Bank maintains an allowance for loan losses at a level considered by management to be adequate to cover the inherent risks of loss associated with its loan portfolio under prevailing and anticipated economic conditions.

Hanmi Bank follows the Interagency Policy Statement on the Allowance for Loan and Lease Losses and analyzes the allowance for loan losses using the above factors on a monthly basis. In addition, as an integral part of the quarterly credit review process of Hanmi Bank, the allowance for loan losses is reviewed for adequacy. The California Department of Financial Institutions and/or the Federal Reserve Bank of San Francisco may require Hanmi Bank to recognize additions to the allowance for loan losses based upon their assessment of the information available to them at the time of their examinations.

Hanmi Bank s Chief Credit Officer reports quarterly to the Bank s board of directors and continuously reviews loan quality and loan classifications. Such reviews assist the board in reviewing the level of allowance for loan losses on a quarterly basis.

Deposits

The Company raises funds primarily through Hanmi Bank s network of fifteen branches. Hanmi Bank attracts deposits by offering a wide variety of transaction and term accounts and personalized customer service. Accounts offered include business and personal checking accounts, savings accounts, NOW accounts, money market accounts and certificates of deposit.

Website

The Company maintains an internet website at www.hanmi.com. The Company makes available free of charge on the website its Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K and any amendments thereto, as soon as reasonably practicable after the Company files such reports with the Securities and Exchange Commission. None of the information on or hyperlinked from our website is incorporated into this Annual Report on Form 10-K.

Employees

As of December 31, 2003, the Company has 372 full-time equivalent employees. Hanmi Bank s employees are not represented by a union or covered by a collective bargaining agreement.

Insurance

Hanmi Bank maintains financial institution bond and commercial insurance at levels deemed adequate by management to protect the Bank from certain damages.

Competition

The banking and financial services industry in California generally, and in Hanmi Bank s market areas specifically, are highly competitive. The increasingly competitive environment is a result primarily of changes in regulation, changes in technology and product delivery systems, and the pace of consolidation among financial service providers. Hanmi Bank competes for loans, deposits, and customers with other commercial banks, savings and loan associations, securities and brokerage companies, mortgage companies, insurance companies, finance companies, money market funds, credit unions, and other non-bank financial service providers. Some of these competitors are larger in total assets and capitalization, have greater access to capital markets and offer a broader range of financial services than the Bank. In addition, recent Federal legislation may have the effect of further increasing the pace of consolidation within the financial services industry. See Item 1. Business Supervision and Regulation.

Among the advantages which the major banks have over Hanmi Bank is their ability to finance extensive advertising campaigns and to allocate their investment assets to regions of highest yield and demand. Many of the major commercial banks operating in Hanmi Bank s service areas offer specific services (for instance, trust and international banking services) which are not offered directly by Hanmi Bank. By virtue of their greater total capitalization, these banks also have substantially higher lending limits than Hanmi Bank.

Banks generally, and Hanmi Bank in particular, face increasing competition for loans and deposits from non-bank financial intermediaries including credit unions, savings and loan associations, brokerage firms, thrift and loan companies, mortgage companies, insurance companies, and other financial and non-financial institutions. In addition, there is increased competition among banks, savings and loan institutions, and credit unions for the deposit and loan business of individuals.

The recent trend has been for other institutions, including brokerage firms, credit card companies and retail establishments to offer banking services to consumers, including money market funds with check access and cash advances on credit card accounts. In addition, other entities (both public and private) seeking to raise capital through the issuance and sale of debt or equity securities compete with banks in the acquisition of deposits. While the direction of recent legislation and economic developments seems to favor increased competition between different types of financial institutions for both deposits and loans, resulting in increased cost of funds to banks, it is not possible to predict the full impact these developments will have on commercial banking or Hanmi Bank.

Hanmi Bank s major competitors are relatively smaller community banks that focus their marketing efforts on Korean-American businesses in Hanmi Bank s service areas. Of the five such banks that are publicly traded, Hanmi Bank is the largest, with a loan portfolio that is approximately 35% larger than its nearest competitor s, and a deposits portfolio approximately 50% larger than its nearest competitor s.

These banks compete for loans primarily through the interest rates and fees they charge and the convenience and quality of service they provide to borrowers. The principal basis of competition for deposits is the interest rate paid.

