CATHAY GENERAL BANCORP
Form 10-K
March 01, 2007
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2006

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

Commission file number 0-18630

Cathay General Bancorp

(Exact name of Registrant as specified in its charter)

Delaware **(State or other jurisdiction of incorporation or organization)**	**95-4274680** **(I.R.S. Employer Identification No.)**
777 North Broadway, **Los Angeles, California** **(Address of principal executive offices)**	**90012** **(Zip Code)**

Registrant s telephone number, including area code:

(213) 625-4700

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

Title of each class	Name of each exchange on which registered
Common Stock, $.01 par value Preferred Stock Purchase Rights	The NASDAQ Stock Market LLC

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

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes þ No ¨

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes ¨ No þ

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ 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. ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ Accelerated filer ¨ Non-accelerated filer ¨

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

The aggregate market value of the voting stock held by non-affiliates of the Registrant, computed by reference to the price at which the common equity was last sold as of the last business day of the Registrant s most recently completed second fiscal quarter (June 30, 2006) was $1,659,636,319. This value is estimated solely for the purposes of this cover page. The market value of shares held by Registrant s directors, executive officers, and Employee Stock Ownership Plan have been excluded because they may be considered to be affiliates of the Registrant.

As of February 15, 2007, there were 51,779,544 shares of common stock outstanding, par value $.01 par value.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of Registrant s definitive proxy statement relating to Registrant s 2007 Annual Meeting of Stockholders which will be filed within 120 days of the fiscal year ended December 31, 2006, are incorporated by reference into Part III.

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CATHAY GENERAL BANCORP

2006 ANNUAL REPORT ON FORM 10-K

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Forward-Looking Statements

In this Annual Report on Form 10-K, the term Bancorp refers to Cathay General Bancorp and the term Bank refers to Cathay Bank. The terms Company, we, us, and our refer to Bancorp and the Bank collectively. The statements in this report include forward-looking statements within the meaning of the applicable provisions of the Private Securities Litigation Reform Act of 1995 regarding management s beliefs, projections, and assumptions concerning future results and events. These forward-looking statements may include, but are not limited to, such words as believes, expects, anticipates, intends, plans, estimates, may, will, should, could, predicts, potential, continue, or the negative of such terms and other comparable terminology or similar expressions. Forward-looking statements are not guarantees. They involve known and unknown risks, uncertainties, and other factors that may cause the actual results, performance, or achievements of the Bancorp to be materially different from any future results, performance, or achievements expressed or implied by such forward-looking statements. Such risks and uncertainties and other factors include, but are not limited to adverse developments or conditions related to or arising from:

- *expansion into new market areas;*
- *acquisitions of other banks, if any;*
- *fluctuations in interest rates;*
- *demographic changes;*
- *earthquake or other natural disasters;*
- *competitive pressures;*
- *deterioration in asset or credit quality;*
- *legislative and regulatory developments;*
- *changes in business strategy, including the formation of a real estate investment trust;*
- *general economic or business conditions in California and other regions where the Bank has operations; and*
- *other factors discussed in Part I Item 1A Risk Factors of this Annual Report on Form 10-K.*

Actual results in any future period may also vary from the past results discussed in this report. Given these risks and uncertainties, we caution readers not to place undue reliance on any forward-looking statements, which speak as of the date of this report. We have no intention and undertake no obligation to update any forward-looking statement or to publicly announce the results of any revision of any forward-looking statement to reflect future developments or events.

PART I

Item 1. Business.

Business of Bancorp

Overview

Cathay General Bancorp is a corporation organized under the laws of the State of Delaware. We are the holding company of Cathay Bank, a California state-chartered commercial bank. Our principal current business activity is to hold all of the outstanding stock of Cathay Bank. In the future, we may become an operating company or acquire savings institutions, other banks, or companies engaged in bank-related activities and may engage in or acquire such other businesses, or activities as may be permitted by applicable law. Our only office, and our principal place of business, is located at the main office of our wholly owned subsidiary, Cathay Bank, at 777 North Broadway, Los Angeles, California 90012. Our telephone number is (213) 625-4700. Our common stock is traded on the NASDAQ Global Select Market and our trading symbol is CATY .

We completed two acquisitions in 2006. In May 2006, we completed the acquisition of Great Eastern Bank for $56.3 million in cash and 1,181,164 shares of our common stock. In October 2006, we acquired New Asia Bancorp in a merger for $12.9 million in cash and 291,165 shares of our common stock.

Subsidiaries of Bancorp

In addition to its wholly-owned bank subsidiary, the Bancorp has the following subsidiaries:

Cathay Capital Trust I, Cathay Statutory Trust I and Cathay Capital Trust II. The Bancorp established Cathay Capital Trust I in June 2003, Cathay Statutory Trust I in September 2003, and Cathay Capital Trust II in December 2003 (collectively, the Trusts) as wholly owned subsidiaries. The Trusts are statutory business trusts. In separate transactions in 2003, the Trusts issued capital securities representing undivided preferred beneficial interests in the assets of the Trusts. The Trusts exist for the purpose of issuing the capital securities and investing the proceeds thereof, together with proceeds from the purchase of the common stock of the Trusts by the Bancorp, in Junior Subordinated Notes issued by the Bancorp. The Bancorp guarantees, on a limited basis, payments of distributions on the capital securities of the Trusts and payments on redemption of the capital securities of the Trusts. The Bancorp is the owner of all the beneficial interests represented by the common securities of the Trusts. The purpose of issuing the capital securities was to provide the Company with a cost-effective means of obtaining Tier 1 Capital for regulatory purposes in connection with the merger of GBC Bancorp (GBC merger) in 2003.

Because the Bancorp is not the primary beneficiary of the Trusts, the financial statements of the Trusts are not included in the consolidated financial statements of the Company. The capital securities of the Trusts are currently included in the Tier 1 capital of the Bancorp for regulatory capital purposes. On March 1, 2005, the Federal Reserve adopted a final rule that retains trust preferred securities in the Tier I capital of bank holding companies, but with stricter quantitative limits and clearer qualitative standards. Under the rule, after a five-year transition period, the aggregate amount of trust preferred securities and certain other capital elements will be limited to 25 percent of Tier I capital elements, net of goodwill, less any associated deferred tax liability. The amount of trust preferred securities and certain other elements in excess of the limit could be included in Tier II capital, subject to restrictions. In the last five years before maturity, the outstanding amount must be excluded from Tier I capital and included in Tier II capital. Bank holding companies with significant international operations would generally be expected to limit trust preferred securities and certain other capital elements to 15% of Tier I capital elements, net of goodwill. We do not expect that this rule will have a materially adverse effect on our capital positions.

GBC Venture Capital, Inc. The business purpose of GBC Venture Capital, Inc. is to hold equity interests (such as options or warrants) received as part of business relationships and to make equity investments in companies and limited partnerships subject to applicable regulatory restrictions.

Competition

Our primary business is to act as the holding company for the Bank. Accordingly, we face the same competitive pressures as those expected by the Bank. For a discussion of those risks, see Business of the Bank *Competition* below under this Item 1.

Employees

Due to the limited nature of the Bancorp s activities, the Bancorp currently does not employ any persons other than Bancorp s management, which includes the Chief Executive Officer and President, the Chief Operating Officer, the Chief Financial Officer, Executive Vice Presidents, the Secretary, Assistant Secretary, and the General Counsel. See also Business of the Bank *Employees* below under this Item 1.

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Business of the Bank

General

Cathay Bank was incorporated under the laws of the State of California on August 22, 1961, and was licensed by the California Department of Financial Institutions (previously known as the California State Banking Department), and commenced operations as a California state-chartered bank on April 19, 1962. Cathay Bank is an insured bank under the Federal Deposit Insurance Act, but, like most state-chartered banks of similar size in California, it is not a member of the Federal Reserve System.

The Bank s main office is located in the Chinatown area of Los Angeles, at 777 North Broadway, Los Angeles, California 90012. In addition, as of December 31, 2006, the Bank had branch offices in Southern California (20 branches), Northern California (10 branches), New York (nine branches), Massachusetts (one branch), Texas (one branch), Washington (two branches), Illinois (three branches), one loan production office in Dallas, Texas, and representative offices in Hong Kong, Shanghai, and Taipei. Each branch office has loan approval rights subject to the branch manager s authorized lending limits. The Company has filed an application to convert its Hong Kong representative office into a full service branch which is expected to open in the first half of 2007. Current activities of the Hong Kong, Shanghai, and Taipei representative offices are limited to coordinating the transportation of documents to the Bank s head office and performing liaison services.

Our primary market area is defined by the Community Reinvestment Act delineation, which includes the contiguous areas surrounding each of the Bank s branch offices. It is the Bank s policy to reach out and actively offer services to low and moderate income groups in the delineated branch service areas. Many of the Bank s employees speak both English and one or more Chinese dialects or Vietnamese, and are thus able to serve the Bank s Chinese, Vietnamese, and English speaking customers.

