

NARA BANCORP INC  
Form 10-K/A  
April 08, 2004

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

**FORM 10-K/A**

**(AMENDMENT NO. 1)**

**þ 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**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File # 000-50245

**NARA BANCORP, INC.**

**(Exact name of Registrant as specified in its charter)**

**Delaware**  
(State or other jurisdiction  
of incorporation or organization)

**95-4849715**  
(I.R.S. Employer  
Identification Number)

**3701 Wilshire Boulevard**  
**Suite 220**  
**Los Angeles, California 90010**  
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: **(213) 639-1700**

Securities registered pursuant to Section 12(b) of the Act: **None**

Securities registered pursuant to Section 12(g) of the Act:

**Common Stock, par value \$0.001 per share**

(Title of Class)

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. x Yes o No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of 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 this Form 10-K or any amendment to this Form 10-K. o

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

The aggregate market value of the Common Stock held by non-affiliates of the Registrant based upon the closing sale price of the Common Stock on June 30, 2003, as reported on the Nasdaq National Market, was approximately \$202,103,930.

Number of shares outstanding of the Registrant s Common Stock, as of March 11, 2004: 11,580,089

Portions of the Definitive Proxy Statement that will be filed in connection with the registrant s Annual Meeting of Stockholders to be held on May 13, 2004 are incorporated by reference into Part III of this Form 10-K.

**Table of Contents****EXPLANATORY NOTE**

This Annual Report on Form 10-K/A amends our previously filed Annual Report on Form 10-K for the year ended December 31, 2003. All references in this amendment to this Annual Report on Form 10-K or the Annual Report on Form 10-K for the year ended December 31, 2003 shall refer to this amendment. Readers should note that the only change made in this amendment was to correct a clerical error that appeared on page F-6 of the original filing. On page F-6, a correction was made to the balance, as of December 31, 2003, of Capital Surplus to change it from \$430,547,760 to \$43,057,760, which reflects the amount shown on the consolidated statement of financial condition on page F-2. All other information contained in the original filing remains unchanged. For the convenience of the reader, we have included in this amendment our entire Annual Report on Form 10-K, as amended hereby.

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**PART I**

**Forward-Looking Information**

*Certain matters discussed in this Annual Report on Form 10-K may constitute forward-looking statements under Section 27A of the Securities Act of 1933, as amended (the Securities Act ), and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act ). These statements may involve risks and uncertainties. These forward-looking statements relate to, among other things, expectations of the business environment in which we operate, projections of future performance, perceived opportunities in the market and statements regarding our mission and vision. Forward-looking statements include, but are not limited to, statements preceded by, followed by or that include the word will, believes, expects, anticipates, intends, plans, estimates or similar expressions. Our actual results, performance or achievements may differ significantly from the results, performance or achievements expressed or implied in such forward-looking statements. For a detailed discussion of the factors that might cause such a difference, see Item 1. Factors That May Impact Our Business or the Value of Our Stock.*

*Factors that might affect forward-looking statements include, among other things:*

*the demand for our products;*

*actions taken by ours competitors;*

*changes in the FDIC insurance premium;*

*tax rate changes, new tax laws and revised tax law interpretations;*

*adverse changes occurring in the securities markets;*

*inflation and changes in prevailing interest rates that reduce our margins or the fair market value of the financial instruments that we hold;*

*economic or business conditions, either nationally or in our market areas, that are worse than we anticipated;*

*legislative or regulatory changes that adversely affect our business;*

*the timing, impact and other uncertainties of our asset sales or securitizations;*

*technology changes that are more difficult or expensive than we expect;*

*increases in delinquencies and defaults by our borrowers and other loan delinquencies;*

*increases to our provision for losses on loans and leases due to loan quality/performance deterioration;*

*our inability to sustain or improve the performance of our subsidiaries;*

*our inability to achieve our financial goals and strategic plans, including any financial goals related both to contemplated and consummated assets sales or acquisitions;*

*the outcome of lawsuits or regulatory disputes; and*

*credit and other risks of lending, leasing and investment activities.*

*As a result of the above, we cannot assure you that our future results of operations or financial conditions or any other matters will be consistent with those presented in any forward-looking statements. Accordingly, we caution you not to rely on these forward-looking statements. We do not undertake, and specifically disclaim any obligation, to update these forward-looking statements, which speak only as of the date made.*

**Table of Contents****Item 1. BUSINESS****General**

Nara Bancorp, Inc. and subsidiaries ( Nara Bancorp, on a parent-only basis, and we or our on a consolidated basis) is a bank holding company headquartered in Los Angeles, California. We offer a full range of commercial banking and consumer financial services through our wholly owned subsidiary, Nara Bank, N.A., a national bank (the Bank or Nara Bank ). During the first quarter of 2001, Nara Bancorp became a bank holding company regulated by the Board of Governors of the Federal Reserve System (the Federal Reserve Board ) as part of the reorganization of Nara Bank into a holding company structure. Nara Bank was organized in 1989 and Nara Bancorp was incorporated under the laws of the State of Delaware in 2000. Nara Bancorp's principal business is to serve as a holding company for Nara Bank and other bank-related subsidiaries, which Nara Bancorp may establish or acquire. Our headquarters are located at 3701 Wilshire Boulevard, Suite 220, Los Angeles, California 90010, and our telephone number at that address is (213) 639-1700. Nara Bank's deposits are insured by the Bank Insurance Fund ( BIF ), as administered by the Federal Deposit Insurance Corporation ( FDIC ), up to applicable limits. Nara Bank is a member of the Federal Reserve System.

Nara Bancorp currently has five special-purpose subsidiaries that were formed for capital-raising transactions; Nara Capital Trust I, Nara Statutory Trust II, Nara Capital Trust III, Nara Statutory Trust IV, and Nara Statutory Trust V. In March 2000 and 2001, Nara Bancorp established Nara Capital Trust I ( Trust I ) and Nara Statutory Trust II (Trust II ), respectively. The Trust I and Trust II are statutory business trusts. The Trust I issued \$10.0 million in trust preferred securities bearing a fixed rate of 10.18%. The interest is payable semi-annually for a 30 year term. Trust II issued \$8.0 million in trust preferred securities. In both issuances, we participated as part of a pooled offering with several other financial institutions. The interest rate is adjusted quarterly on March 26, June 26, September 26 and December 26 during its 30-year term based on the 3-month LIBOR plus 3.60 % and is paid quarterly. In June 2003, Nara Bancorp established Nara Capital Trust III ( Trust III ), and in December of 2003 Nara Bancorp established Nara Statutory Trust IV ( Trust IV ) and Nara Statutory Trust V ( Trust V ), respectively. In three separate private placement transactions, the Trusts issued \$5.0 million, \$5.0 million and \$10.0 million with quarterly adjustable rates based on the 3-month LIBLOR plus 3.15%, 2.85 %, and 2.95%, respectively, and interests are payable semi-annually for a 30 year term. The statutory business trusts were established as part of our capital planning to compliment our support future growth.

With the adoption of FIN No. 46, Bancorp deconsolidated the five grantor trusts as of December 31, 2003. As a result, the junior subordinated debentures issued by Bancorp to the grantor trusts, totaling \$39.3 million, are reflected in our consolidated balance sheet in the liabilities section at December 31, 2003, under the caption as junior subordinated debentures. We record interest expense on the corresponding junior subordinated debentures in the consolidated statements of income. The Company also recorded \$2.0 million in other assets in the consolidated statement of financial condition at December 31, 2003 for the common capital securities issued by the issuer trusts.

Nara Bank, opened for business on June 16, 1989 under the name United Citizens National Bank as a national banking association. The institution's name was changed to Nara Bank, National Association on January 27, 1994. Nara Bank is headquartered at 3701 Wilshire Boulevard, Suite 220, Los Angeles, California 90010. Nara Bank primarily focuses its business in Korean communities in California and in the greater New York City metropolitan area.

On October 13, 1998, the Bank purchased the Flushing branch of Korea Exchange Bank in New York. The Bank acquired approximately \$10.0 million in net loans and assumed approximately \$21.0 million in deposits.



On February 28, 2000, the Bank acquired Korea First Bank of New York for a purchase price of approximately \$8.7 million. Korea First Bank of New York had three branches in New York area: one in Manhattan, one in Jackson Heights, and one in Flushing. The Bank acquired approximately \$30.5 million in net loans and assumed approximately \$67.8 million in deposits.

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On November 29, 2002, the Bank purchased certain loans and deposits from the Industrial Bank of New York. Assumed deposits totaled approximately \$49.6 million and the loans purchased totaled approximately \$1.3 million.

On August 25, 2003, the Bank purchased Asiana Bank at a price of \$8.0 million in Nara Bancorp stock. Nara Bancorp issued approximately 426,000 shares for this acquisition. Asiana Bank had two branches in Northern California: one branch in Silicon Valley and one branch in Oakland. Both branches have been closed and consolidated into the Bank's existing branch in both locations. The Bank acquired approximately \$22.4 million in net loans and assumed approximately \$29.3 million in deposits.

On October 30, 2003, the Bank purchased certain loans and deposits from Korea Exchange Bank, Broadway branch in New York. Assumed deposits totaled approximately \$46.2 million and the loans purchased totaled approximately \$39.5 million.