In order to compete with other financial institutions in its service area, Hanmi Bank relies principally upon local promotional activity including:

advertising in the local media;

personal contacts by its directors, officers, employees and stockholders;

direct mail; and

specialized services.

Hanmi Bank s promotional activities emphasize the advantages of dealing with a locally owned and headquartered institution attuned to the particular needs of the community. For customers whose loan demands exceed Hanmi Bank s lending limits, the bank attempts to arrange for a loan on a participation basis with other financial institutions.

Economic Conditions, Government Policies, Legislation, and Regulation

Hanmi Financial s profitability, like most financial institutions , is primarily dependent on interest rate differentials. In general, the difference between the interest rates paid by the Bank on interest-bearing liabilities, such as deposits and other borrowings, and the interest rates received by the Bank on its interest-earning assets, such as loans extended to its clients and securities held in its investment portfolio, comprise the major portion of Hanmi Financial s earnings. These rates are highly sensitive to many factors that are beyond the control of Hanmi Financial and the Bank, such as inflation, recession and unemployment, and the impact which future changes in domestic and foreign economic conditions might have on Hanmi Financial and the Bank cannot be predicted.

The business of Hanmi Financial and the Bank is also influenced by the monetary and fiscal policies of the Federal government and the policies of regulatory agencies, particularly the Board of Governors of the Federal Reserve System (the FRB). The FRB implements national monetary policies (with objectives such as curbing inflation and combating recession) through its open-market operations in U.S. government securities, by adjusting the required level of reserves for depository institutions subject to its reserve requirements, and by varying the target Federal funds and discount rates applicable to borrowings by depository institutions. The actions of the FRB in these areas influence the growth of bank loans, investments, and deposits and also affect interest rates earned on interest-earning assets and paid on interest-bearing liabilities. The nature and impact on Hanmi Financial and the Bank of any future changes in monetary and fiscal policies cannot be predicted.

From time to time, legislation, as well as regulations, are enacted which have the effect of increasing the cost of doing business, limiting or expanding permissible activities, or affecting the competitive balance between banks and other financial services providers. Proposals to change the laws and regulations governing the operations and taxation of banks, bank holding companies, and other financial institutions and financial services providers are frequently made in the U.S. Congress, in the state legislatures, and before various regulatory agencies. This legislation may change banking statutes and the operating environment of Hanmi Financial and its subsidiaries in substantial and unpredictable ways. If enacted, such legislation could increase or decrease the cost of doing business, limit or expand permissible activities or affect the competitive balance among banks, savings associations, credit unions, and other financial institutions. Hanmi Financial cannot predict whether any of this potential legislation will be enacted, and if enacted, the effect that it, or any implementing regulations, would have on the financial condition or results of operations of Hanmi Financial or any of its subsidiaries. See Item 1. Business Supervision and Regulation.

Supervision and Regulation

General

Bank holding companies and banks are extensively regulated under both federal and state law. This regulation is intended primarily for the protection of depositors and the deposit insurance fund and not for the benefit of stockholders of Hanmi Financial. Set forth below is a summary description of the material laws and regulations which relate to the operations of Hanmi Financial and the Bank**.** The description is qualified in its entirety by reference to the applicable laws and regulations.

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Hanmi Financial

Hanmi Financial is a registered bank holding company, and subject to regulation under the Bank Holding Company Act of 1956, as amended (the BHCA). Hanmi Financial is required to file with the FRB periodic reports and such additional information as the FRB may require pursuant to the BHCA. The FRB may conduct examinations of Hanmi Financial and its subsidiaries.

The FRB may require that Hanmi Financial terminate an activity or terminate control of or liquidate or divest certain subsidiaries or affiliates when the FRB believes the activity or the control of the subsidiary or affiliate constitutes a significant risk to the financial safety, soundness or stability of any of its banking subsidiaries. The FRB also has the authority to regulate provisions of certain bank holding company debt, including the authority to impose interest ceilings and reserve requirements on such debt. Under certain circumstances, Hanmi Financial must file written notice and obtain approval from the FRB prior to purchasing or redeeming its equity securities.

Further, Hanmi Financial is required by the FRB to maintain certain levels of capital. See Capital Standards.