As a commercial bank, Cathay Bank accepts checking, savings, and time deposits, and makes commercial, real estate, personal, home improvement, automobile, and other installment and term loans. From time to time, the Bank invests available funds in other interest-earning assets, such as U.S. Treasury securities, U.S. government agency securities, state and municipal securities, mortgage-backed securities, asset-backed securities, corporate bonds, and venture capital investments. The Bank also provides letters of credit, wire transfers, forward currency spot and forward contracts, traveler s checks, safe deposit, night deposit, Social Security payment deposit, collection, bank-by-mail, drive-up and walk-up windows, automatic teller machines (ATM), Internet banking services, and other customary bank services.

The Bank primarily services individuals, professionals, and small to medium-sized businesses in the local markets in which its branches are located and provides residential mortgage loans, commercial mortgage loans, construction loans, home equity lines of credit; commercial loans, trade financing loans, Small Business Administration (SBA) loans; and installment loans to individuals for automobile, household, and other consumer expenditures.

Through Cathay Wealth Management, Cathay Bank provides its customers the ability to trade stocks online and to purchase mutual funds, annuities, equities, bonds, and short-term money market instruments, through PrimeVest Financial Services.

Securities

The Bank s securities portfolio is managed in accordance with a written Investment Policy which addresses strategies, types, and levels of allowable investments, and which is reviewed and approved by our Board of Directors.

Our investment portfolio is managed to meet our liquidity needs through proceeds from scheduled maturities and is also utilized for pledging requirements for deposits of state and local subdivisions, securities sold under repurchase agreements, and Federal Home Loan Bank (FHLB) advances. The portfolio is comprised of U.S. government agency securities, mortgage-backed securities, collateralized mortgage obligations, obligations of states and political subdivisions, corporate debt instruments and equity securities. At December 31, 2006, the aggregate investment securities portfolio, with a carrying value of $1.52 billion, was classified as investment grade securities. We do not include federal funds sold and certain other short-term securities as investment securities. These other investments are included in cash and cash equivalents.

Information concerning the carrying value, maturity distribution, and yield analysis of the Company s securities available-for-sale portfolios as well as a summary of the amortized cost and estimated fair value of the Bank s securities by contractual maturity is included in this Annual Report on Form 10-K at Part II Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations, and in Note 4 to the Consolidated Financial Statements.

Loans

Cathay Bank s Board of Directors and senior management establish, review, and modify Cathay Bank s lending policies. These policies include, but are not limited to a potential borrower s financial condition, ability to repay the loan, character, existence of secondary repayment source (such as guaranty), quality and availability of collateral, capital, leverage capacity of the borrower, market conditions for the borrower s business or project, and prevailing economic trends and conditions. For mortgage loans, our lending policies require an independent appraisal of the real property in accordance with applicable regulatory guidelines. Loan originations are obtained through a variety of sources, including existing customers, walk-in customers, referrals from brokers or existing customers, and advertising. While loan applications are accepted at all branches, the Bank s centralized document department supervises the application process including documentation of loans, review of appraisals, and credit reports.

Commercial Mortgage Loans. These loans are typically secured by first deeds of trust on commercial properties, including primarily commercial retail properties, shopping centers, and owner-occupied industrial facilities, and secondarily office buildings, multiple-unit apartments, and multi-tenanted industrial properties.

The Bank also makes medium-term commercial mortgage loans which are generally secured by commercial or industrial buildings where the borrower uses the property for business purposes or derives income from tenants.

Commercial Loans. The Bank provides financial services to diverse commercial and professional businesses in its market areas. Commercial loans consist primarily of short-term loans (normally with a maturity of up to one year) to support general business purposes, or to provide working capital to businesses in the form of lines of credit to finance trade-finance loans. The Bank continues to focus primarily on commercial lending to small-to-medium size businesses, within the Bank s geographic market areas. Commercial loan pricing is generally at a rate tied to the prime rate, as quoted in the Wall Street Journal, or the Bank s reference rate.

SBA Loans. The Bank originates SBA loans in California, under the preferred lender status. Preferred lender status is granted to a lender which has made a certain number of SBA loans and which, in the opinion of the SBA, has staff qualified and experienced in small business loans. As a preferred lender, the Bank s SBA Lending Group has the authority to issue, on behalf of the SBA, the SBA guaranty on loans under the 7(a) program which may result in shortening the time it takes to process a loan. In addition, under this program, the SBA delegates loan underwriting, closing, and most servicing and liquidation authority and responsibility to selected lenders.

The Bank utilizes both the 504 program, which is focused toward long-term financing of buildings and other long-term fixed assets, and the 7(a) program, which is the SBA s primary loan program and which can be used for financing of a variety of general business purposes such as acquisition of land and buildings, equipment, inventory and working capital needs of eligible businesses generally over a 5- to 25-year term. The collateral

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position in the SBA loans is enhanced by the SBA guaranty in the case of 7(a) loans, and by lower loan-to-value ratios under the 504 program. The Bank has sold and may, in the future, sell the guaranteed portion of certain of its SBA 7(a) loans in the secondary market. SBA loan pricing is generally at a rate tied to the prime rate, as quoted in the Wall Street Journal.

Residential Mortgage Loans. The Bank originates single-family-residential mortgage loans, and home equity lines of credit. The single-family-residential mortgage loans are comprised of conforming, nonconforming, and jumbo residential mortgage loans, and are secured by first and subordinate liens on single (one-to-four) family residential properties. The Bank s products include a fixed-rate residential mortgage loan, an adjustable-rate residential mortgage loan, and a variable-rate home equity line of credit loan. The pricing on our variable-rate home equity line of credit is generally at a rate tied to the prime rate, as quoted in The Wall Street Journal, or the Banks reference rate. Mortgage loans are underwritten in accordance with the Bank s guidelines, on the basis of the borrower s financial capabilities, historical loan quality, and other relevant qualifications. As of December 31, 2006, approximately 71% of the Bank s residential mortgages were for properties located in California.

Real Estate Construction. The Bank s real estate construction loan activity focuses on providing short-term loans to individuals and developers, primarily, for the construction of multi-unit projects. Residential real estate construction loans are typically secured by first deeds of trust and guarantees of the borrower. The economic viability of the projects, borrower s credit worthiness, and borrower s and contractor s experience are primary considerations in the loan underwriting decision. The Bank utilizes approved independent licensed appraisers and monitors projects during the construction phase through construction inspections and a disbursement program tied to the percentage of completion of each project. The Bank also occasionally makes unimproved property loans to borrowers who intend to construct a single-family-residence on their lots generally within twelve months. In addition, the Bank also makes commercial real estate construction loans to high net worth clients with adequate liquidity for construction of office and warehouse properties. Such loans are typically secured by first deeds of trust and are guaranteed by the borrower.

Installment Loans. Installment loans tend to be fixed rate and longer-term (one-to-six year maturities). These loans are funded primarily for the purpose of financing the purchase of automobiles and other personal uses of the borrower.

Distribution and Maturity of Loans. Information concerning loan type and mix, distribution of loans and maturity of loans is included in this Annual Report on Form 10-K at Part II Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations, and in Note 5 to the Consolidated Financial Statements.

Asset Quality

The Bank s lending and credit policies require management to review regularly the Bank s loan portfolio so that the Bank can monitor the quality of its assets. If during the ordinary course of business, management becomes aware that a borrower may not be able to meet his or her contractual or payment obligations under a loan, then that loan is supervised more closely with consideration given to placing the loan on non-accrual status, the need for an additional allowance for loan losses, and (if appropriate) partial or full charge-off.

Under the Bank s current policy a loan will be placed on a non-accrual status if interest or principal is past due 90 days or more, or in cases where management deems the full collection of principal and interest unlikely. When a loan is placed on non-accrual status, any current year unpaid accrued interest is reversed against current income and any unpaid accrued interest from the prior year is reversed against the allowance for loan losses. Thereafter, any payment is generally first applied towards the principal balance. Depending on the circumstances, management may elect to continue the accrual of interest on certain past due loans if partial payment is received and/or the loan is well collateralized, and in the process of collection. The loan is generally returned to accrual status when the borrower has brought the past due principal and interest payments current and, in the opinion of management, the borrower has demonstrated the ability to make future payments of

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principal and interest as scheduled. A non accrual loan may also be returned to accrual status if all principal and interest contractually due are reasonably assured of repayment within a reasonable period and there has been a sustained period of payment performance. Information concerning non-accrual, past due, and restructured loans is included in this Annual Report on Form 10-K at Part II Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations, and in Note 5 to the Consolidated Financial Statements.

Non-performing Loans and Allowance for Loan Losses. Information concerning non-performing loans, allowance for loan losses, loans charged-off, loan recoveries, and other real estate owned is included in this Annual Report on Form 10-K at Part II Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations, and in Note 5 and Note 6 to the Consolidated Financial Statements.

Deposits

The Bank offers a variety of deposit products in order to meet its customers needs. As of December 31, 2006, the Bank offered passbook accounts, checking accounts, money market deposit accounts, certificates of deposit, individual retirement accounts, college certificates of deposit, and public funds deposits. These products are priced in order to promote growth of deposits. From time to time, the Bank may offer special deposit promotions.