At December 31, 2003, the Bank had two wholly owned subsidiaries. The first subsidiary, Nara Loan Center, is a New Jersey corporation organized in 2000. It is a loan production office, generating mostly SBA loans. The second subsidiary, Nara Real Estate Trust, a Maryland real estate investment trust, was formed in April of 2003. As of December 31, 2003, Nara Real Estate Trust had total assets of \$120.0 million.

Our website address is [www.narabank.com](http://www.narabank.com). Electronic copies of our annual report on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, and amendments to those reports, are available free of charge by visiting our website at [www.narabank.com/financial.asp](http://www.narabank.com/financial.asp). These reports are generally posted as soon as reasonably practicable after they are electronically filed with the Securities and Exchange Commission.

## **Recent Developments**

On March 11, 2004, Nara Bancorp declared a dividend of \$0.05 per common share for the first quarter of 2004, which is payable on April 12, 2004 to stockholders of record on March 31, 2004.

On March 9, 2004, Nara Bank signed a Purchase and Assumption Agreement with Interchange Bank, a New Jersey chartered bank, for the purchase of the Hackensack branch of Interchange. Upon closing of this transaction, Nara Bank will assume approximately \$1.5 million in deposits, and no loans. The purchase will allow Nara Bank to expand its branch network to the New Jersey market and meet the demands of the growing Korean-American community in New Jersey. The transaction is expected to close during the second quarter of 2004 and is subject to normal closing conditions.

## **Business Overview**

Our principal business activities are conducted through Nara Bank by earning interest on loans and investment securities that are funded by customer deposits and other borrowings. The difference between interest received and interest paid comprises the majority of our operating earnings. The FDIC insures Nara Bank's deposits up to the maximum legal limits, and the Bank is a member of the Federal Reserve System.

Through our network of 15 branches and 5 loan production offices, we offer a full range of commercial banking and consumer financial services for our customers, who typically are individuals and small- to medium-sized businesses in our market areas. We accept deposits and originate a variety of loans including commercial loans, commercial real estate loans, trade finance, Small Business Administration (SBA) loans, automobile and various consumer loans. To better meet our customers' needs, our mini-market branches generally offer extended



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hours from 9 a.m. to 6 p.m. Each of our branches, except for our Downtown Los Angeles branch, operates 24-hour automated teller machines. We provide courier services to qualifying customers and have personal banking officers for our key customers to better support their banking needs. We honor merchant drafts for both VISA and MasterCard and provide debit card services to our customers. In addition, most of our branches offer travelers checks, safe deposit boxes, notary public and other customary bank services. We also offer 24-hour banking by telephone. Our website at [www.narabank.com](http://www.narabank.com) features both English and Korean applications and internet banking services.

A significant amount of our operating income and net income depends on the difference between interest revenue received from interest-earning assets and interest expense paid on interest-bearing liabilities. However, interest rates are highly sensitive to many factors that are beyond our control, such as general economic conditions and the policies of various governmental and regulatory authorities, in particular those of the Federal Reserve Board. Although our business may vary with local and national economic conditions, such variations are not seasonal in nature.

## **Lending Activities**

### ***Commercial Loans***

Commercial loans are extended to businesses for various purposes such as providing working capital, purchasing inventory, purchasing machinery and equipment, debt refinance, business acquisition and other business related financing needs. Commercial loans are typically classified as (1) Short-term loans (or lines of credits), which are often used to finance current assets such as inventories and accounts receivable, which have terms of one year with interest paid monthly on the outstanding balance and principal balance due at maturity and (2) Long-term loans (or term loans to businesses) have terms of 5 to 7 years with principal and interest paid monthly. The credit-worthiness of our borrowers is determined before the loan is originated and periodically reviewed to ascertain credit quality for both short-term and long-term loans. Commercial loans are typically collateralized by the borrower's business assets and/or real estate. Recently, the Bank began making commercial loans in the U.S. that are secured by real estate located in South Korea. This program is being offered in conjunction with Hana Bank, South Korea's third largest commercial bank. We do not expect the loans made on South Korean Real Estate Collateral loans to make up significant portion of our loan portfolio. We also offer small business loans to smaller retail businesses up to \$100,000 with terms of 3 to 5 years at a fixed interest rate.

Our commercial loan portfolio includes trade finance loans from the Bank's International Department, which generally serves businesses involved in international trade activities. These loans are typically collateralized by business assets and are used to meet the short-term working capital needs (accounts receivable and inventories) of the subject business. The department also issues and advises and letters of credit for export and import businesses

### ***Commercial Real Estate Loans***

Real estate loans are extended for the purchase and refinance of commercial real estate and are generally secured by first deeds of trust. The maturities on such loans are generally restricted to seven years with a balloon payment due at maturity and are amortized for up to 25 years. We offer both fixed and floating rate loans. It is our policy to restrict real estate loans to 70% of Nara Bank's appraised value of the subject property.

### ***Small Business Administration Loans***

Small Business Administration (SBA) 7(a) loans are typically extended for the purpose of providing working capital, purchase of inventory, purchase of machinery and equipment, debt refinance, business acquisition, start-up financing, or to purchase/construct owner-occupied commercial property. SBA 7(a) loans typically are term loans

with maturities ranging from 7 to 10 years for business only related loans and are 25 years for real estate related loans. SBA loans are fully amortized with payment of principal and interest monthly. SBA loans normally provide for floating interest rates and are secured by business assets and/or real estate. Each loan is typically guaranteed 75% to 85% by the U.S. Small Business Administration depending on the loan amount, with a maximum loan amount per borrower of \$750,000.

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The SBA 7(a) loans we generate represent an important segment of our non-interest income because of our ability to sell the guaranteed portion in the secondary market at a premium while earning servicing fee income on the sold portion over the remaining life of the loan. Thus, in addition to the interest yield earned on the un-guaranteed portion of the SBA loans that we retained, we recognize income from the gains on the sales and from loan servicing on the SBA loans sold in the secondary market.

SBA 504 loans are typically extended for the purpose of purchasing owner-occupied commercial real estate or long-term capital equipment. SBA 504 loans are typically extended for 20 years or the life of the asset being financed. SBA 504 loans are financed as participation between the Bank and the U.S. SBA through a Certified Development Company (CDC). Generally, the loans are structured as 50% Bank first deed of trust (T/D), 40% second T/D (SBA), and 10% injection by borrower. Rates for the first T/D Bank loans are subject to normal bank commercial rate and the second T/D SBA loans are fixed for the life of the loans with the U.S. Treasury rate used as its index.

All our SBA loans are handled through Nara Bank's SBA Loan department. The SBA loan department is staffed by loan officers who provide assistance to qualified businesses. For SBA 7a loans, we attained our initial SBA Preferred Lender status in the Los Angeles and Santa Ana districts on January 16, 1997. SBA Preferred Lender status is the highest designation awarded by the U.S. Small Business Administration and generally facilitates the marketing and approval process for SBA loans. We have since attained SBA Preferred Lender statuses in San Francisco, Seattle, Spokane, Illinois, Atlanta, New York, New Jersey, Virginia, Baltimore, Washington D.C. and Denver.

**Consumer Loans**

Consumer loans are extended for automobile and home equity loans with a majority of the consumer loan portfolio currently consisting of automobile loans. Referrals from automobile dealers comprise the majority of originations for automobile loans. We offer fixed rate loans to buyers who are not qualified for automobile dealers' most preferential loan rates for new and used car financing. We offer home equity loans and lines up to 89% of the appraisal value. Recently, the Bank has started to accept South Korean real estate as security on a select few loans.

**Concentrations**

Loan concentrations are considered to exist when there are significant amounts of loans to a multiple number of borrowers engaged in similar activities, which would cause them to be similarly impacted by economic or other conditions. The following table describes the industry concentrations in our loan portfolio over the past five years, which exceeded 10% of our total loans as of the dates indicated:

(dollars in thousands)	At December 31,									
	2003		2002		2001		2000		1999	
	Amount	% of Portfolio	Amount	% of Portfolio	Amount	% of Portfolio	Amount	% of Portfolio	Amount	% of Portfolio
Manufacturing	\$ 73,675	7.4%	\$ 48,245	6.6%	\$ 38,665	7.6%	\$ 36,142	10.0%	\$ 30,072	12.6%
Wholesale Trade	174,195	17.4%	127,659	17.5%	109,112	21.4%	89,609	24.7%	71,283	29.8%
Retail Trade	158,821	15.9%	126,988	17.4%	85,515	16.8%	61,282	16.9%	35,878	15.0%
Services	198,940	19.9%	138,203	18.9%	104,669	20.6%	63,792	17.6%	25,702	10.8%
Finance, Insurance, Property Management	355,557	35.5%	248,417	34.0%	129,495	25.4%	75,567	20.8%	48,453	20.3%

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Total	961,188	689,512	467,456	326,392	211,388
Gross Loans, net of unearned *	\$1,001,265	\$729,815	\$508,850	\$362,704	\$238,931

\* Includes loans held for sale: \$3,926,885 in 2003, \$6,337,519 in 2002, \$3,657,842 in 2001, and \$168,250 in 1999

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### **Investing Activities**

The main objectives of our investment strategy are to support a sufficient level of liquidity while providing a means to manage our interest rate risk, and to generate an adequate level of interest income without taking undue risks. Our investment policy permits investment in various types of securities, certificates of deposits and federal funds sold in compliance with various restrictions in our policy. Our investment portfolio consists of government sponsored agency bonds, mortgage backed securities, Collateralized Mortgage Obligations ( CMOs ), bank-qualified California municipals, and corporate bonds.