Hanmi Financial is prohibited by the BHCA, except in certain statutorily prescribed instances, from acquiring direct or indirect ownership or control of more than 5% of the outstanding voting shares of any company that is not a bank or bank holding company and from engaging directly or indirectly in activities other than those of banking, managing or controlling banks, or furnishing services to its subsidiaries. However, Hanmi Financial, subject to the prior approval of the FRB, may engage in any, or acquire shares of companies engaged in, activities that are deemed by the FRB to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. In addition, without the prior approval of the FRB, and as described below for bank holding companies which have elected to become financial holding companies, Hanmi Financial may acquire companies engaged in activities that are financial in nature or incidental to activities that are financial in nature, as determined by the FRB. Prior approval of the FRB is required for the merger or consolidation of Hanmi Financial and another bank holding company.

Under FRB regulations, a bank holding company is required to serve as a source of financial and managerial strength to its subsidiary banks and may not conduct its operations in an unsafe or unsound manner. In addition, it is the FRB s policy that a bank holding company should stand ready to use available resources to provide adequate capital funds to its subsidiary banks during periods of financial stress or adversity and should maintain the financial flexibility and capital-raising capacity to obtain additional resources for assisting its subsidiary banks. A bank holding company s failure to meet its obligations to serve as a source of strength to its subsidiary banks will generally be considered by the FRB to be an unsafe and unsound banking practice or a violation of the FRB s regulations or both.

Hanmi Financial also is a bank holding company within the meaning of Section 3700 of the California Financial Code. As such, Hanmi Financial and its subsidiaries are subject to examination by, and may be required to file reports with, the California Department of Financial Institutions.

Hanmi Financial s securities are registered with the Securities and Exchange Commission under the Securities Exchange Act of 1934, as amended (the Exchange Act). As such, Hanmi Financial is subject to the information, proxy solicitation, corporate governance, insider trading, and other requirements and restrictions of the Exchange Act.

Financial Holding Companies

Bank holding companies that elect to become a financial holding company, like Hanmi Financial, which became a financial holding company on March 14, 2000, may affiliate with securities firms and insurance companies and engage in other activities that are financial in nature or are incidental or complementary to activities that are financial in nature. Financial in nature activities include:

- securities underwriting;
- dealing and market making;
- sponsoring mutual funds and investment companies;
- insurance underwriting and agency;
- merchant banking; and
- activities that the FRB, in consultation with the Secretary of the Treasury, determines from time to time to be so closely related to banking or managing or controlling banks as to be a proper incident thereto.

Prior to filing a declaration of its election to become a financial holding company, all of the bank holding company s depository institution subsidiaries must be well capitalized, well managed, and, except in limited circumstances, in satisfactory compliance with the Community Reinvestment Act.

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Failure to sustain compliance with the financial holding company election requirements or correct any noncompliance within a fixed time period could lead to divestiture of subsidiary banks or require all activities of such company to conform to those permissible for a bank holding company. No FRB approval is required for a financial holding company to acquire a company (other than a bank holding company, bank or savings association) engaged in those activities that are financial in nature or incidental to activities determined by FRB that are financial in nature, including but not limited to**:**

- lending, exchanging, transferring, investing for others, or safeguarding financial assets other than money or securities;
- providing any devise or other instrumentality for transferring money or other financial assets; or
- arranging, effecting or facilitating financial transactions for the account of third parties.

A bank holding company that is not also a financial holding company can only engage in banking and such other activities determined by the FRB to be so closely related to banking or managing or controlling banks as to be a proper incident thereto.

The Bank

As a California chartered member bank, the Bank is subject to primary supervision, periodic examination, and regulation by the California Commissioner of Financial Institutions (Commissioner) and the Federal Reserve Board, and, as insurer of the Bank s deposits, by the Federal Deposit Insurance Corporation (the FDIC). If, as a result of an examination of the Bank, the FRB should determine that the financial condition, capital resources, asset quality, earnings prospects, management, liquidity, or other aspects of the Bank s operations are unsatisfactory or that the Bank or its management is violating or has violated any law or regulation, various remedies are available to the FRB. Such remedies include the power to enjoin unsafe or unsound practices, to require affirmative action to correct any conditions resulting from any violation or practice, to issue an administrative order that can be judicially enforced, to direct an increase in capital, to restrict the growth of the Bank, to assess civil monetary penalties, to remove officers or directors, and ultimately to terminate the Bank s deposit insurance, which for a California chartered bank would result in a revocation of the Bank s charter. The Commissioner separately has many of the same remedial powers.