The Bank s deposits are generally obtained from residents within the Company s geographic market area. The Bank utilizes traditional marketing methods to attract new customers and deposits, by offering a wide variety of products and services and utilizing various forms of advertising media. Information concerning types of deposit accounts, average deposits and rates, and maturity of time deposits of $100,000 or more is included in this Annual Report on Form 10-K at Part II Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations.

Borrowings

Borrowings from time to time include securities sold under agreements to repurchase, the purchase of federal funds, funds obtained as advances from the FHLB of San Francisco, borrowing from other financial institutions, subordinated debt, and Junior Subordinated Notes. Information concerning the types, amounts, and maturity of our borrowings is included in Note 10 and Note 11 to the Consolidated Financial Statements.

Return on Equity and Assets

Information concerning the return on average assets, return on average stockholders equity, the average equity to assets ratio and the dividend payout ratio is included in Part II Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations.

Interest Rates and Differentials

Information concerning the interest-earning asset mix, average interest-earning assets, average interest-bearing liabilities and the yields on interest-earning assets and interest-bearing liabilities is included in Part II Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations.

Analysis of Changes in Net Interest Income

An analysis of changes in net interest income due to changes in rate and volume is included in Part II Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations.

Commitments and Letters of Credit

Information concerning the Bank s outstanding loan commitments and letters of credit is included in Note 14 to the Consolidated Financial Statements.

Expansion

We continue to look for opportunities to expand the Bank s branch network by seeking new branch locations and/or by acquiring other financial institutions to diversify our customer base in order to compete for new deposits and loans, and to be able to serve our customers more effectively. In addition to the acquisitions of Great Eastern Bank and New Asia Bancorp (both of which were completed in 2006), on November 21, 2006, we entered into an agreement to acquire United Heritage Bank for approximately $9.4 million in cash subject to adjustments, if any. United Heritage Bank was formed in 1997 in Edison, New Jersey and has one branch office. As of December 31, 2006, total assets of United Heritage Bank were $57.5 million. We expect to convert our Hong Kong representative office into a full service branch in the first half of 2007.

Subsidiaries of Cathay Bank

Cathay Investment Company is a wholly-owned subsidiary of the Bank that was formed in 1984 to invest in real property. In 1987, Cathay Investment Company opened an office in Taipei, Taiwan, to promote Taiwanese real estate investments in Southern California. The office in Taipei is located at Sixth Floor, Suite 3, 146 Sung Chiang Road, Taipei, Taiwan.

Cathay Real Estate Investment Trust (CB REIT) is a real estate investment trust subsidiary of the Bank that was formed in February 2003 to provide the Bank with flexibility in raising capital. During 2003, the Bank contributed $1.13 billion in loans and securities to CB REIT in exchange for 100% of the common stock of CB REIT. CB REIT sold $4.4 million in 2003 and $4.2 million in 2004 of its 7.0% Series A Non-Cumulative preferred stock to accredited investors. During 2005, CB REIT repurchased $131,000 of its preferred stock. At December 31, 2006, total assets of CB REIT were consolidated with the Company and totaled approximately $1.42 billion. See discussion below in Part I Item 1A Risk Factors of this Annual Report on Form 10-K.

GBC Investment & Consulting Company, Inc. a wholly-owned subsidiary of the Bank, was incorporated to provide expertise in the areas of investment and consultation on an international and domestic basis. It is currently inactive.

GBC Real Estate Investments, Inc. is a wholly-owned subsidiary of the Bank. The purpose of this subsidiary is to engage in real estate investment activities. To date, there have been no transactions involving this subsidiary.

Cathay Trade Services, Asia Limited (Trade Services), is a wholly-owned subsidiary of the Bank. Trade Services is a Hong Kong based non-financial institution that serves as a vehicle to reissue, in Hong Kong, letters of credit for the account of its U.S. based import customers in favor of beneficiaries.

GB Capital Trust II (GB REIT) was incorporated in January 2002 to provide General Bank with flexibility in raising capital. As a result of the GBC merger, the Bank owns 100% of the voting common trust units issued by the GB REIT. At December 31, 2006, total assets of GB REIT were consolidated with the Company and were approximately $861 million.

Cathay Community Development Corporation (CCDC) is a wholly-owned subsidiary of the Bank and was incorporated on September 14, 2006. The primary mission of CCDC is to help in the development of low-income neighborhoods in the Bank s California and New York service areas by providing or facilitating the availability of capital to businesses and real estate developers working to renovate these neighborhoods. On October 6, 2006, CCDC formed a wholly-owned subsidiary, Cathay New Asia Community Development Corporation (CNACDC), to assume New Asia Bank s pre-existing New Markets Tax Credit activities in the greater Chicago area by providing or facilitating the availability of capital to businesses and real estate developers working to renovate these neighborhoods. Both CCDC and CNACDC will seek to obtain community development entity status and CNACDC will also seek to participate in the U.S. Treasury Department s New Markets Tax Credit program.

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Competition

The banking business in California and the other markets served by the Bank, is highly competitive. The Bank competes for deposits and loans with other commercial banks, savings and thrift institutions, brokerage houses, insurance companies, mortgage companies, credit unions, credit card companies and other financial and non-financial institutions and entities. The Bank also competes with other banks of similar size that are focused on servicing the same communities that are served by the Bank. In addition, the Bank competes with other entities (both governmental and private industry) that are seeking to raise capital through the issuance and sale of debt and equity securities. Many of these competitors have substantially greater financial, marketing, and administrative resources than the Bank and may also offer services that are not offered directly by the Bank, all of which results in greater and more intense competition for the Bank.

In addition, current federal legislation encourages increased competition between different types of financial institutions and has encouraged new entrants to enter the financial services market. Competitive conditions are expected to continue to intensify as legislation is enacted which will have the effect of, among other things, (i) eliminating historical barriers that limited participation by certain institutions in certain markets, (ii) increasing the cost of doing business for banks, and/or (iii) affecting the competitive balance between banks and other financial and non-financial institutions and entities. Technological factors, such as on-line banking and brokerage services, and economic factors are also expected to increase competitive conditions.

To compete with other financial institutions in its primary service areas, the Bank relies principally upon local promotional activities, personal contacts by its officers, directors, employees, and stockholders, extended hours on weekdays, Saturday banking, Sunday banking in certain locations, Internet banking, an Internet website (*www.cathaybank.com),* and certain other specialized services. The content of our website is not incorporated into and is not part of this Annual Report on Form 10-K.

If a proposed loan exceeds the Bank s internal lending limits, the Bank has, in the past, and may in the future, arrange such loans on a participation basis with correspondent banks. The Bank also assists customers requiring other services not offered by the Bank to obtain such services from its correspondent banks.

In California, at least two Chinese-American banks of comparable size compete for loans and deposits with the Bank and at least two super-regional banks compete with the Bank for deposits. In addition, there are many other Chinese-American banks in both Southern and Northern California. Banks from the Pacific Rim countries, such as Taiwan, Hong Kong, and China also continue to open branches in the Los Angeles area, thus increasing competition in the Bank s primary markets. See discussion below in Part I Item 1A Risk Factors of this Annual Report on Form 10-K.

Employees

As of December 31, 2006, the Bancorp and Bank (including subsidiaries) employed approximately 1,051 persons, including 332 banking officers. None of the employees are represented by a union. We believe that our relations with our employees are good.

Available Information

We invite you to visit us at our Web site at *www.cathaybank.com*, to access free of charge Bancorp s Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to those reports, all of which are made available as soon as reasonably practicable after we electronically file such material with or furnish it to the Securities and Exchange Commission (the SEC). In addition, you can write to us to obtain a free copy of any of those reports at Cathay General Bancorp, 777 North Broadway, Los Angeles, California 90012, Attn: Investor Relations. These reports are also available through the SEC s Public Reference Room, located at 100 F Street NE, Washington, DC 20549 and online at the SEC s website, located at *www.sec.gov*. Investors can obtain information about the operation of the SEC s Public Reference Room by calling 800-SEC-0300.

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Regulation and Supervision

General

The Bancorp and the Bank are subject to significant regulation and restrictions by federal and state regulatory agencies. The following discussion of statutes and regulations is a summary and does not purport to be complete. This discussion is qualified in its entirety by reference to the statutes and regulations referred to in this discussion. No assurance can be given that these statutes and regulations will not change in the future.

Bank Holding Company Regulation

The Bancorp is a bank holding company within the meaning of the Bank Holding Company Act (BHCA) and is registered as such with the Federal Reserve Board. A bank holding company is required to file with the Federal Reserve Board annual reports and other information regarding its business operations and those of its nonbanking subsidiaries. It is also subject to supervision and examination by the Federal Reserve Board. Examinations are designed to inform the Federal Reserve Board of the financial condition and nature of the operations of the bank holding company and its subsidiaries and to monitor compliance with the BHCA and other laws affecting the operations of bank holding companies. To determine whether potential weaknesses in the condition or operations of bank holding companies might pose a risk to the safety and soundness of their subsidiary banks, examinations focus on whether a bank holding company has adequate systems and internal controls in place to manage the risks inherent in its business, including credit risk, interest rate risk, market risk (for example, from changes in value of portfolio instruments and foreign currency), liquidity risk, operational risk, legal risk, and reputation risk.