Securities are classified as held-to-maturity or available-for-sale. We do not maintain a trading portfolio. Securities in the held-to-maturity category consist of securities purchased for long-term investment in order to enhance our ongoing stream of net interest income. Securities deemed held-to-maturity are classified as such because we have both the intent and ability to hold these securities to maturity. Securities purchased to meet investment-related objectives such as interest rate risk and liquidity management, but which may be sold as necessary to implement management strategies, are designed as available-for-sale at the time of purchase. At December 31, 2003, we had \$2.0 million in securities held-to-maturity and \$126.4 million in securities available-for-sale. We purchased \$92.4 million and sold \$21.6 million in investment securities during 2003.

### **Deposit Activities**

We attract both short-term and long-term deposits from the general public by offering a wide range of deposit products and services. Through our branch network, we provide our banking customers with money market accounts, savings and checking accounts, certificate of deposit, individual retirement accounts, business checking accounts, 24-hour automated teller machines, and internet banking and bill-pay services.

Our primary source of funds is FDIC-insured deposits. We try to match our interest-bearing liabilities with our interest-earning assets. We cover all volatile funds with liquid assets as a method to ensure adequate liquidity. Thus, we analyze our deposits' maturities and interest rates to monitor and control the cost of funds and review the stability of the supply of funds. We believe our deposits are a stable and reliable funding source.

### **Borrowing Activities**

When we have more funds than required for our reserve requirements or short-term liquidity needs, we sell federal funds to other financial institutions. Conversely, when we have less funds than required, we may borrow funds from both our corresponding banks and the Federal Reserve Bank, also known as the FRB. The maximum amount that we currently are authorized to borrow from our correspondent banks is \$46 million on an overnight basis. In addition to the correspondent banks, the maximum amount that we may borrow from the FRB discount window is 97% of the market value of the pledged security. At December 31, 2003, the par value of the pledged security was \$5.0 million.

The Federal Home Loan Bank System functions in a reserve credit capacity for qualifying financial institutions. As a member, we are required to own capital stock in the Federal Home Loan Bank of San Francisco ( FHLBSF ) and may apply for advances from the FHLBSF utilizing Federal Home Loan Bank stock, qualifying mortgage loans and mortgage-backed securities as collateral.

The FHLBSF offers a full range of borrowing program on its advance with terms of up to ten years at competitive market rates. A prepayment penalty is usually imposed for early repayment of these advances. As a member of Federal Reserve Bank, we may also borrow from the Federal Reserve Bank of San Francisco.



**Market Area and Competition**

Most of our services are offered in Los Angeles County, Orange County, the San Francisco Bay Area, Silicon Valley (Santa Clara County), and the New York metropolitan area, each of which have high concentrations

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of Korean-Americans. The banking and financial services industry generally, and in our 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 accelerating pace of consolidation among financial services providers as well as strong competition amongst the banks serving the Korean-American communities. 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 Financial Services Modernization Legislation.

We compete 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. Many of these competitors are much larger in total assets and capitalization, have greater access to capital markets and offer a broader range of financial services than we do. We have 15 branch offices located in Los Angeles, Orange County, Oakland, Silicon Valley, New York and 5 loan production offices located in Seattle, Chicago, New Jersey, Atlanta, and Virginia.

**Economic Conditions, Government Policies and Legislation**

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

Our business also is 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 Federal Reserve ). The Federal Reserve 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 Federal Reserve 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 Nara Bancorp and Nara Bank of 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 Nara Bancorp 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. We 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 our financial condition or results of operations of us or any of our subsidiaries. See Item 1. Business - Supervision and Regulation below.

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**Supervision and Regulation**

*General*

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

*Nara Bancorp*

As a registered bank holding company, we are subject to regulation under the Bank Holding Company Act of 1956, as amended (the BHCA ). We are required to file with the FRB periodic reports and such additional information as the FRB may require pursuant to the BHCA. The OCC and FRB may conduct examinations of our subsidiaries and us.

The FRB may require that we terminate an activity or terminate control of or liquidate or divest ourselves of 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 our 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, we must file written notice and obtain approval from the FRB prior to purchasing or redeeming our equity securities.

Further, we are required by the FRB to maintain certain levels of capital. See Capital Standards.

We are required to obtain the prior approval of the FRB for the acquisition of more than 5% of the outstanding shares of any class of voting securities or substantially all of the assets of any bank or bank holding company. Prior approval of the FRB is also required if we merge or consolidate with another bank holding company. We are 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 our subsidiaries. However, subject to the prior approval of the FRB, we 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 there to.

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.

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

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Our securities are registered with the Securities and Exchange Commission under the Securities Exchange Act of 1934, as amended (the Exchange Act ). As such, we are subject to the information, proxy solicitation, insider trading, and other requirements and restrictions of the Exchange Act.

### ***Nara Bank, N.A.***

Nara Bank, as a national banking association, is subject to primary supervision, examination, and regulation by the Office of the Comptroller of the Currency (the OCC ). To a lesser extent, Nara Bank is also subject to regulations of the Federal Deposit Insurance Corporation (the FDIC ) as administrator of the Bank Insurance Fund and the FRB. If, as a result of an examination of Nara Bank, the Office of the Comptroller of the Currency should determine that the financial condition, capital resources, asset quality, earnings prospects, management, liquidity or other aspects of Nara Bank's operations are unsatisfactory or that Nara Bank or its management is violating or has violated any law or regulation, various remedies are available to the Office of the Comptroller of the Currency. 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 Nara Bank, to assess civil monetary penalties, and to remove officers and directors. The FDIC has similar enforcement authority, in addition to its authority to terminate Nara Bank's deposit insurance in the absence of action by the Office of the Comptroller of the Currency and upon a finding that Nara Bank is in an unsafe or unsound condition, is engaging in unsafe or unsound activities, or that its conduct poses a risk to the deposit insurance fund or may prejudice the interest of its depositors.

Various requirements and restrictions under the laws of the United States and the State of California affect the operations of Nara Bank. Federal and California statutes and regulations relate to many aspects of Nara Bank's operations, including reserves against deposits, ownership of deposit accounts, interest rates payable on deposits, loans, investments, mergers and acquisitions, borrowings, dividends, locations of branch offices and new products and services. Further, Nara Bank is also required to maintain certain minimum levels of capital. See Capital Standards.

In February 2002, Nara Bank entered into a Stipulation and Consent to the Issuance of a Consent Order (the Consent Order ) in connection with alleged deficiencies relating to the lack of sufficient internal controls, procedures and inadequate compliance with the Bank Secrecy Act. During 2002, management took steps to comply with the Consent Order and to further compliance with the Bank Secrecy Act, including, but not limited to, the implementation of new IT systems and the expansion of employee training programs. On January 22, 2003, the OCC terminated the Consent Order, and as of such date Nara Bank was no longer subject to its requirements.

### ***Sarbanes-Oxley Act of 2002***

On July 30, 2002, the President signed into law the Sarbanes-Oxley Act of 2002 (the SOA ). The stated goals of the SOA are to increase corporate responsibility, to provide for enhanced penalties for accounting and auditing improprieties at publicly traded companies and to protect investors by improving the accuracy and reliability of corporate disclosures pursuant to the securities laws. The SOA has resulted in broad corporate and accounting reform for public companies and the accounting firms that audit them. Many provisions of the SOA became effective immediately and others became effective since passage of the law or will become effective during 2003.

The SOA generally applies to all companies, both U.S. and non-U.S., that file or are required to file periodic reports with the Securities and Exchange Commission (the SEC ) under the Securities Exchange Act of 1934, or the Exchange Act . The SOA includes very specific additional disclosure requirements and new corporate governance rules, requires the SEC and securities exchanges to adopt extensive additional disclosure, corporate governance and other related rules and mandates further studies of certain issues by the SEC and the Comptroller General. The SOA also represents significant federal involvement in matters traditionally left to state regulatory systems, such as the

regulation of the accounting profession, and to state corporate law, such as the relationship between a board of directors and management and between a board of directors and its committees.

The SOA contains the following important requirements, among other things:

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prohibition of most loans to a public company's directors and executive officers;

the chief executive officer and chief financial officer of a public company must certify each SEC periodic report containing financial statements;

audit committee approval is required for any services provided to a company by the audit firm, with certain exceptions for *de minimis* services;

new requirements for the major stock exchanges to adopt independence standards for audit committees and boards of directors;

all SEC periodic reports containing financial statements must reflect all material correcting adjustments that have been identified by a company's audit firm;

new real time reporting by the company of certain material changes in the financial condition or operations of the company, via reports filed on Form 8-K;

new whistleblower protections for employees who come forward with information relating to violations of the federal securities laws;

potential compensation disgorgement provisions applicable to the company's CEO and CFO upon a restatement of financial results attributable to misconduct;

timing for Form 4 reports by executive officers and directors and other Section 16 insiders has been accelerated to two business days from the date of any transaction;

new and expanded criminal penalties for various securities law violations and changes to the statute of limitations applicable to private securities law enforcement actions.