The Sarbanes-Oxley Act of 2002

On July 30, 2002, President Bush signed into law the Sarbanes-Oxley Act of 2002. This new legislation addresses accounting oversight and corporate governance matters, including:

- increased penalties for financial crimes;
- expanded disclosure of corporate operations and certification as to the effectiveness of disclosure controls;
- enhanced controls on and reporting of insider trading; and
- annual management assessment of internal controls over financial reporting and their effectiveness.

Hanmi Financial has addressed and continues to address all issues posed by past, current and proposed regulations relating to the Sarbanes-Oxley Act, including forming an Audit Committee and a Nominating and Corporate Governance Committee (and establishing their respective charters), updating our Corporate Governance Guidelines and Code of Business Conduct and Ethics, and meeting NASDAQ s and the SEC s procedural and disclosure requirements.

USA Patriot Act of 2001

On October 26, 2001, President Bush signed the USA Patriot Act of 2001. The Patriot Act is intended to strengthen the U.S. law enforcement and the intelligence communities abilities to work cohesively to combat terrorism on a variety of fronts. The potential impact of the Patriot Act on financial institutions of all kinds is significant and wide ranging. The Patriot Act contains sweeping anti-money laundering and financial transparency laws and requires various regulations, including:

- due diligence requirements for financial institutions that administer, maintain, or manage private bank accounts or correspondent accounts for non-U.S. persons;
- standards for verifying customer identification at account opening;
- rules to promote cooperation among financial institutions, regulators, and law enforcement entities in identifying parties that may be involved in terrorism or money laundering; and

reports by non-financial trades and businesses filed with the Treasury Department s Financial Crimes Enforcement Network for transactions exceeding $10,000, and filing of suspicious activities reports by securities brokers and dealers if they believe a customer may be violating U.S. laws and regulations.

To implement the Patriot Act, the U.S. Treasury Department published the Customer Identification Program regulation, which became effective October 1, 2003. The regulation requires financial institutions to establish written policy and procedures for:

verifying the identity of any person seeking to open an account, to the extent reasonable and practicable;

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maintaining records of the information used to verify the person s identity; and

determining whether the person appears on a list issued by the Federal government of known or suspected terrorists or terrorist organizations. As of the date of this Report, the Federal government had yet to publish such a list.

Account is defined as a formal banking or business relationship established to provide ongoing services, dealings, or other financial transactions. The regulation did not require any significant additional customer identification procedures beyond those already practiced by the Bank.

Financial Services Modernization Legislation

General. On November 12, 1999, President Clinton signed into law the Gramm-Leach-Bliley Act of 1999 (the GLBA). The general effect of the law is to establish a comprehensive framework to permit affiliations among commercial banks, insurance companies, securities firms, and other financial service providers by revising and expanding the BHCA framework to permit a holding company system to engage in a full range of financial activities through a new entity known as a Financial Holding Company.

The law also:

broadened the activities that may be conducted by national banks, banking subsidiaries of bank holding companies, and their financial subsidiaries;

provided an enhanced framework for protecting the privacy of consumer information;

adopted a number of provisions related to the capitalization, membership, corporate governance, and other measures designed to modernize the Federal Home Loan Bank system;

modified the laws governing the implementation of the Community Reinvestment Act; and

addressed a variety of other legal and regulatory issues affecting both day-to-day operations and long-term activities of financial institutions.

Hanmi Financial and the Bank do not believe that the GLBA will have a material adverse effect on operations in the near-term. However, to the extent that it permits banks, securities firms, and insurance companies to affiliate, the financial services industry may experience further consolidation. The GLBA is intended to grant to community banks certain powers as a matter of right that larger institutions have accumulated on an ad hoc basis. Nevertheless, this act may have the result of increasing the amount of competition that Hanmi Financial and the Bank face from larger institutions and other types of companies offering financial products, many of which may have substantially more financial resources than Hanmi Financial and the Bank.

Expanded Bank Activities. The GLBA also permits national banks to engage in expanded activities through the formation of financial subsidiaries. A national bank may have a subsidiary engaged in any activity authorized for national banks directly or any financial activity, except for insurance underwriting, insurance investments, real estate investment or development, or merchant banking, which may only be conducted through a subsidiary of a financial holding company. Financial activities include all activities permitted under new sections of the BHCA or permitted by regulation.