Bank holding companies may be subject to potential enforcement actions by the Federal Reserve Board 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 Federal Reserve Board or any written agreement with the Federal Reserve Board. Enforcement actions may include the issuance of cease and desist orders, the imposition of civil money penalties, the issuance of directives to increase capital, formal and informal agreements, or removal and prohibition orders against institution-affiliated parties.

Bank holding companies are subject to capital maintenance requirements on a consolidated basis that are parallel to those required for banks. See Capital Adequacy Requirements below. Further, 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 Federal Reserve Board s view that, in serving as a source of strength to its subsidiary banks, 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 financial flexibility and capital-raising capacity to obtain additional resources for assisting its subsidiary banks. A bank holding company s failure to meet its source-of-strength obligations may constitute an unsafe and unsound practice or a violation of the Federal Reserve Board s regulations, or both.

The source-of-strength doctrine most directly affects bank holding companies where a bank holding company s subsidiary bank fails to maintain adequate capital levels. In such a situation, the subsidiary bank will be required by the bank s federal regulator to take prompt corrective action. The prompt corrective action regulatory framework is discussed below. See Prompt Corrective Action Provisions below. Under the prompt corrective action program, the subsidiary bank will be required to submit to its federal regulator a capital restoration plan and to comply with the plan. Each parent company that controls the subsidiary bank will be required to provide assurances of compliance by the bank with the capital restoration plan. However, the aggregate liability of such parent companies will not exceed the lesser of (i) 5% of the bank s total assets at the time it became undercapitalized and (ii) the amount necessary to bring the bank into compliance with the plan. Failure to restore capital under a capital restoration plan can result in the bank s being placed into receivership if it becomes critically undercapitalized. A bank subject to prompt corrective action also may affect its parent bank holding company in other ways. These include possible restrictions or prohibitions on dividends to the parent bank holding company by the bank; subordinated debt payments to the parent; and other transactions between the bank and the holding company. In addition, the regulators may impose restrictions on the ability of the holding company itself to make distributions; require divestiture of holding company affiliates that pose a significant risk to the bank; and require divestiture of the undercapitalized subsidiary bank.

A bank holding company is generally required to give the Federal Reserve Board prior notice of any redemption or repurchase of its own equity securities, if the consideration to be paid, together with the consideration paid for any repurchases in the preceding year, is equal to 10% or more of the company s consolidated net worth.

A bank holding company is required to obtain Federal Reserve Board approval before acquiring, directly or indirectly, ownership or control of any voting shares of any bank if it would thereby directly or indirectly own or control more than 5% of the voting stock of that bank, unless it already owns a majority of the voting stock. Prior approval from the Federal Reserve is also required in connection with the acquisition of control of a bank or another bank holding company, or business combinations with another bank holding company.

The business activities and investments of bank holding companies are also regulated by the BHCA. Bank holding companies, as a general rule, are prohibited from acquiring direct or indirect control of more than 5% of the outstanding voting shares of any company that is not engaged in the business of banking or managing or controlling banks or furnishing services to or performing services for its subsidiary banks. However, subject to prior approval or notification to the Federal Reserve Board, bank holding companies are permitted to engage in activities that are so closely related to banking as to be deemed a proper incident thereto. As a general rule, such closely related activities do not include underwriting or dealing in securities or underwriting of insurance. More expansive non-banking activities are permitted for bank holding companies that qualify as financial holding companies under the BHCA, but the Bancorp has not sought this status even though it qualifies to do so. See section below entitled Financial Modernization Act.

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

Financial Modernization Act

The Gramm-Leach-Bliley Financial Modernization Act became effective March 11, 2000 (the Financial Modernization Act). It repealed two 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 restricted officer, director, or employee interlocks between a member bank and any company or person primarily engaged in specified securities activities. In addition, it also contained 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 bank holding company that qualifies as a financial holding company. Financial activities are broadly defined to include not only banking, insurance, and securities activities, but also merchant banking and additional activities that the Federal Reserve Board, in consultation with the Secretary of the Treasury, determines to be financial in nature, incidental to such financial activities, or complementary activities that do not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally.

In order for the Bancorp to engage in expanded financial activities permissible under the Financial Modernization Act, it must elect to qualify as a financial holding company. The Bancorp currently meets the requirements to make this election, but its management has thus far decided not to do so, as the Bancorp has no present intention to engage in the expanded range of financial activities permitted to financial holding companies.

Bank Regulation

Federal law mandates frequent examinations of all banks, with the costs of examinations to be assessed against the bank being examined. The Bank s primary federal regulator is the Federal Deposit Insurance Corporation (FDIC). The FDIC has substantial enforcement powers over the banks that it regulates. Civil and criminal penalties may be imposed on such institutions and persons associated with those institutions for violations of laws or regulations.

As a California commercial bank whose deposits are insured by the FDIC, the Bank is subject to regulation, supervision and regular examination by the California Department of Financial Institutions and the FDIC, and must comply with applicable regulations of the Federal Reserve Board. The regulations of these agencies govern most aspects of the Bank s business, including the making of periodic reports, its activities relating to dividends, investments, loans, borrowings, capital requirements, certain check-clearing activities, branching, mergers and acquisitions and numerous other areas. Supervision, legal action, and examination by these agencies is generally intended to protect depositors, creditors, borrowers and the deposit insurance fund and generally is not intended for the protection of stockholders. The activities of the Bank are also regulated by state law.

California law authorizes the Bank to engage in the commercial banking business, which generally encompasses lending, deposit-taking, and all other kinds of banking business in which banks, including national banks, customarily engage in the United States. In addition, California banks are authorized by state law to invest in subsidiaries that engage in real estate development and conduct certain real estate related activities (including property management and real estate appraisal) and in management consulting and data processing services for third parties. Such operating subsidiaries are not permitted by California law to engage in insurance activities. However, federal law prohibits the Bank and its subsidiaries from engaging in any banking activities in which a national bank (acting as principal rather than agent) cannot engage, unless the activity is found by the FDIC not to pose a significant risk to the deposit insurance fund. This prohibition does not extend to those activities in which the Bank (or a subsidiary of the Bank) is authorized under state law to engage as agent, advisor, custodian, administrator or trustee for its customer. The FDIC has found real estate development not to pose a significant risk to the deposit insurance fund if conducted within specified parameters.

In addition, under the Financial Modernization Act, the Bank can engage in expanded financial activities through specially qualified financial subsidiaries to the same extent as a national bank. In order to form a financial subsidiary, the Bank must be well-capitalized and would be subject to the same capital deduction, risk management and affiliate transaction rules as apply to national banks. Generally, a financial subsidiary is permitted to engage in activities that are financial in nature or incidental thereto, even though they are not permissible for the national bank to conduct directly within the bank. The definition of financial in nature includes, among other items, underwriting, dealing in or making a market in securities, including, for example, distributing shares of mutual funds. The subsidiary may not, however, engage as principal in underwriting insurance (other than credit life insurance), issue annuities, or engage in real estate development or investment or merchant banking. Presently, none of the Bank s subsidiaries are financial subsidiaries.

The Bank operates branches and/or loan production offices in New York, Illinois, Massachusetts, Texas, and Washington. While the California Department of Financial Institutions remains the Bank s primary state regulator, the Bank s operations in these jurisdictions are subject to examination and supervision by local bank regulators, and transactions with customers in those states are subject to local laws, including consumer protection laws.

The Bank also operates representative offices in Taipei, Shanghai, and Hong Kong. The operations of these offices (and limits on the scope of their activities) are subject to local law in those jurisdictions in addition to regulation and supervision by the California Department of Financial Institutions and the FDIC.

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Deposit Insurance

The FDIC is an independent federal agency that insures deposits, up to prescribed statutory limits, of federally insured banks and savings institutions and safeguards the safety and soundness of the banking and savings industries. Previously, the FDIC administered two separate insurance funds, the Bank Insurance Fund (BIF), which generally insured commercial bank and state savings bank deposits, and the Savings Association Insurance Fund (SAIF), which generally insured savings association deposits. Under the Federal Deposit Insurance Reform Act of 2005 (the "FDI Reform Act"), which was signed into law in February 2006:

- the BIF and the SAIF were merged into a new combined fund, called the Deposit Insurance Fund (DIF), effective March 31, 2006;
- the current $100,000 deposit insurance coverage cap has been indexed for inflation (with adjustments every five years commencing January 1, 2011);
- deposit insurance coverage for retirement accounts has been increased to $250,000 per participant subject to adjustment for inflation; and
- a cap has been imposed on the level of the DIF, providing for the payment of dividends when the DIF grows beyond a specified threshold.

The FDIC has also been given greater latitude over management of the DIF s reserve ratio to help dampen sharp fluctuations in assessment rates. Pursuant to enabling regulations enacted in November of 2006, the FDIC has set the designated reserve ratio for 2007 at 1.25% of estimated insured deposits.