To date, the SEC and the securities exchanges have implemented most of the requirements of the SOA. However, the SEC continues to issue final rules and interpretations in connection with the new requirements, and we intend to review these new requirements and comply as required. Although we anticipate that we will incur additional expense in complying with the new requirements under SOA and applicable rules and regulations, management does not expect that such compliance will have a material impact on our results of operations or financial condition.

***USA Patriot Act of 2001***

On October 26, 2001, the President signed the USA Patriot Act of 2001 (the Patriot Act). Enacted in response to the terrorist attacks on September 11, 2001, the Patriot Act is intended to strengthen U.S. law enforcement's 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 banks 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;



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reports by nonfinancial trades and businesses filed with the Treasury Department's Financial Crimes Enforcement Network for cash transactions exceeding \$10,000; and

filing of suspicious activities reports securities by brokers and dealers if they believe a customer may be violating U.S. laws and regulations.

The Department of the Treasury in consultation with the FRB and other federal financial institution regulators has promulgated rules and regulations implementing the Patriot Act which:

prohibits U.S. correspondent accounts with foreign banks that have no physical presence in any jurisdiction;

require financial institutions to maintain certain records for correspondent accounts of foreign banks;

require financial institutions to produce certain records relating to anti-money laundering compliance upon request of the appropriate federal banking agency;

require due diligence with respect to private banking and correspondent banking accounts;

facilitate information sharing between the government and financial institutions; and

require financial institutions to have in place a money laundering program.

On May 9, 2003, the Department of Treasury, in conjunction with other bank regulators, issued a Joint Final Rule that provides for minimum standards with respect to customer identification and verification. We were required to comply with this rule by October 1, 2003. We have implemented and will continue to implement the provisions of the Patriot Act as such provisions become effective. We currently maintain and will continue to maintain policies and procedures to comply with the Patriot Act requirements. At this time, we do not expect that the Patriot Act will have a significant impact on our operations.

***Financial Services Modernization Legislation***

**General.** On November 12, 1999, President Clinton signed into law the Gramm-Leach-Bliley Act of 1999 also referred to as the FSMA. The FSMA repeals the two affiliation provisions of the Glass-Steagall Act: Section 20, which restricted the affiliation of Federal Reserve Member Banks with firms engaged principally in specified securities activities; and Section 32, which restricts officer, director, or employee interlocks between a member bank and any company or person primarily engaged in specified securities activities. In addition, the FSMA also contains provisions that expressly preempt any state law restricting the establishment of financial affiliations, primarily related to insurance. 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:

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

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

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



modifies the laws governing the implementation of the Community Reinvestment Act; and  
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addresses a variety of other legal and regulatory issues affecting both day-to-day operations and long-term activities of financial institutions.

We do not believe that the FSMA will have a material adverse effect on our 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 and banks may increasingly diversify the financial products that they offer. The FSMA is intended to grant to community banks, such as Nara Bank, certain powers as a matter of right that larger institutions have accumulated on an *ad hoc* basis. Nevertheless, the FSMA may have the result of increasing the amount of competition that we face from larger institutions and other types of companies offering financial products, many of which may have substantially greater financial resources than we do.

***Financial Holding Companies.*** Bank holding companies that elect to become a financial holding company 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 compliance with the Community Reinvestment Act.

Failure to comply with the financial holding company requirements 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 activities that are financial in nature or incidental to activities that are financial in nature, as determined by the FRB:

lending, exchanging, transferring, investing for others, or safeguarding financial assets other than money or securities;

providing any device 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.

We have not elected to become a financial holding company, although our management may reevaluate this decision as business conditions require.

***Expanded Bank Activities.*** The FSMA 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

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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 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.

**Privacy.** Under the FSMA, federal banking regulators adopted rules that limit the ability of banks and other financial institutions to disclose non-public information about consumers to nonaffiliated third parties. Pursuant to these rules, financial institutions must provide:

initial notices to customers about their privacy policies, describing the conditions under which they may disclose nonpublic personal information to nonaffiliated third parties and affiliates;

annual notices of their privacy policies to current customers; and

a reasonable method for customers to opt out of disclosures to nonaffiliated third parties.

These privacy provisions affect how consumer information is transmitted through diversified financial companies and conveyed to outside vendors. We do not believe that these privacy provisions will have a significant impact on our operations.

### ***Dividends and Other Transfers of Funds***

Dividends from Nara Bank constitute the principal source of income to Nara Bancorp. Nara Bancorp is a legal entity separate and distinct from Nara Bank. Nara Bank is subject to various statutory and regulatory restrictions on its ability to pay dividends to Nara Bancorp. Under such restrictions, the amount available for payment of dividends to Nara Bancorp by Nara Bank totaled \$56.8 million at December 31, 2003. In addition, the OCC and the FRB have the authority to prohibit Nara Bank from paying dividends, depending upon Nara Bank's financial condition, if such payment is deemed to constitute an unsafe or unsound practice.

### ***Transactions with Affiliates***

Nara 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, Nara Bancorp 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 Nara Bancorp or other affiliates. Such restrictions prevent Nara Bancorp and such other affiliates from borrowing from Nara Bank unless the loans are secured by marketable obligations of designated amounts. Further, such secured loans and investments by Nara Bank to or in Nara Bancorp or to or in any other affiliate are limited in the amounts indicated below for covered transactions under Regulation W. California law also imposes certain restrictions with respect to transactions involving Nara Bancorp and other controlling persons of Nara Bank. Additional restrictions on transactions with affiliates may be imposed on Nara Bank under the prompt corrective action provisions of federal law. See - Prompt Corrective Action and Other Enforcement Mechanisms.

**Regulation W.** During 2003 the Federal Reserve Board's newly-issued Regulation W became effective, which codifies prior regulations under and interpretative guidance with respect to transactions with affiliates. Affiliates of a

bank include, among other entities, the bank's holding company and companies that are under common control with the bank. In general, subject to certain specified exemptions, a bank or its subsidiaries are limited in their ability to engage in covered transactions (as defined below) with affiliates:

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to an amount equal to 10% of the bank's capital and surplus, in the case of covered transactions with any one affiliate; and

to an amount equal to 20% of the bank's capital and surplus, in the case of covered transactions with all affiliates.

In addition, a bank and its subsidiaries may engage in covered transactions and other specified transactions only on terms and under circumstances that are substantially the same, or at least as favorable to the bank or its subsidiary, as those prevailing at the time for comparable transactions with nonaffiliated companies.

A covered transaction includes:

a loan or extension of credit to an affiliate;

a purchase of, or an investment in, securities issued by an affiliate;

a purchase of assets from an affiliate, with some exceptions;

the acceptance of securities issued by an affiliate as collateral for a loan or extension of credit to any party; and

the issuance of a guarantee, acceptance or letter of credit on behalf of an affiliate. In addition, under Regulation W:

a bank and its subsidiaries may not purchase a low-quality asset from an affiliate;

covered transactions and other specified transactions between a bank or its subsidiaries and an affiliate must be on terms and conditions that are consistent with safe and sound banking practices; and

with some exceptions, each loan or extension of credit by a bank to an affiliate must be secured by collateral with a market value ranging from 100% to 130%, depending on the type of collateral, of the amount of the loan or extension of credit.

Regulation W generally excludes all non-bank and non-savings association subsidiaries of banks from treatment as affiliates, except to the extent that the FRB decides to treat these subsidiaries as affiliates. Concurrently with the adoption of Regulation W, the FRB has proposed a regulation, which would further limit the amount of loans that could be purchased by a bank from an affiliate to not more than 100% of the bank's capital and surplus.

***Capital Requirements***

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, such as federal banking agencies, to 100% for assets with relatively high credit risk. The higher the category, the more risk a bank is subject to and thus the more capital that is required. As of December 31, 2003, Nara Bank's total risk-based capital ratio was 10.4 %.

The guidelines divide a bank's capital into two tiers. Tier I includes common equity, retained earnings, certain non-cumulative perpetual preferred stock, and minority interest in equity accounts of consolidated subsidiaries. Goodwill and other intangible assets (except for mortgage servicing rights and purchased credit card relationships, subject to certain limitations) are subtracted from Tier I capital.



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Tier II capital includes, among other items, cumulative perpetual and long-term, limited-life preferred stock, mandatory convertible securities, certain hybrid capital instruments, term subordinated debt and the allowance for loan losses (subject to certain limitations). Certain items are required to be deducted from Tier II capital. Banks must maintain a total risk-based ratio of 8%, of which at least 4% must be Tier I capital.

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 4%. 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. For further discussion of our capital, see Capital Resources under Management Discussion and Analysis .