A national bank seeking to have a financial subsidiary, and each of its depository institution affiliates, must be well-capitalized, well-managed and in satisfactory compliance with the Community Reinvestment Act. The total assets of all financial subsidiaries may not exceed the lesser of 45% of a bank s total assets, or $50 billion. A national bank must exclude from its assets and equity all equity investments, including retained earnings, in a financial subsidiary. The assets of the subsidiary may not be consolidated with the bank s assets. The bank must also have policies and procedures to assess financial subsidiary risk and protect the bank from such risks and potential liabilities.

The GLBA also includes a new section of the Federal Deposit Insurance Act governing subsidiaries of state banks that engage in activities as principal that would only be permissible for a national bank to conduct in a financial subsidiary. It expressly preserves the ability of a state bank to retain all existing subsidiaries. Because California permits commercial banks chartered by the state to engage in any activity permissible for national banks, the Bank will be permitted to form subsidiaries to engage in the activities authorized by the GLBA, to the same extent as a national bank. In order to form a financial subsidiary, the Bank must be well-capitalized, and the Bank would be subject to the same capital deduction, risk management and affiliate transaction rules as applicable to national banks.

Dividends and Other Transfers of Funds

Dividends from the Bank constitute the principal source of income to Hanmi Financial. Hanmi Financial is a legal entity separate and distinct from the Bank. The Bank is subject to various statutory and regulatory restrictions on its ability to pay dividends to Hanmi Financial. Under such restrictions, the amount available for payment of dividends to Hanmi Financial by the Bank totaled $17 million at

December 31, 2003. In addition, the Bank s regulators have the authority to prohibit the Bank from paying dividends, depending upon the Bank s financial condition, if such payment is deemed to constitute an unsafe or unsound practice.

Transactions with Affiliates

The Bank is subject to certain restrictions imposed by Federal law on any extensions of credit to, or the issuance of a guarantee or letter of credit on behalf of, Hanmi Financial or other affiliates, the purchase of, or investments in, stock or other securities thereof, the taking of such securities as collateral for loans, and the purchase of assets of Hanmi Financial or other affiliates. Such restrictions prevent Hanmi Financial and such other affiliates from borrowing from the Bank unless the loans are secured by marketable obligations of designated amounts. Further, such secured loans and investments by the Bank to or in Hanmi Financial or to or in any other affiliate are limited, individually, to 10% of the Bank s capital and surplus (as defined by Federal regulations), and such secured loans and investments are limited, in the aggregate, to 20% of the Bank s capital and surplus (as defined by Federal regulations). California law also imposes certain restrictions with respect to transactions involving Hanmi Financial and other controlling persons of the Bank. Additional restrictions on transactions with affiliates may be imposed on the Bank under the prompt corrective action provisions of Federal law. See Item 1. Business Supervision and Regulation Prompt Corrective Action and Other Enforcement Mechanisms.

Capital Standards

The Federal banking agencies have adopted risk-based minimum capital guidelines intended to provide a measure of capital that reflects the degree of risk associated with a banking organization s operations for both transactions reported on the balance sheet as assets and transactions which are recorded as off-balance sheet items. Under these guidelines, nominal dollar amounts of assets and credit equivalent amounts of off-balance sheet items are multiplied by one of several risk adjustment percentages, which range from 0% for assets with low credit risk to 100% for assets with relatively high credit risk.

The guidelines require a minimum ratio of qualifying total capital to risk-adjusted assets of 8% and a minimum ratio of Tier 1 capital to risk-adjusted assets of 4%. In addition to the risk-based guidelines, Federal banking regulators require banking organizations to maintain a minimum amount of Tier 1 capital to total assets, referred to as the leverage ratio. For a banking organization rated in the highest of the five categories used by regulators to rate banking organizations, the minimum leverage ratio of Tier 1 capital to total assets must be 3%. In addition to these uniform risk-based capital guidelines and leverage ratios that apply across the industry, the regulators have the discretion to set individual minimum capital requirements for specific institutions at rates significantly above the minimum guidelines and ratios.

Prompt Corrective Action and Other Enforcement Mechanisms

Federal banking agencies possess broad powers to take corrective and other supervisory action to resolve the problems of insured depository institutions, including but not limited to those institutions that fall below one or more prescribed minimum capital ratios. Each Federal banking agency has promulgated regulations defining the following five categories in which an insured depository institution will be placed, based on its capital ratios: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. At December 31, 2003, the Bank and Hanmi Financial had capital ratios that exceeded the required ratios for classification as well capitalized.