The FDI Reform Act has revised the prior risk-based system for assessing premiums, with the intention of more closely linking premiums to the risk posed by institutions to the DIF. The FDIC will evaluate risk to the DIF based on three primary factors: supervisory ratings for all institutions; financial ratios for most institutions; and long-term debt issuer ratings for large institutions that have such ratings. As a result of these rules, it is contemplated that the assessment rates that took effect at the beginning of 2007 for nearly all of the industry will vary between five and seven cents for every $100 of domestic deposits.

Banks in existence on December 31, 1996, that paid assessments prior to that date (or their successors) are entitled to a one-time credit against future assessments based on their past contributions to the BIF. As a result, most banks will have assessment credits that will initially offset all of their deposit premiums for 2007. The Bank anticipates that it will be able to offset its deposit insurance premium for 2007 with an estimated assessment credit of $ 4.0 million for premiums paid prior to 1996.

In addition, banks must pay a fluctuating amount towards the retirement of the Financing Corporation bonds (commonly referred to as FICO bonds) which had been issued in the 1980s to assist in the recovery of the savings and loan industry. The current FICO assessment rate as of January 1, 2007, for institutions insured by the Deposit Insurance Fund (DIF) is $0.0122 per $100 of assessable deposit. The FICO assessments are adjusted quarterly and do not vary depending on an institution s capitalization or supervisory evaluations. These assessments will continue until the Financing Corporation bonds mature in 2017.

Capital Adequacy Requirements

The Bank (as well as the Bancorp) is subject to capital adequacy regulations. Those regulations incorporate both risk-based and leverage capital requirements. These capital adequacy regulations define capital in terms of core capital elements, or Tier 1 capital, and supplemental capital elements, or Tier 2 capital. Tier 1 capital is generally defined as the sum of the core capital elements less goodwill and certain other deductions, notably the unrealized net gains or losses (after tax adjustments) on available for sale investment securities carried at fair value. The following items are included as core capital elements: (i) common shareholders equity; (ii) qualifying non-cumulative perpetual preferred stock and related surplus, including trust preferred securities (but not in excess of 25% of Tier 1 capital); and (iii) minority interests in the equity accounts of consolidated subsidiaries.

Supplementary capital elements include: (i) allowance for loan and lease losses (but not more than 1.25% of an institution s risk-weighted assets); (ii) perpetual preferred stock and related surplus not qualifying as core capital; (iii) hybrid capital instruments, perpetual debt and mandatory convertible debt instruments; and (iv) term subordinated debt and intermediate-term preferred stock and related surplus. The maximum amount of supplemental capital elements which qualifies as Tier 2 capital is limited to 100% of Tier 1 capital.

The minimum required ratio of qualifying total capital to total risk-weighted assets, or the total risk-based capital ratio, is 8.0%, at least one-half of which must be in the form of Tier 1 capital, and the minimum required ratio of Tier 1 capital to total risk-weighted assets, or the Tier 1 risk-based capital ratio, is 4.0%. Risk-based capital ratios are calculated 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, such as letters of credit and recourse arrangements, which are recorded as off-balance sheet items. Under the risk-based capital guidelines, the 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 certain U.S. Treasury securities, to 100% for assets with relatively high credit risk, such as business loans. As of December 31, 2006, the Bank s total risk-based capital ratio was 10.99% and its Tier 1 risk-based capital ratio was 9.37%. As of December 31, 2006, the Bancorp s Total Risk-Based Capital ratio was 11.00% and its Tier 1 risk-based capital ratio was 9.40%

The risk-based capital requirements also take into account concentrations of credit (*i.e.*, relatively large proportions of loans involving one borrower, industry, location, collateral or loan type) and the risks of non-traditional activities (those that have not customarily been part of the banking business). The regulations require institutions with high or inordinate levels of risk to operate with higher minimum capital standards and authorize the regulators to review an institution s management of such risks in assessing an institution s capital adequacy.

The risk-based capital regulations also include exposure to interest rate risk as a factor that the regulators will consider in evaluating a bank s capital adequacy. Interest rate risk is the exposure of a bank s current and future earnings and equity capital arising from adverse movements in interest rates. While interest risk is inherent in a bank s role as financial intermediary, it introduces volatility to bank earnings and to the economic value of the institution.

Since 1997, the federal banking regulators have also required financial institutions with significant exposure to market risk to maintain adequate capital to support that exposure. In September of 2006, the federal banking agencies proposed revisions to the market risk capital rules to enhance the rules sensitivity to market risk and to require public disclosure of certain qualitative and quantitative market risk information. Financial institutions covered by this aspect of the capital rules are those with trading assets constituting 10% or more of total assets, or $1 billion or more, or such other institutions as the appropriate federal bank regulatory agency deems appropriate to include. Neither the Bancorp nor the Bank is currently subject to the market risk capital rules.

The Bancorp and the Bank are also required to maintain a leverage capital ratio designed to supplement the risk-based capital guidelines. Banks and bank holding companies that have received the highest rating of the five categories used by regulators to rate banks and that are not anticipating or experiencing any significant growth must maintain a ratio of Tier 1 capital (net of all intangibles) to adjusted total assets of at least 3%. All other institutions are required to maintain a leverage ratio of at least 100 to 200 basis points above the 3% minimum, for a minimum of 4% to 5%. Pursuant to federal regulations, banks must maintain capital levels commensurate with the level of risk to which they are exposed, including the volume and severity of problem loans. Federal regulators may, however, set higher capital requirements when a bank s particular circumstances warrant. As of December 31, 2006, the Bank s leverage capital ratio was 8.95%, and the Bancorp s leverage capital ratio was 8.98%, both ratios exceeding regulatory minimums.

The federal regulatory authorities risk-based capital guidelines are based upon the 1988 capital accord of the Basel Committee on Banking Supervision (Basel I). In June 2004, the Basel Committee on Banking Supervision published a new capital accord, referred to as Basel II, for adoption by those countries adhering to

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the overall Basel framework. Basel II emphasizes internal assessment of credit, market and operational risk, supervisory assessment and market discipline in determining minimum capital requirements. Basel II will become mandatory for US banks with over $250 billion in assets or total on-balance-sheet foreign exposure of $10 billion or more. Other banks can elect to be governed by Basel II. Basel II would not apply to the Bancorp or the Bank, and management does not contemplate electing to calculate its risk-based capital based on the Basel II capital framework.

In October 2005, U.S. banking regulators issued an advance rulemaking notice that contemplated modifications to the Basel I risk-based capital framework applicable to domestic banking organizations that are not required (or do not elect) to adopt Basel II. This was followed by a rulemaking notice dated December 26, 2006, also proposing modifications to the Basel I framework. These proposed modifications to Basel I are referred to as Basel 1A. Basel 1A is designed to redress perceived competitive inequities between financial institutions using Basel II and those using Basel I. In principle, Basel 1A would (i) expand the number of risk-weight categories, (ii) allow the use of external credit ratings to risk weight certain exposures, (iii) expand the range of collateral and guarantors that qualify for a lower risk weight, (iv) use loan-to-value ratios to risk weight most residential mortgages, and (v) revise other provisions of the existing risk-based capital requirements to increase the risk sensitivity of the risk-based capital rules for those banks that will not use Basel II. If implemented, Basel 1A would likely apply to the Bancorp and the Bank.

Prompt Corrective Action Provisions

Federal law requires each federal banking agency to take prompt corrective action when a bank falls below one or more prescribed minimum capital ratios. The federal banking agencies have by regulation defined the following five capital categories: well capitalized (total risk-based capital ratio of 10%; Tier 1 risk-based capital ratio of 6%; and leverage capital ratio of 5%); adequately capitalized (total risk-based capital ratio of 8%; Tier 1 risk-based capital ratio of 4%; and leverage capital ratio of 4%) (or 3% if the institution receives the highest rating from its primary regulator); undercapitalized (total risk-based capital ratio of less than 8%; Tier 1 risk-based capital ratio of less than 4%; or leverage capital ratio of less than 4%) (or 3% if the institution receives the highest rating from its primary regulator); significantly undercapitalized (total risk-based capital ratio of less than 6%; Tier 1 risk-based capital ratio of less than 3%; or leverage capital ratio less than 3%); and critically undercapitalized (tangible equity to total assets less than 2%). A bank may be treated as though it were in the next lower capital category if after notice and the opportunity for a hearing, the appropriate federal agency finds an unsafe or unsound condition or practice so warrants, but no bank may be treated as critically undercapitalized unless its actual capital ratio warrants such treatment. Undercapitalized banks are required to submit capital restoration plans and, during any period of capital inadequacy, may not pay dividends or make other capital distributions, are subject to asset growth and expansion restrictions and may not be able to accept brokered deposits. At each successively lower capital category, banks are subject to increased restrictions on operations.