On July 2, 2003, the Federal Reserve Bank issued Supervisory Letter SR 03-13 clarifying that Bank Holding Companies should continue to report trust preferred securities in accordance with current Federal Reserve Bank instructions which allows trust preferred securities to be counted in Tier 1 capital subject to certain limitations. The Federal Reserve has indicated it will review the implications of any accounting treatment changes and, if necessary or warranted, will provide appropriate guidance.

The following table presents the amounts of regulatory capital and the capital ratios for Nara Bancorp and Nara Bank, compared to their minimum regulatory capital requirements as of December 31, 2003.

<b>As of December 31, 2003 (Dollars in thousands)</b>						
<b>Nara Bancorp</b>	<b>Actual</b>		<b>Required</b>		<b>Excess</b>	
	<b>Amount</b>	<b>Ratio</b>	<b>Amount</b>	<b>Ratio</b>	<b>Amount</b>	<b>Ratio</b>
Tier 1 capital to average assets	\$ 106,632	8.8%	\$ 48,255	4.0%	\$ 58,377	4.8%
Tier 1 risk-based capital ratio	\$ 106,632	9.8%	\$ 43,414	4.0%	\$ 63,218	5.8%
Total risk-based capital ratio	\$ 127,907	11.8%	\$ 86,829	8.0%	\$ 41,078	3.8%
<b>As of December 31, 2003 (Dollars in thousands)</b>						
<b>Nara Bank</b>	<b>Actual</b>		<b>Required</b>		<b>Excess</b>	
	<b>Amount</b>	<b>Ratio</b>	<b>Amount</b>	<b>Ratio</b>	<b>Amount</b>	<b>Ratio</b>
Tier I capital to average assets	\$ 100,167	8.3%	\$ 48,256	4.0%	\$ 51,911	4.3%
Tier 1 risk-based capital ratio	\$ 100,167	9.2%	\$ 43,365	4.0%	\$ 56,802	5.2%
Total risk-based capital ratio	\$ 112,638	10.4%	\$ 86,730	8.0%	\$ 25,908	2.4%

In addition, federal banking regulators may set capital requirements higher than the minimums described above for financial institutions whose circumstances warrant it. For example, a financial institution experiencing or anticipating significant growth may be expected to maintain capital positions substantially above the minimum supervisory levels without significant reliance on intangible assets. For further discussion of our Capital, see Capital Resources under



Management Discussion and Analysis.

***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, Nara Bank 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

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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 any condition imposed in writing by the agency or any 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 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 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 Nara 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.

FDIC-insured depository institutions pay an assessment rate equal to the rate assessed on deposits insured by the Savings Association Insurance Fund ( SAIF ).

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. An increase in the assessment rate could have a material adverse effect on our 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 Nara Bank could have a material adverse effect on our 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

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Federal Savings and Loan Insurance Corporation. The current FICO assessment rate for BIF-insured deposits is \$0.016 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 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***

We are subject to certain fair lending requirements and reporting obligations involving home mortgage lending operations and Community Reinvestment Act activities (CRA). 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 based 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 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.

### ***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, we believe that Nara Bank was in compliance with these requirements.

## **Employees**

As of December 31, 2003, we had 320 full-time equivalent employees. None of our employees are represented by a union or covered by a collective bargaining agreement. Management believes that its relations with its employees are good. See Item 4(a) below for a list of executive officers.

## **Factors That May Impact Our Business or the Value of Our Stock**

Set forth below are certain factors that may affect our financial results and operations, which you should consider when evaluating our business and prospects.

***Deterioration of economic conditions in California, New York or South Korea could adversely affect our loan portfolio and reduce the demand for our services.*** We focus our business primarily in Korean communities in California and in the greater New York City metropolitan area. A deterioration in economic conditions in our market areas could have a material adverse impact on the quality of our business. An economic slowdown in

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California, New York, or South Korea could have the following consequences, any of which could reduce our net income:

Loan delinquencies may increase;

Problem assets and foreclosures may increase;

Claims and lawsuits may increase;

Demand for our products and services may decline; and

Collateral for loans may decline in value below the principal amount owed by the borrower.

***Loan loss reserves may not cover actual loan losses.*** If our actual loan losses exceed the amount we have reserved for probable losses, it will hurt our business. We try to limit the risk that borrowers will fail to repay loans by carefully underwriting the loans. Losses nevertheless occur. We create reserves for estimated loan losses in our accounting records. We base these allowances on estimates of the following:

industry standards;

historical experience with our loans;

evaluation of current economic conditions;

regular reviews of the quality, mix and size of the overall loan portfolio;

regular reviews of delinquencies; and

the quality of the collateral underlying our loans.

***A downturn in the real estate market could seriously impair our loan portfolio.*** As of December 31, 2003, approximately 48.7% of the value of our loan portfolio consisted of loans secured by various types of real estate. If real estate values decline significantly, especially in California or New York, higher vacancies and other factors could harm the financial condition of our borrowers, the collateral for our loans will provide less security, and we would be more likely to suffer losses on defaulted loans.

***Changes in interest rates affect our profitability.*** Changes in prevailing interest rates may hurt our business. We derive our income mainly from the difference or spread between the interest earned on loans, securities and other interest-earning assets, and interest paid on deposits, borrowings and other interest-bearing liabilities. In general, the wider the spread, the more we earn. When market rates of interest change, the interest we receive on our assets and the interest we pay on our liabilities will fluctuate. This can cause decreases on our spread and can greatly affect our income. In addition, interest rate fluctuation can affect how much money we may be able to lend. For example, when interest rates rise, loan originations tend to decrease.

***If we lose key employees, our business may suffer.*** If we lost key employees temporarily or permanently, it could hurt our business. We could be particularly hurt if our key employees went to work for competitors. Our future success depends on the continued contributions of existing senior management personnel.

***Environmental laws could force us to pay for environmental problems.*** The cost of cleaning up or paying damages and penalties associated with environmental problems could increase our operating expenses. When a borrower defaults on a loan secured by real property, we often purchase the property in foreclosure or accept a deed to

the property surrendered by the borrower. We may also take over the management of commercial properties whose owners have defaulted on loans. We also lease premises where our branches and other facilities are located and where environmental problems may exist. Although we have lending, foreclosure and facilities guidelines intended to exclude properties with an unreasonable risk of contamination, hazardous substances may exist on some of the properties that we own, lease, manage or occupy. We may face the risk that environmental laws could force

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us to clean up the properties at our expense. It may cost much more to clean a property than the property is worth. We also could be liable for pollution generated by a borrower's operations if we take a role in managing those operations after a default. We may find it difficult or impossible to sell contaminated properties.

***We are exposed to the risks of natural disasters.*** A significant portion of our operations is concentrated in Southern California. California is in an earthquake-prone region. A major earthquake could result in material loss to us. A significant percentage of our loans are and will be secured by real estate. Many of our borrowers could suffer uninsured property damage, experience interruption of their businesses or lose their jobs after an earthquake. Those borrowers might not be able to repay their loans, and the collateral for such loans could decline significantly in value. Unlike a bank with operations that are more geographically diversified, we are vulnerable to greater losses if an earthquake, fire, flood or other natural catastrophe occurs in Southern California.

***An increase in non-performing assets would reduce our income and increase our expenses.*** If the level of non-performing assets rises in the future, it could adversely affect our operating results. Non-performing assets are mainly loans on which the borrowers are not making their required payments. Non-performing assets also include loans that have been restructured to permit the borrower to have smaller payments and real estate that has been acquired through foreclosure of unpaid loans. To the extent that assets are non-performing, we have less cash available for lending and other activities.

***Changes in Governmental regulation may impair our operations or restrict our growth.*** We are subject to significant governmental supervision and regulation. These regulations are intended primarily for the protection of depositors. Statutes and regulations affecting our business may be changed at any time, and the interpretation of these statutes and regulations by examining authorities may also change. Within the last several years Congress and the President have passed and enacted significant changes to these statutes and regulations. There can be no assurance that such changes to the statutes and regulations or in their interpretation will not adversely affect our business. Nara Bank is subject to regulation and examination by the Comptroller of the Currency. In addition to governmental supervision and regulation, Nara Bank is subject to changes in other federal and state laws, including changes in tax laws, which could materially affect the banking industry. Nara Bancorp is subject to the rules and regulations of the Federal Reserve Board. If we fail to comply with federal and state bank regulations, the regulators may limit our activities or growth, fine us or ultimately put us out of business. Banking laws and regulations change from time to time. Bank regulations can hinder our ability to compete with financial services companies that are not regulated or are less regulated. In addition, Nara Bank has an active program of originating and selling loans guaranteed by the Small Business Administration (SBA). There have been recent proposals to the percentage of loan guarantees provided by the SBA on some categories of SBA loans to 50% from 75%. If this occurs, it is likely that we will experience a significant decrease in the number of SBA loans that we originate and sell, particularly the 7(a) loans. See Lending Activities above.

Federal and state bank regulatory agencies regulate many aspects of our operations. These areas include:

- the capital that must be maintained;
- the kinds of activities that can be engaged in;
- the kinds and amounts of investments that can be made;
- the locations of offices;
- how much interest can be paid on demand deposits;



insurance of deposits and the premiums that must be paid for this insurance; and

how much cash must be set aside as reserves for deposits.