An institution that, based upon its capital levels, is classified as well capitalized, adequately capitalized, or undercapitalized may be treated as though it were in the next lower capital category if the appropriate Federal banking agency, after notice and opportunity for hearing, determines that an unsafe or unsound condition or an unsafe or unsound practice warrants such treatment. At each successive lower capital category, an insured depository institution is subject to more restrictions. The Federal banking agencies, however, may not treat a significantly undercapitalized institution as critically undercapitalized unless its capital ratio actually warrants such treatment.

In addition to measures taken under the prompt corrective action provisions, commercial banking organizations may be subject to potential enforcement actions by the Federal regulators for unsafe or unsound practices in conducting their businesses or for violations of any law, rule, regulation, or condition imposed in writing by the agency or written agreement with the agency. Finally, pursuant to an interagency agreement, the FDIC can examine any institution that has a substandard regulatory examination score or is considered undercapitalized without the express permission of the institution s primary regulator.

Safety and Soundness Standards

The Federal banking agencies have adopted guidelines designed to assist the Federal banking agencies in identifying and addressing potential safety and soundness concerns before capital becomes impaired. The guidelines set forth operational and managerial standards relating to (i) internal controls, information systems and internal audit systems, (ii) loan documentation, (iii) credit underwriting, (iv) asset growth, (v) earnings, and (vi) compensation, fees and benefits. In addition, the Federal banking agencies have

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also adopted safety and soundness guidelines with respect to asset quality and earnings standards. These guidelines provide six standards for establishing and maintaining a system to identify problem assets and prevent those assets from deteriorating. Under these standards, an insured depository institution should (i) conduct periodic asset quality reviews to identify problem assets, (ii) estimate the inherent losses in problem assets and establish reserves that are sufficient to absorb estimated losses, (iii) compare problem asset totals to capital, (iv) take appropriate corrective action to resolve problem assets, (v) consider the size and potential risks of material asset concentrations, and (vi) provide periodic asset quality reports with adequate information for management and the board of directors to assess the level of asset risk. These new guidelines also set forth standards for evaluating and monitoring earnings and for ensuring that earnings are sufficient for the maintenance of adequate capital and reserves.

Premiums for Deposit Insurance

Through the Bank Insurance Fund (BIF), the FDIC insures the deposits of the Bank up to prescribed limits for each depositor. The amount of FDIC assessments paid by each BIF member institution is based on its relative risk of default as measured by regulatory capital ratios and other factors. Specifically, the assessment rate is based on the institution s capitalization risk category and supervisory subgroup category. An institution s capitalization risk category is based on the FDIC s determination of whether the institution is well capitalized, adequately capitalized or less than adequately capitalized. An institution s supervisory subgroup category is based on the FDIC s assessment of the financial condition of the institution and the probability that FDIC intervention or other corrective action will be required.

The assessment rate currently ranges from zero to 27 cents per $100 of domestic deposits. The FDIC may increase or decrease the assessment rate schedule on a semi-annual basis. Due to continued growth in deposits and some recent bank failures, the BIF is nearing its minimum ratio of 1.25% of insured deposits as mandated by law. If the ratio drops below 1.25%, it is likely the FDIC will be required to assess premiums on all banks for the first time since 1996. Any increase in assessments or the assessment rate could have a material adverse effect on Hanmi Financial s earnings, depending on the amount of the increase.

The FDIC is authorized to terminate a depository institution s deposit insurance upon a finding by the FDIC that the institution s financial condition is unsafe or unsound or that the institution has engaged in unsafe or unsound practices or has violated any applicable rule, regulation, order or condition enacted or imposed by the institution s regulatory agency. The termination of deposit insurance for Hanmi Financial s subsidiary depository institution could have a material adverse effect on Hanmi Financial s earnings, depending on the collective size of the particular institutions involved.