Dividends

Holders of the Bancorp s common stock are entitled to receive dividends as and when declared by the board of directors out of funds legally available therefore under the laws of the State of Delaware. Delaware corporations such as the Bancorp may make distributions to their stockholders out of their surplus, or out of their net profits for the fiscal year in which the dividend is declared and for the preceding fiscal year. However, dividends may not be paid out of a corporation s net profits if, after the payment of the dividend, the corporation s capital would be less than the capital represented by the issued and outstanding stock of all classes having a preference upon the distribution of assets.

The Federal Reserve Board has advised bank holding companies that it believes that payment of cash dividends in excess of current earnings from operations is inappropriate and may be cause for supervisory action. As a result of this policy, banks and their holding companies may find it difficult to pay dividends out of retained

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earnings from historical periods prior to the most recent fiscal year or to take advantage of earnings generated by extraordinary items such as sales of buildings or other large assets in order to generate profits to enable payment of future dividends. Further, the Federal Reserve Board s position that holding companies are expected to provide a source of managerial and financial strength to their subsidiary banks potentially restricts a bank holding company s ability to pay dividends.

The Bank is a legal entity that is separate and distinct from its holding company. The Bancorp receives income through dividends paid by the Bank. Subject to the regulatory restrictions described below, future cash dividends by the Bank will depend upon management s assessment of future capital requirements, contractual restrictions, and other factors.

The powers of the board of directors of the Bank to declare a cash dividend to its holding company is subject to California law, which restricts the amount available for cash dividends to the lesser of a bank s retained earnings or net income for its last three fiscal years (less any distributions to shareholders made during such period). Where the above test is not met, cash dividends may still be paid, with the prior approval of the California Department of Financial Institutions in an amount not exceeding the greatest of (1) retained earnings of the bank; (2) the net income of the bank for its last fiscal year; or (3) the net income of the bank for its current fiscal year. The amount of retained earnings available for cash dividends to the Bancorp immediately after December 31, 2006, is restricted to approximately $211.3 million under this regulation.

Bank regulators also have authority to prohibit a bank from engaging in business practices considered to be unsafe or unsound. It is possible, depending upon the financial condition of a bank and other factors, that such regulators could assert that the payment of dividends or other payments might, under certain circumstances, be an unsafe or unsound practice, even if technically permissible.

Safety and Soundness Standards and Enforcement Actions

The federal banking agencies have adopted guidelines establishing safety and soundness standards for all insured depository institutions. Those guidelines set forth managerial and operational standards relating to (i) internal controls and information systems, (ii) internal audit systems, (iii) loan documentation, (iv) credit underwriting, (v), interest rate exposure, (vi) asset growth, (vii) asset quality, (viii) earnings and (ix) compensation and benefits. In general, the standards are designed to assist the federal banking agencies in identifying and addressing problems at insured depository institutions before capital becomes impaired. If an institution fails to meet safety and soundness standards, the appropriate federal banking agency may require the institution to submit a compliance plan and institute enforcement proceedings if an acceptable compliance plan is not submitted or the deficiency is not corrected.

In addition to these measures and the prompt corrective action provisions, banks may be subject to potential actions by 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. Enforcement actions may include the issuance of cease and desist orders, termination of insurance of deposits, the imposition of civil money penalties, the issuance of directives to increase capital, formal and informal agreements, or removal and prohibition orders against institution-affiliated parties.

Guidance on Nontraditional Mortgage Products

On September 29, 2006, the federal banking agencies issued final guidance on residential mortgage products that allow borrowers to defer repayment of principal or interest, including interest only mortgage loans, and payment option adjustable rate mortgages where a borrower has flexible payment options, including payments that have the potential for negative amortization. The guidance does not apply to home equity lines of credit. While acknowledging that innovations in mortgage lending can benefit some consumers, the federal banking agencies in their joint press release stated their concern that these and other practices described in the guidance

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can present unique risks that institutions must appropriately manage. The guidance states that management should (1) ensure that loan terms and underwriting standards are consistent with prudent lending practices, including consideration of a borrower s repayment capacity, (2) recognize that many nontraditional mortgages are untested in a stressed environment and warrant strong risk management standards as well as appropriate capital and loan loss reserves, and (3) ensure that borrowers have sufficient information to clearly understand loan terms and associated risks prior to making a product or payment choice. It is uncertain at this time what effect the final guidance may have on financial institutions originating such residential mortgage products. As of December 31, 2006, the Bank retained 873 loans with balance of $290.2 million under reduced documentation programs and one loan with balance of $83,000 under a simultaneous second-lien loan program. No nontraditional residential mortgages were sold by the Bank during 2006.

Guidance on Real Estate Concentrations

On December 6, 2006, the federal banking agencies issued a guidance on sound risk management practices for concentrations in commercial real estate lending. The particular focus is on exposure to commercial real estate loans that are dependent on the cash flow from the real estate held as collateral and that are likely to be sensitive to conditions in the commercial real estate market (as opposed to real estate collateral held as a secondary source of repayment or as an abundance of caution). The purpose of the guidance is not to limit a bank s commercial real estate lending but to guide banks in developing risk management practices and capital levels commensurate with the level and nature of real estate concentrations. The FDIC and other bank regulatory agencies will be focusing their supervisory resources on institutions that may have significant commercial real estate loan concentration risk. A bank that has experienced rapid growth in commercial real estate lending, has notable exposure to a specific type of commercial real estate loan, or is approaching or exceeding the following supervisory criteria may be identified for further supervisory analysis with respect to real estate concentration risk:

- Total reported loans for construction, land development and other land represent 100% or more of the bank s capital; or

- Total commercial real estate loans (as defined in the Guidance) represent 300% or more of the bank s total capital and the outstanding balance of the bank s commercial real estate loan portfolio has increased 50% or more during the prior 36 months.

The strength of an institution s lending and risk management practices with respect to such concentrations will be taken into account in supervisory evaluation of capital adequacy. At December 31, 2006, total commercial real estate loans as defined in the Guidance were 514% of the Bank s total capital. It is uncertain at this time what effect this guidance may have on the Bank.

Transactions with Affiliates

Federal banking law imposes restrictions on extensions of credit by the Bank to the Bancorp or its nonbanking affiliates, the purchase by the Bank of assets of, or securities issued by, the Bancorp or its nonbanking affiliates, and the taking by the Bank of securities issued by the Bancorp as collateral for loans made by the Bank. Such restrictions prevent the Bancorp and its nonbanking affiliates from borrowing from the Bank unless the loans are secured by marketable obligations of designated amounts. Further, these secured loans and investments by the Bank to or in the Bancorp, or to or in any nonbanking affiliate, are limited, individually, to 10% of the Bank s capital and surplus, and these secured loans and investments are limited, in the aggregate, to 20% of the Bank s capital and surplus. California law also imposes certain restrictions with respect to transactions involving persons or entities controlling the Bank, such as the Bancorp, and requires that such transactions be approved in advance by the California Department of Financial Institutions. Additional restrictions on transactions with affiliates may be imposed on the Bank under the prompt corrective action provisions of federal law discussed above. See Prompt Corrective Action Provisions below.

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Loans-to-One-Borrower

With certain limited exceptions, the maximum amount that a California bank may lend to any borrower at any one time (including the obligations to the bank of certain related entities of the borrower) may not exceed 25% (and unsecured loans may not exceed 15%) of the bank s shareholder equity, allowance for loan losses, and any capital notes and debentures of the bank.

Extension of Credit to Insiders

Federal law place limitations and conditions on loans or extensions of credit to:

- a bank s or bank holding company s executive officers, directors, and principal shareholders (*i.e.*, in most cases, those persons who own, control or have power to vote more than 10% of any class of voting securities);

- any company controlled by any such executive officer, director, or shareholder, or any political or campaign committee controlled by such executive officer, director, or principal shareholder.

Loans and leases extended to any of the above persons must comply with California s loan-to-one-borrower limits (described above), require prior full board approval when aggregate extensions of credit to the person exceed specified amounts, must be made on substantially the same terms (including interest rates and collateral) as, and follow credit-underwriting procedures that are not less stringent than those prevailing at the time for comparable transactions with non-insiders, and must not involve more than the normal risk of repayment, or present other unfavorable features. A bank is also prohibited from paying an overdraft on an account of an executive officer or director, except pursuant to a written pre-authorized interest-bearing extension of credit plan that specifies a method of repayment or a written pre-authorized transfer of funds from another account of the executive officer or director at the Bank. In addition, the aggregate limit on extensions of credit to all insiders of a California bank as a group cannot exceed the bank s unimpaired capital and unimpaired surplus.

Community Reinvestment Act

The Bank is subject to certain requirements and reporting obligations involving the Community Reinvestment Act (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. The CRA further requires the agencies to take into account a financial institution s record of meeting its community credit needs when evaluating applications for, among other things, domestic branches, consummating mergers or acquisitions, or holding company formations. In measuring a bank s compliance with its CRA obligations, the regulators utilize a performance-based evaluation system which bases CRA ratings on the bank s actual lending, service, and investment performance, rather than on the extent to which the institution conducts needs assessments, documents community outreach activities, or complies with other procedural requirements. In connection with its assessment of CRA performance, the FDIC assigns a rating of outstanding, satisfactory, needs to improve or substantial noncompliance. In its most recently released public reports, from February 2004, the Bank received a satisfactory rating.