***Our stock price may be volatile, which could result in substantial losses for our stockholders.*** The market price of our common stock could be subject to wide fluctuations in response to a number of factors, including:

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issuing new equity securities pursuant to this offering or otherwise;

the amount of our common stock outstanding and the trading volume of our stock;

actual or anticipated changes in our future financial performance;

changes in financial estimates of us by securities analysts;

competitive developments, including announcements by us or our competitors of new products or services or significant contracts, acquisitions, strategic partnerships, joint ventures or capital commitments;

the operating and stock performance of our competitors;

changes in interest rates; and

additions or departures of key personnel at the management company.

***Future offerings of debt securities, which would be senior to our common stock upon liquidation, or equity securities, which would dilute our existing stockholders and may be senior to our common stock for the purposes of dividend distributions, may adversely affect the market price of our common stock.*** In the future, we may attempt to increase our capital resources by making additional offerings of debt or equity securities, including commercial paper, medium-term notes, senior or subordinated notes and classes of preferred stock or common stock. Upon liquidation, holders of our debt securities and shares of preferred stock and lenders with respect to other borrowings will receive a distribution of our available assets prior to the holders of our common stock. Additional equity offerings by us may dilute the holdings of our existing stockholders or reduce the market price of our common stock, or both. Our preferred stock, if issued, would have a preference on dividend payments that could limit our ability to make a dividend distribution to the holders of our common stock. Because our decision to issue securities in any future offering will depend on market conditions and other factors beyond our control, we cannot predict or estimate the amount, timing or nature of our future offerings. Thus, our stockholders bear the risk of our future offerings reducing the market price of our common stock or diluting their stock holdings in us.

**Accounting Matters**

SFAS No. 148, *Accounting for Stock-based Compensation Transition and Disclosure* an amendment of FASB *Statement No. 123*, amends SFAS No. 123 to provide alternative methods of transition for a voluntary change to the fair value-based method of accounting for stock-based employee compensation. It also amends the disclosure provisions of SFAS No. 123 to require prominent disclosure in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The provisions of SFAS No. 148 are effective for annual financial statements for fiscal years ending after December 15, 2002 and for financial reports containing condensed financial statements for interim periods beginning after December 15, 2002. We have not determined whether we will adopt the fair value-based method of accounting for stock-based employee compensation in future periods.

The FASB issued Interpretation No. ( FIN ) 45, *Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees and Indebtedness of Others*, an interpretation of SFAS Nos. 5, 57 and 107 and rescission of FIN 34, *Disclosure of Indirect Guarantees of Indebtedness of Others*, in November 2002. FIN

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45 elaborates on the disclosures to be made by the guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. It also requires that a guarantor recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. The initial recognition and measurement provisions of the interpretation are applicable on a prospective basis to guarantees issued or modified after December 31, 2002, while the provisions of the disclosure requirements are effective for financial statements of interim or annual periods ending after December 15, 2002. The adoption of such interpretation did not have a material impact on our results of operations, financial position or cash flows.

In January 2003, the FASB issued Interpretation No. 46 Consolidation of Variable Interest Entities ( FIN 46 ). In December 2003, the FASB revised FIN 46 and codified certain FASB Staff Positions previously issued for FIN 46 ( FIN 46R). The objective of FIN 46 as originally issued, and as revised by FIN 46R, was to improve financial reporting by companies involved with variable interest entities. Prior to the effectiveness of FIN 46, we generally included another entity in our consolidated financial statements only if it controlled the entity through voting interests. FIN 46 changed that standard by requiring a variable interest entity to be consolidated if we were subject to a majority of the risk of loss from the variable interest entity's activities or entitled to receive a majority of the entity's residual returns or both. The consolidation requirements of FIN 46 applied immediately to variable interest entities created after January 31, 2003. The consolidation requirements applied to older entities in the first fiscal year or interim period beginning after June 15, 2003. The provisions of FIN 46R are required to be adopted prior to the first reporting period that ends after March 15, 2004. Our adoption of FIN 46 and FIN46R did not have a significant impact on our financial position, results of operations, or cash flows.

In December 2003, the Accounting Standards Executive Committee of the AICPA issued Statement of Position No. 03-3 ( SOP 03-3 ), *Accounting for Certain Loans or Debt Securities Acquired in a Transfer*. SOP 03-3 addresses the accounting for differences between the contractual cash flows and the cash flows expected to be collected from purchased loans or debt securities if those differences are attributable, in part, to credit quality. SOP 03-3 requires purchased loans and debt securities to be recorded initially at fair value based on the present value of the cash flows expected to be collected with no carryover of any valuation allowance previously recognized by the seller. Interest income should be recognized based on the effective yield from the cash flows expected to be collected. To the extent that the purchased loans or debt securities experience subsequent deterioration in credit quality, a valuation allowance would be established for any additional cash flows that are not expected to be received. However, if more cash flows subsequently are expected to be received than originally estimated, the effective yield would be adjusted on a prospective basis. SOP 03-3 will be effective for loans and debt securities acquired after December 31, 2004. Although we anticipate that the implementation of SOP 03-3 will require significant loan system and operational changes to track credit related losses on loans purchased starting in 2005, it is not expected to have a significant effect on our consolidated financial statements.

**Item 2. PROPERTIES**

Our principal executive offices are located at 3701 Wilshire Blvd., Los Angeles, California 90010. We conduct our operations through nine full branch offices, six mini branch offices and four loan production offices located throughout California, in the greater New York City metropolitan area and in Chicago, Seattle, New Jersey, and Atlanta. We lease all of our offices. We believe our present facilities are adequate for our present needs. We also believe that, if necessary, we could secure suitable alternative facilities or similar terms, without adversely impacting operations. The locations of our full branch offices, including headquarters are as follows:

**Office Name**

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**Address**

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Cerritos	4875 La Palma Avenue, La Palma, CA 90623
Downtown	1122 S. Wall Street, Los Angeles, CA 90015
Flushing	138-02 Northern Blvd., Flushing, NY 11354
Headquarters	3701 Wilshire Blvd, Suite 220, Los Angeles, CA 90010
Jackson Heights	78-14 Roosevelt Avenue, Jackson Heights, NY 11372

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Manhattan	29 W. 30th Street, New York, NY 10001
Oakland	2250 Broadway, Oakland, CA 94612
Olympic	2727 W. Olympic Blvd., Los Angeles, CA 90006
Silicon Valley	1102 E. El Camino Real, Sunnyvale, CA 94087
Wilshire	3600 Wilshire Blvd, Suite 100-A, Los Angeles, CA 90010

Our five mini branches are located inside supermarkets and the Aroma office is located inside the Sports Center Building in Los Angeles. The locations are as follows:

Aroma	3680 Wilshire Blvd., Suite 106, Los Angeles, CA 90010
Fullerton	5301 Beach Blvd., Buena Park, CA 90621
Glendale	831 N. Pacific Ave., Glendale, CA 91203
Torrance	3030 W. Sepulveda Blvd., Torrance, CA 90505
Valley	17369 Sherman Way, Van Nuys, CA 91406
Diamond Bar	21080 Golden Springs Drive, Diamond Bar, CA 91789

We currently have five loan production offices to promote SBA loans. We have SBA Preferred Lender status in those areas. The locations are as follows:

<b><u>Office Name</u></b>	<b><u>Address</u></b>
Atlanta	3510 Shallowford Road, Suite 207, Atlanta, GA 30341
Chicago	5901 N. Cicero Avenue Suite 508, Chicago, IL 60646
New Jersey	118 Broad Avenue Suite N-11, Palisades Park, NJ 07650
Seattle	12600 S.E. 38th Street, Suite 230, Bellevue, WA 98006
Virginia	7023 Little River Turnpike Suite 206 Annandale, VA 22003

**Item 3. LEGAL PROCEEDINGS**

We are a party to routine litigation incidental to our business, none of which is considered likely to have a material adverse effect on us.

**Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

No matter was submitted to a vote of our security holders, through the solicitation of proxies or otherwise, during the fourth quarter of the fiscal year ended December 31, 2003.

**Item 4(a). EXECUTIVE OFFICERS OF THE REGISTRANT**

The following individuals are executive officers of Nara Bancorp and officers who are deemed to be executive officers of Nara Bancorp. Pertinent information relating to these individuals is set forth below. There are no family relationships between any of the officers.

***Benjamin B. Hong- Chief Executive Officer and President Age 71***

Mr. Hong has served as President and Chief Executive Officer of Nara Bank since 1994 and as President and Chief Executive Officer of Nara Bancorp since February 2001. Mr. Hong previously served as President and Chief Executive Officer of Hanmi Bank from 1988 to 1994. Mr. Hong briefly retired from September 2, 2003 to December 1, 2003 when Mr. Seong-Hoon Hong served as President and CEO of Nara Bank and Nara Bancorp. In December 2003, Mr. Hong returned as Interim President and CEO after Mr. Seong-Hoon Hong resigned. Mr. Hong is currently acting as Interim President and CEO until the board appoints a successor.