All FDIC-insured depository institutions must pay an annual assessment to provide funds for the payment of interest on bonds issued by the Financing Corporation, a Federal corporation chartered under the authority of the Federal Housing Finance Board. The bonds, commonly referred to as FICO bonds, were issued to capitalize the Federal Savings and Loan Insurance Corporation. The FDIC established the FICO assessment rates effective for the fourth quarter of 2003 at approximately $0.0154 per $100 of assessable deposits. The FICO assessments are adjusted quarterly to reflect changes in the assessment bases of the FDIC s insurance funds and do not vary depending on a depository institution s capitalization or supervisory evaluations.

Interstate Banking and Branching

The BHCA permits bank holding companies from any state to acquire banks and bank holding companies located in any other state, subject to certain conditions, including certain nationwide and state-imposed concentration limits. The Bank has the ability, subject to certain restrictions, to acquire by acquisition or merger branches outside its home state. The establishment of new interstate branches is also possible in those states with laws that expressly permit it. Interstate branches are subject to certain laws of the states in which they are located. Competition may increase further as banks branch across state lines and enter new markets.

Community Reinvestment Act and Fair Lending Developments

The Bank is subject to certain fair lending requirements and reporting obligations involving residential mortgage lending operations and Community Reinvestment Act (CRA) activities. The CRA generally requires the Federal banking agencies to evaluate the record of a financial institution in meeting the credit needs of its local communities, including low- and moderate-income neighborhoods. A bank may be subject to substantial penalties and corrective measures for a violation of certain fair lending laws. The Federal banking agencies may take compliance with such laws and CRA obligations into account when regulating and supervising other activities. Furthermore, financial institutions are subject to annual reporting and public disclosure requirements for certain written agreements that are entered into between insured depository institutions or their affiliates and nongovernmental entities or persons that are made pursuant to, or in connection with, the fulfillment of the CRA.

A bank s compliance with its CRA obligations is a performance-based evaluation system which bases CRA ratings on an institution s lending, service and investment performance. When a bank holding company applies for approval to acquire a bank or other

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bank holding company, the FRB will review the assessment of each subsidiary bank of the applicant bank holding company, and such records may be the basis for denying the application. Based on an examination conducted by FRB, the Bank received an **Outstanding** rating.

Federal Reserve System

The Federal Reserve Board requires all depository institutions to maintain non-interest bearing reserves at specified levels against their transaction accounts (primarily checking, NOW, and Super NOW checking accounts) and non-personal time deposits. At December 31, 2003, the Bank was in compliance with these requirements.

Taxation

General. We report income and expenses using the accrual method on a calendar year basis and are subject to Federal income tax under the Internal Revenue Code of 1986, as amended, generally in the same manner as other corporations.

State. The Company s operations are concentrated in the state of California, which imposes an income tax on financial institutions.

In 2002, the Bank formed a real estate investment trust to hold certain real estate-related assets of the Bank and provide a vehicle for raising capital. In 2002 and throughout the first three quarters of 2003, the Bank recognized certain tax benefits arising from this structure. In the fourth quarter of 2003, in response to newly enacted California legislation, the Bank reversed all such benefits recognized in 2003. The Company believes it has established adequate valuation allowances to account for any future inability to realize income tax benefits recognized by the Bank.

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ITEM 2. PROPERTIES

Hanmi Financial s principal office is located at 3660 Wilshire Boulevard, Penthouse Suite A, Los Angeles, California. The office is leased pursuant to a 5-year term lease, which expires on November 30, 2008.

The following table sets forth information about Hanmi Bank s banking offices, all of which are located in California:

Location	Type of Office	Owned/Leased
3660 Wilshire Boulevard, Suite 103, Los Angeles	Main Branch(1)	Leased
3737 West Olympic Boulevard, Los Angeles	Branch(2)	Owned
2610 West Olympic Boulevard, Los Angeles	Branch	Leased
950 South Los Angeles Street, Los Angeles	Branch	Leased
9820 Garden Grove Boulevard, Garden Grove	Branch	Owned
120 South Western Avenue, Los Angeles	Branch	Leased
3250 West Olympic Boulevard, Suite 200, Los Angeles	Branch	Leased
18720 East Colima Road, Rowland Heights	Branch	Leased
11754 East Artesia Boulevard, Artesia	Branch	Leased
4637 Convoy Street, Suite 101, San Diego	Branch	Leased
2001 West Redondo Beach Boulevard, Gardena	Branch	Leased
14474 Culver Drive, Suite D, Irvine	Branch	Leased
2370 Crenshaw Boulevard, Suite H, Torrance		