Other Consumer Protection Laws and Regulations

Examination and enforcement have become intense, and banks have been advised to monitor carefully compliance with various consumer protection laws and their implementing regulations. The federal Interagency Task Force on Fair Lending issued a policy statement on discrimination in home mortgage lending describing three methods that federal agencies will use to prove discrimination: overt evidence of discrimination, evidence of disparate treatment, and evidence of disparate impact. Due to heightened regulatory concern related to compliance with consumer protection laws and regulations generally, the Bank may incur additional compliance costs or be required to expend additional funds for investments in the local communities it serves.

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In addition to the other laws and regulations discussed herein, the Bank is subject to certain consumer and public interest laws and regulations that are designed to protect customers in transactions with banks. While the list set forth below is not exhaustive, these laws and regulations include the Truth in Lending Act, the Truth in Savings Act, the Electronic Funds Transfer Act, the Expedited Funds Availability Act, the Equal Credit Opportunity Act, the Fair Housing Act, the Real Estate Settlement Procedures Act, the Home Mortgage Disclosure Act, the Fair Credit Reporting Act, the Fair Debt Collection Practices Act, and the Right to Financial Privacy Act. These laws and regulations mandate certain disclosure requirements and regulate the manner in which financial institutions must deal with customers when taking deposits, making loans, collecting loans, and providing other services. Failure to comply with these laws and regulations can subject the Bank to various penalties, including but not limited to enforcement actions, injunctions, fines or criminal penalties, punitive damages to consumers, and the loss of certain contractual rights.

The Americans with Disabilities Act, in conjunction with similar California legislation, has increased the cost of doing business for banks. The legislation requires employers with 15 or more employees and all businesses operating commercial facilities or public accommodations to accommodate disabled employees and customers. The Americans with Disabilities Act has two major objectives: (i) to prevent discrimination against disabled job applicants, job candidates and employees, and (ii) to provide disabled persons with ready access to commercial facilities and public accommodations. Commercial facilities, such as the Bank, must ensure that all new facilities are accessible to disabled persons, and in some instances may be required to adapt existing facilities to make them accessible.

Interstate Banking and Branching

Federal law regulates the interstate activities of banks and bank holding companies and establishes a framework for nationwide interstate banking and branching. Since June 1, 1997, a bank in one state has generally been permitted to merge with a bank in another state without the need for explicit state law authorization. However, states generally were given the ability to prohibit interstate mergers with banks in their own state by opting-out (enacting state legislation applying equality to all out-of-state banks prohibiting such mergers) prior to June 1, 1997.

Since 1995, adequately capitalized and managed bank holding companies have been permitted to acquire banks located in any state, subject to two exceptions: first, any state may still prohibit bank holding companies from acquiring a bank which is less than five years old; and second, no interstate acquisition can be completed by a bank holding company if the acquirer would control more than 10% of the deposits held by insured depository institutions nationwide or 30% or more of the deposits held by insured depository institutions in any state in which the target bank has branches.

A bank may establish and operate *de novo* branches in any state in which that bank does not maintain a branch if that state has enacted legislation to expressly permit all out-of-state banks to establish branches in that state.

Bank Secrecy Act and USA Patriot Act

The Bank Secrecy Act (BSA) is a disclosure law that forms the basis of the federal government s framework to prevent and detect money laundering and to deter other criminal enterprises. Under the BSA, financial institutions such as the Bank are required to maintain certain records and file certain reports regarding domestic currency transactions and cross-border transportations of currency. Among other requirements, the BSA requires financial institutions to report imports and exports of currency in the amount of $10,000 or more and, in general, all cash transactions of $10,000 or more. The Bank has established a BSA compliance policy under which, among other precautions, the Bank keeps currency transaction reports to document cash transactions in excess of $10,000 or in multiples totaling more than $10,000 during one business day, monitors certain potentially suspicious transactions such as the exchange of a large number of small denomination bills for

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large denomination bills, and scrutinizes electronic funds transfers for BSA compliance. The BSA also requires that financial institutions report to relevant law enforcement agencies any suspicious transactions potentially involving violations of law.

The terrorist attacks in September 2001 impacted the financial services industry and led to the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, or the USA Patriot Act. Part of the USA Patriot Act is the International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001, or IMLAFATA. Pursuant to IMLAFATA, an additional purpose was added to the BSA: To assist in the conduct of intelligence or counter-intelligence activities, including analysis, to protect against international terrorism.

IMLAFATA also significantly expanded the role of financial institutions in combating money laundering. In particular, it required financial institutions to establish anti-money laundering programs, which, at a minimum, include internal policies, procedures, and controls designed to prevent the institution from being used for money laundering; the designation of a BSA compliance officer; ongoing employee training; and an independent audit program to test the effectiveness of the institution s anti-money laundering programs. The FDIC and the other federal banking agencies promptly adopted regulations requiring each financial institution to establish comprehensive anti-money laundering compliance programs designed to assure compliance with the BSA and otherwise meeting the statutory requirements for such programs set forth in IMLAFATA. In addition, these regulations required each financial institution to establish a customer identification program to be implemented as part of the institution s anti-money laundering compliance program.

IMLAFATA authorizes the Secretary of the Treasury, in consultation with the heads of other government agencies, to adopt special measures applicable to banks, bank holding companies, and/or other financial institutions. These measures may include enhanced recordkeeping and reporting requirements for certain financial transactions that are of primary money laundering concern, due diligence requirements concerning the beneficial ownership of certain types of accounts, and restrictions or prohibitions on certain types of accounts with foreign financial institutions.

Among its other provisions, IMLAFATA requires each financial institution to (i) establish due diligence policies, procedures, and controls with respect to its private banking accounts and correspondent banking accounts involving foreign individuals and certain foreign banks and (ii) avoid establishing, maintaining, administering, or managing correspondent accounts in the United States of America for, or on behalf of, a foreign bank that does not have a physical presence in any country. In addition, IMLAFATA contains a provision encouraging cooperation among financial institutions, regulatory authorities and law enforcement authorities with respect to individuals, entities, and organizations engaged in, or reasonably suspected of engaging in, terrorist acts or money laundering activities. IMLAFATA expands the circumstances under which funds in a bank account may be forfeited and requires covered financial institutions to respond under certain circumstances to requests for information from federal banking agencies within 120 hours. IMLAFATA also requires the federal banking agencies to consider the effectiveness of a financial institution s anti-money laundering activities when reviewing an application under the BHCA or in connection with a potential bank merger under the Bank Merger Act.

Customer Information Security

The federal bank regulatory agencies have adopted guidelines for safeguarding confidential, personal customer information. The guidelines require each financial institution, under the supervision and ongoing oversight of its Board of Directors or an appropriate committee thereof, to create, implement and maintain a comprehensive written information security program designed to ensure the security and confidentiality of customer information, protect against any anticipated threats or hazards to the security or integrity of such information and protect against unauthorized access or use of such information that could result in substantial harm or inconvenience to any customer.

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Privacy

The Bank is required under federal law to implement policies and procedures regarding the disclosure of nonpublic personal information about consumers to non-affiliate third parties. In general, the statute requires a financial institution to (i) provide notice to customers about its privacy policies and practices, (ii) describe the conditions under which the institution may disclose nonpublic personal information about consumers to nonaffiliated third parties, and (iii) provide a method for consumers to prevent the financial institution from disclosing that information to nonaffiliated third parties by opting out of that disclosure.

Securities Exchange Act of 1934

The Bancorp s common stock is publicly held and listed on NASDAQ, and the Bancorp is subject to the periodic reporting, information, proxy solicitation, insider trading, corporate governance and other requirements and restrictions of the Securities Exchange Act of 1934 and the regulations of the Securities and Exchange Commission promulgated hereunder and the listing requirements of NASDAQ.

Sarbanes-Oxley Act

The Sarbanes-Oxley Act of 2002 implemented legislative reforms applicable to companies with securities traded publicly in the United States of America. The Sarbanes-Oxley Act is intended to address corporate and accounting fraud and contains provisions dealing with corporate governance and management, disclosure, oversight of the accounting profession and auditor independence. Although the Bancorp has incurred and expects to continue to incur additional expenses in complying with the provisions of the Sarbanes-Oxley Act, it does not expect that compliance will have a material effect on its financial condition or results of operations.

Audit Requirements

The Bank is required to have an annual independent audit, alone or as a part of its bank holding company s audit, and to prepare all financial statements in accordance with U.S. generally accepted accounting principles. The Bank (or the Bancorp) is also required to have an audit committee comprised entirely of independent directors. As required by NASDAQ, the Bancorp has certified that its audit committee has adopted formal written charters and meets the requisite number of directors, independence, and qualification standards. In addition, because the Bank has more than $3 billion in total assets, it is subject to the FDIC requirements for audit committees of large institutions. As such, among other requirements, the Bancorp must maintain an audit committee which includes members with banking or related financial management expertise, has access to its own outside counsel, and does not include members who are large customers of the Bank.