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***Min Jung Kim Executive Vice President and Chief Operating Officer Age 44***

Ms. Kim has served as Executive Vice President and Chief Operating Officer of Nara Bank and Nara Bancorp since November 2003. Mr. Kim previously served as Executive Vice President and Credit Officer of Nara Bank since 1995 and as Executive Vice President and Chief Credit Officer of Nara Bancorp since February 2001. Ms. Kim served as Vice President and Manager of the Western Branch of Hanmi Bank from 1992 to 1995.

***Timothy Chang Senior Vice President and Chief Financial Officer Age 35***

Mr. Chang has served as Senior Vice President and Chief Financial Officer of Nara Bank and Nara Bancorp since 2003 . Mr. Chang previously served as Vice President and Treasurer of Nara Bank from 2000 to 2003.

***Bonita Lee Senior Vice President and Chief Credit Officer Age 41***

Ms. Bonita Lee has served as Senior Vice President and Chief Credit Officer of Nara Bank since 2003. Ms. Lee previously served as Senior Vice President and Credit Administrator from February 2000 to 2003. She joined the Bank in November of 1993 and served in various positions in lending department.

**Table of Contents****Part II****Item 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS**

Our common stock, par value \$0.001 per share, began trading on the Nasdaq National Market on February 5, 2001 under the symbol NARA. The common stock of Nara Bank, par value \$3.00 per share, also was traded on the Nasdaq National Market under the symbol NARA through February 2, 2001, which was Nara Bank's last trading day.

There were 11,582,700 shares of common stock held by approximately 1,655 beneficial owners and 598 registered owners as of February 29, 2004. The following table sets forth, for the calendar quarters indicated, the range of high and low sales prices for the common stock of Nara Bancorp and Nara Bank, as applicable, for each quarter within the last two fiscal years. Sales prices represent actual sales of which our management has knowledge. Prices adjusted to reflect the effect of stock split which took effect in March 17, 2003

Quarters ended:	High Sales Price	Low Sales Price
March 31, 2002	\$ 10.88	\$ 7.87
June 30, 2002	\$ 11.83	\$ 10.63
September 30, 2002	\$ 11.74	\$ 7.92
December 31, 2002.	\$ 11.05	\$ 8.49
March 31, 2003	\$ 13.35	\$ 10.28
June 30, 2003	\$ 18.73	\$ 12.43
September 30, 2003	\$ 21.62	\$ 17.14
December 31, 2003.	\$ 27.95	\$ 18.12

## Dividends

The following table shows cash dividends declared during 2003.

Declaration Date	Payable Date	Record Date	Amount
December 1, 2003	January 12, 2004	December 31, 2003	\$0.05/share
August 25, 2003	October 10, 2003	September 30, 2003	\$0.05/share
May 28, 2003	July 10, 2003	June 30, 2003	\$0.05/share
February 18, 2003	April 11, 2003	March 31, 2003	\$0.05/share

Future dividends are subject to the discretion of our Board of Directors and will depend upon a number of factors, including future earnings, financial condition, cash needs and general business conditions. Any dividend must comply with applicable bank regulations.

Our ability to pay dividends is subject to restrictions set forth in the Delaware General Corporation Law. The Delaware General Corporation Law provides that a Delaware corporation may pay dividends either (i) out of





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the corporation's surplus (as defined by Delaware law), or (ii) if there is no surplus, out of the corporation's net profits for the fiscal year in which the dividend is declared and/or the preceding fiscal year.

Our ability to pay cash dividends in the future will depend in large part on the ability of Nara Bank to pay dividends on its capital stock to us. The ability of Nara Bank to pay dividends to us is subject to restrictions set forth in the National Bank Act and the rules of the Office of Comptroller of the Currency. Pursuant to such regulations, among other restrictions, Nara Bank cannot pay dividends out of its capital; all dividends must be paid out of net profits then on hand, after deducting for expenses such as losses and bad debts. In addition, the payment of dividends out of net profits of a national bank is further limited by a statute which prohibits a bank from declaring a dividend on its shares of common stock until the surplus fund equals the amount of capital stock, or if the surplus fund does not equal the amount of capital stock, until not less than one-tenth of its net profits for the preceding half-year (in the case of quarterly dividends) or at least one-tenth of its net profits for the preceding year (in case of annual dividends) are transferred to the surplus fund.

**Item 6. SELECTED FINANCIAL DATA**

The following table presents selected financial and other data of Nara Bancorp and prior to the February 2001 reorganization, financial and other data of Nara Bank, for each of the years in the five-year period ended December 31, 2003. The information below should be read in conjunction with, and is qualified in its entirety by, the more detailed information included elsewhere herein including our Audited Consolidated Financial Statements and Notes thereto.

**Table of Contents****For The Year Ended December 31,**

	<b>2003</b>	<b>2002</b>	<b>2001</b>	<b>2000</b>	<b>1999</b>
<b>(Dollars in thousands, except per share data)</b>					
<b>Statement of Income Data</b>					
Total interest income	\$ 61,425	\$ 48,571	\$ 47,860	\$ 41,602	\$ 25,256
Total interest expense	15,934	13,464	16,970	14,149	7,919
Net interest income before provision for (recapture of) loan losses	45,491	35,107	30,890	27,453	17,337
Provision for (recapture of) loan losses	5,385	2,686	750	(1,100)	3,395
Non-interest income	20,378	18,001	15,324	13,518	8,024
Non-interest expense	37,305	32,341	28,364	24,830	16,337
Income before income tax provision and cumulative effect of a change in accounting principle	23,179	18,081	17,100	17,241	5,629
Income tax provision	8,866	6,777	6,316	6,784	1,657
Net income before cumulative effect of a change in accounting principle	14,313	11,304	10,784	10,457	3,972
Cumulative effect of a change in accounting principle.		4,192			
<b>Net Income</b>	<b>\$ 14,313</b>	<b>\$ 15,496</b>	<b>\$ 10,784</b>	<b>\$ 10,457</b>	<b>\$ 3,972</b>
<b>Per Share Data:</b>					
Earnings before cumulative effect of a change in accounting principle basic	\$ 1.30	\$ 1.03	\$ 0.98	\$ 1.04	\$ 0.42
Earnings before cumulative effect of a change in accounting principle diluted	1.24	0.98	0.93	0.99	0.40
Earnings after cumulative effect of a change in accounting	1.30	1.41	0.98	1.04	0.42

principle basic					
Earnings after cumulative effect of a change in accounting					
principle diluted	1.24	1.35	0.93	0.99	0.40
Book value (period end)	7.35	6.11	4.97	4.07	3.03
Number of common shares outstanding (period end)	11,560,089	10,690,630	11,145,674	10,923,858	8,807,506
<b>Statement of Financial</b>					
<b>Condition Data At Period End:</b>					
Assets	\$ 1,260,028	\$ 980,484	\$ 679,438	\$ 602,563	\$ 359,090
Securities	128,414	104,402	69,455	70,659	33,331
Loans, net	988,794	721,357	502,141	355,724	235,479
Deposits	1,061,415	816,918	589,844	527,709	319,869
Federal Home Loan Bank					
Borrowings	60,000	65,000	5,000	5,000	N/A
Junior Subordinated Debenture	39,268	18,648	10,400	N/A	N/A
Stockholders equity	84,997	65,369	55,427	44,512	26,726
<b>Average Balance Sheet Data:</b>					
Assets	\$ 1,087,041	\$ 786,218	\$ 635,337	\$ 479,898	\$ 312,757
Securities	135,362	90,460	70,615	50,244	22,622
Loans, net	828,796	600,075	447,225	307,382	205,991
Deposits	895,883	649,829	550,356	428,872	280,283
Stockholders equity	75,284	62,224	50,447	34,496	24,944
<b>Selected Performance Ratios:</b>					
Return on average assets before cumulative effect	1.32%	1.44%	1.70%	2.18%	1.27%
Return on average assets after cumulative effect	N/A	1.97%	N/A	N/A	N/A
Return on average stockholders equity before cumulative effect	19.01%	18.17%	21.38%	30.31%	15.92%
Return on average stockholders equity after cumulative effect	N/A	24.90%	N/A	N/A	N/A
Net interest spread (1)	3.92%	4.03%	3.97%	4.83%	4.87%
Net interest margin (2)	4.51%	4.86%	5.40%	6.53%	6.37%
Average shareholders equity to average assets	6.93%	7.91%	7.94%	7.19%	7.98%
<b>Regulatory Capital Ratio:</b>					
Leverage: Bank	8.30%	9.26%	8.46%	7.66%	7.23%
Bancorp	8.84%	8.72%	9.64%	N/A	N/A
Tier 1 risk-based Bank	9.25%	10.00%	9.47%	10.03%	9.01%
Bancorp	9.82%	9.64%	10.91%	N/A	N/A
Total risk-based Bank	10.40%	11.05%	10.92%	11.49%	11.49%
Bancorp	11.78%	10.69%	12.37%	N/A	N/A

**Table of Contents****For The Year Ended December 31,**

	<b>2003</b>	<b>2002</b>	<b>2001</b>	<b>2000</b>	<b>1999</b>
<b>(Dollars in thousands, except per share data)</b>					
<b>Asset Quality:</b>					
Nonaccrual loans	\$ 4,855	\$ 1,064	\$ 1,720	\$ 2,038	\$ 1,523
Loans 90 days or more past due	209	18	36		
Total nonperforming loans	5,064	1,082	1,756	2,038	1,523
Other real estate owned		36		263	44
Restructured loans	529	1,067			
Total nonperforming assets	\$ 5,593	\$ 2,185	\$ 1,756	\$ 2,301	\$ 1,567
<b>Asset Quality Ratios:</b>					
Nonaccrual loans to net loans	0.49%	0.15%	0.34%	0.57%	0.65%
Nonaccrual assets to total assets	0.39%	0.11%	0.25%	0.34%	0.42%
Allowance for loan losses to net loans	1.26%	1.17%	1.34%	1.96%	1.47%
Allowance for loan losses to nonaccrual loans	256.87%	794.92%	390.12%	342.49%	226.66%
Net charge-offs to average net loans	0.20%	0.17%	0.33%	0.83%	1.32%

- (1) Difference between the average yield on interest-earning assets and average rate paid on interest-bearing liabilities.
- (2) Net interest income expressed as a percentage of average total interest-earning assets.

**Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following discussion provides information about our results of operations, financial condition, liquidity, and capital resources. This information is intended to facilitate the understanding and assessment of significant changes and trends related to our financial condition and the results of our operations. This discussion and analysis should be read in conjunction with our Consolidated Financial Statements and the accompanying notes presented elsewhere herein.

**Critical Accounting Policies**

The discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets and liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities at the date of our financial statements. Actual results may differ from these estimates under different assumptions or conditions.

In accordance with SFAS No. 115, securities are classified as held-to-maturity, available-for-sale, or trading. We do not maintain a trading portfolio. Securities in the held-to-maturity category consist of securities purchased for long-term investment in order to enhance our ongoing stream of net interest income. Securities deemed held-to-maturity are classified as such because we have both the intent and ability to hold these securities to maturity and are recorded at amortized cost. Accreted discounts and amortized premiums on securities are included in interest income using the interest method, and realized gains or losses related to the sale of securities are calculated using the specific identification method. All other securities are classified as available for sale with unrealized gains and losses excluded from earnings and reported in other comprehensive income. Declines in the fair value of held to maturity and available for sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses in current earnings rather than in other comprehensive income. We did not have any impaired investment securities during 2003.

Accounting for the allowance for loan losses involves significant judgments and assumptions by management, which has a material impact on the carrying value of net loans. The judgments and assumptions used by management are based on historical data and management's view of the current economic environment as described in Allowance for Loan and Lease Losses and Methodology .

We generally cease to accrue interest on any loan with respect to which the loan's contractual payments are more than 90 days delinquent, as well as loans classified substandard for which interest payment reserves were established from loan funds rather than borrower funds. In addition, interest is not recognized on any loan for which management has determined that collection of our investment in the loan is not reasonably assured. A nonaccrual loan may be restored to accrual status when delinquent principal and interest payments are brought current, the loan is paying in accordance with its payment terms for a period, minimum six months, and future monthly principal and interest payments are expected to be allocated.

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Properties acquired through foreclosure, or deed in lieu of foreclosure, are transferred to the other real estate owned portfolio and carried at the lower of cost or estimated fair value less the estimated costs to sell the property. The fair value of the property is based upon a current appraisal. The difference between the fair value of the real estate collateral and the loan balance at the time of transfer is recorded as a loan charge-off if fair value is lower. Subsequent to foreclosure, management periodically performs valuations and the property is carried at the lower of carrying value or fair value, less costs to sell. The determination of a property's estimated fair value includes revenues projected to be realized from disposal of the property, construction and renovation costs.

Certain Small Business Administration (SBA) loans that we have the intent to sell prior to maturity are designated as held for sale at origination and are recorded at the lower of cost or market value, on an aggregate basis. A valuation allowance is established if the market value of such loans is lower than their cost, and operations are charged or credited for valuation adjustments. A portion of the premium on sale of SBA loans is recognized as other operating income at the time of the sale. The remaining portion of the premium (relating to the portion of the loan retained) is deferred and amortized over the remaining life of the loan as an adjustment to yield. Servicing assets are recognized when loans are sold with servicing retained. Servicing assets are recorded based on the present value of the contractually specified servicing fee, net of servicing costs, over the estimated life of the loan, using a discount rate based on the related note rate plus 1 to 2 %. Servicing assets are amortized in proportion to and over the period of estimated future servicing income. Management periodically evaluates the servicing asset for impairment, which is the carrying amount of the servicing asset in excess of the related fair value. Impairment, if it occurs, is recognized in a write down or charge-off in the period of impairment.

As part of our asset and liability management strategy, we have entered into derivative financial instruments, such as interest rate swaps, with the overall goal of minimizing the impact of interest rate fluctuations on our net interest margin. The objective for the interest rate swaps is to manage asset and liability positions in connection with our strategy of minimizing the impact of the interest rate fluctuations on interest rate margin. The interest rate swaps qualify as cash flow hedges under Statement of Financial Accounting Standards (SFAS) No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended and interpreted, and are designated as hedges of the variability of cash flows we receive from certain of our Prime-indexed loans. In accordance with SFAS No. 133, these interest rate swap agreements are measured at fair value and reported as assets or liabilities on the consolidated statement of financial condition. The portion of the change in the fair value of the swaps that is deemed effective in hedging the cash flows of the designated assets is recorded as a component of accumulated other comprehensive income (OCI), net of tax, and reclassified into interest income as such cash flows occur in the future. Any ineffectiveness resulting from the hedges is recorded as a gain or loss directly to the consolidated statement of income as a part of non-interest income. Currently, fair value of the interest rate swaps is estimated by discounting the future cash flows using the discount rate that was adjusted by the yield curve.

**Results of Operations*****General***

Our most significant source of income is net interest income, which is the difference between our interest income and our interest expense. Generally, interest income is generated from our loans and investments and interest expense is generated from interest-bearing deposits and other borrowings that we may have, such as Federal Home Loan Bank borrowings, and trust preferred securities. Our ability to generate profitable levels of net interest income is largely dependent on our ability to maintain sound asset quality and appropriate levels of capital and liquidity. Interest income and interest expense can fluctuate widely based on changes in the level of interest rates in the economy.

We attempt to minimize the effect of interest rate fluctuations on net interest margin by matching a portion of our interest-sensitive assets against our interest-sensitive liabilities. Net interest income also can be affected by a change

in the composition of assets and liabilities, for example, if higher yielding loans were to replace a like amount of lower yielding investment securities. Changes in volume and changes in rates also affect net interest income. Volume changes are caused by differences in the level of interest-earning assets and interest-bearing liabilities. Rate changes result from differences in yields earned on assets and rates paid on liabilities.



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We also have non-interest income from sources other than interest income. Those sources include service charges and fees on deposit accounts, fees from trade finance activities and the issuance of letters of credit, and net gains on sale of loans and investment securities available for sale. In addition to interest expense, our income is impacted by non-interest expenses, such as salaries and benefits, occupancy, furniture and equipment expenses, and provision for loan losses.

**Net Income**

Our income before the cumulative effect of a change in accounting principle was \$14.3 million for 2003 as compared to \$11.3 million for 2002 and \$10.8 million for 2001, representing an increase of 26.5% for 2003 and 4.6% for 2002. On a per diluted share basis, net earnings was \$1.24, \$0.98, and \$0.93, for 2003, 2002 and 2001, respectively. The annualized return on average assets was 1.32% for 2003, as compared to 1.44% for 2002 and 1.70% for 2001. The annualized return on average equity was 19.01% for 2003, compared with 18.17% for 2002 and 21.38% for 2001.

The cumulative effect of the change in accounting principle, related to the one-time recognition of negative goodwill in the consolidated statement of income at January 1, 2002 in accordance with SFAS No. 142, resulted in an increase of \$4.2 million of income, for a total net income for the year ended December 31, 2002 of \$15.5 million or \$1.35 per diluted share.

During 2003, the increase in net income was primarily attributable to higher net interest income resulting from growth in the loan portfolio and lower interest paid on interest-bearing liabilities. Net income in 2002 over 2001 also increased primarily due to growth in the loan portfolio despite a decline in net interest margin from a rate cut by the Federal Reserve, and an increase in non-interest income offset by higher non-interest expenses

The following table summarizes increases and decreases, as applicable, in income and expense for the years indicated.

**Operations Summary**

(Dollars in thousands)	Year Ended 2003	Increase (Decrease)		Year Ended 2002	Increase (Decrease)		Year Ended 2001
		Amount	%		Amount	%	
Interest income	\$61,425	\$12,854	26.5%	\$48,571	\$ 711	1.50%	\$47,860
Interest expense	15,934	2,470	18.3%	13,464	(3,506)	-20.7%	16,970
Net interest income	45,491	10,387	29.6%	35,107	4,217	13.7%	30,890
Provision for (recapture of) loan losses	5,385	2,699	100.5%	2,686	1,936	258.1%	750
Non-interest income	20,378	2,377	13.2%	18,001	2,677	17.5%	15,324
Non-interest expense	37,305	4,964	15.3%	32,341	3,977	14.0%	28,364
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