The Sarbanes-Oxley Act of 2002 addresses accounting oversight and corporate governance matters. Management and the Bancorp s independent registered public accounting firm are required to assess the effectiveness of the Bancorp s internal control over financial reporting as of December 31, 2006. These assessments are included in Item 9A, Controls and Procedures, below.

Federal Home Loan Bank System

The Bank is a member of the Federal Home Loan Bank ("FHLB") of San Francisco. Among other benefits, each FHLB serves as a reserve or central bank for its members within its assigned region. Each FHLB is financed primarily from the sale of consolidated obligations of the FHLB system. Each FHLB makes available loans or advances to its members in compliance with the policies and procedures established by the Board of Directors of the individual FHLB. Each member of the FHLB of San Francisco is required to own stock in an amount equal to the greater of (i) a membership stock requirement with an initial cap of $25 million (100% of membership asset value as defined), or (ii) an activity based stock requirement (based on percentage of outstanding advances).

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Impact of Monetary Policies

The earnings and growth of the Bank are largely dependent on its ability to maintain a favorable differential or spread between the yield on its interest-earning assets and the rates paid on its deposits and other interest-bearing liabilities. As a result, the Bank s performance is influenced by general economic conditions, both domestic and foreign, the monetary and fiscal policies of the federal government, and the policies of the regulatory agencies. The Federal Reserve Board implements national monetary policies (such as seeking to curb inflation and combat recession) by its open-market operations in U.S. Government securities, by adjusting the required level of reserves for financial institutions subject to its reserve requirements and by varying the discount rate applicable to borrowings by banks from the Federal Reserve Banks. The actions of the Federal Reserve Board in these areas influence the growth of bank loans, investments, and deposits and also affect interest rates charged on loans and deposits. The nature and impact of any future changes in monetary policies cannot be predicted.

Environmental Regulation

In the course of the Bank s business, the Bank may foreclose and take title to real estate, and could be subject to environmental liabilities with respect to these properties. The Bank may be held liable to a governmental entity or to third parties for property damage, personal injury, investigation and clean-up costs incurred by these parties in connection with environmental contamination, or may be required to investigate or clear up hazardous or toxic substances, or chemical releases at a property. The costs associated with investigation or remediation activities could be substantial. In addition, as the owner or former owner of any contaminated site, the Bank may be subject to common law claims by third parties based on damages and costs resulting from environmental contamination emanating from the property. If the Bank ever becomes subject to significant environmental liabilities, its business, financial condition, liquidity and results of operations could be materially and adversely affected.

Other Pending and Proposed Legislation

Other legislative and regulatory initiatives which could affect the Bancorp and the Bank and the banking industry in general are pending, and additional initiatives may be proposed or introduced, before the U.S. Congress, the California legislature, and other governmental bodies in the future. Such proposals, if enacted, may further alter the structure, regulation, and competitive relationship among financial institutions, and may subject the Bancorp and the Bank to increased regulation, disclosure, and reporting requirements. In addition, the various banking regulatory agencies often adopt new rules and regulations to implement and enforce existing legislation. It cannot be predicted whether, or in what form, any such legislation or regulations may be enacted or the extent to which the business of the Bancorp or the Bank would be affected thereby.

Item 1A. Risk Factors.

The allowance for loan losses is an estimate of probable loan losses. Actual loan losses in excess of the estimate could adversely affect our net income and capital.

The allowance for loan losses is based on management s estimate of the probable losses from our loan portfolio. If actual losses exceed the estimate, the excess losses could adversely affect our net income and capital. Such excess losses could also lead to larger allowances for loan losses in future periods, which could in turn adversely affect net income and capital in those periods. If economic conditions differ substantially from the assumptions used in the estimate or adverse developments arise with respect to our loans, future losses may occur, and increases in the allowance may be necessary. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the adequacy of our allowance. These agencies may require us to establish additional allowances based on their judgment of the information available at the time of their examinations. No assurance can be given that we will not sustain loan losses in excess of present or future levels of the allowance for loan losses.

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Fluctuations in interest rates could reduce our net interest income and adversely affect our business.

The interest rate risk inherent in our lending, investing, and deposit taking activities is a significant market risk to us and our business. Income associated with interest-earning assets and costs associated with interest-bearing liabilities may not be affected uniformly by fluctuations in interest rates. The magnitude and duration of changes in interest rates, events over which we have no control, may have an adverse effect on net interest income. Prepayment and early withdrawal levels, which are also impacted by changes in interest rates, can significantly affect our assets and liabilities. Increases in interest rates may adversely affect the ability of our floating rate borrowers to meet their higher payment obligations, which could in turn lead to an increase in non-performing assets and net charge-offs.

Generally, the interest rates on interest-earning assets and interest-bearing liabilities of the Company do not change at the same rate, to the same extent, or on the same basis. Even assets and liabilities with similar maturities or periods of repricing may react in different degrees to changes in market interest rates. Interest rates on certain types of assets and liabilities may fluctuate in advance of changes in general market interest rates, while interest rates on other types of assets and liabilities may lag behind changes in general market rates. Certain assets, such as fixed and adjustable rate mortgage loans, have features that limit changes in interest rates on a short-term basis and over the life of the asset.

We seek to minimize the adverse effects of changes in interest rates by structuring our asset-liability composition to obtain the maximum spread. We use interest rate sensitivity analysis and a simulation model to assist us in estimating the optimal asset-liability composition. However, such management tools have inherent limitations that impair their effectiveness. There can be no assurance that we will be successful in minimizing the adverse effects of changes in interest rates. See also the sections entitled Risks Elements of the Loan Portfolio under Item 7 and Market Risk under Item 7A of this Annual Report on the Form 10-K.

We have engaged in and may continue to engage in further expansion through mergers and acquisitions, which could negatively affect our business and earnings.

We have engaged in and may continue to engage in expansion through mergers and acquisitions. There are risks associated with such expansion. These risks include, among others, incorrectly assessing the asset quality of a bank acquired in a particular transaction, encountering greater than anticipated costs in integrating acquired businesses, facing resistance from customers or employees, and being unable to profitably deploy assets acquired in the transaction. Additional country- and region-specific risks are associated with transactions outside the United States, including in China. To the extent we issue capital stock in connection with additional transactions, these transactions and related stock issuances may have a dilutive effect on earnings per share and share ownership.

Our earnings, financial condition, and prospects after a merger or acquisition depend in part on our ability to successfully integrate the operations of the acquired company. We may be unable to integrate operations successfully or to achieve expected cost savings. Any cost savings which are realized may be offset by losses in revenues or other charges to earnings.

Inflation and deflation may adversely affect our financial performance.

The consolidated financial statements and related financial data presented in this report have been prepared in accordance with accounting principles generally accepted in the United States. These principles require the measurement of financial position and operating results in terms of historical dollars, without considering changes in the relative purchasing power of money over time due to inflation or deflation. The primary impact of inflation on the operations of the Company is reflected in increased operating costs. Conversely, deflation will tend to erode collateral values and diminish loan quality. Virtually all of our assets and liabilities are monetary in nature. As a result, interest rates have a more significant impact on our performance than the general levels of inflation or deflation. Interest rates do not necessarily move in the same direction or in the same magnitude as the price of goods and services.

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As we expand our business outside of California markets, we will encounter risks that could adversely affect us.

We primarily operate in California markets with a concentration of Chinese-American individuals and businesses; however, one of our strategies is to expand beyond California into other domestic markets that have concentrations of Chinese-American individuals and businesses. In the course of this expansion, we will encounter significant risks and uncertainties that could have a material adverse effect on our operations. These risks and uncertainties include increased operational difficulties arising from, among other things, our ability to attract sufficient business in new markets, to manage operations in noncontiguous market areas, and to anticipate events or differences in markets in which we have no current experience.

To the extent that we expand through acquisitions, such acquisitions may also adversely harm our business, if we fail to adequately address the financial and operational risks associated with such acquisitions. For example, risks can include difficulties in assimilating the operations, technology, and personnel of the acquired company; diversion of management s attention from other business concerns; inability to maintain uniform standards, controls, procedures and policies; potentially dilutive issuances of equity securities; incurrence of additional debt and contingent liabilities; use of cash resources; large write-offs; and amortization expenses related to other intangible assets with finite lives.

Our financial results could be adversely affected by changes in California tax law and changes in its interpretation relating to registered investment companies and real estate investment trusts.

Our effective income tax rate was lower in 2002 and 2001 than in subsequent years due in large part to income tax benefits derived from a registered investment company subsidiary of the Bank. We had relied on the California tax law related to registered investment companies and on an outside tax opinion in creating this subsidiary. In the fourth quarter of 2003, a change in that law was enacted by the California Legislature, which would deny such tax benefits from and after January 1, 2003. On December 31, 2003, the California Franchise Tax Board (FTB) announced its position that certain tax deductions related to regulated investment companies as well as real estate investment trusts prior to January 1, 2003 would also be disallowed.

In December, 2002, we decided to deregister the registered investment company and, in February, 2003, we completed such deregistration. In addition, in the fourth quarter of 2003, the Company reversed the net state tax benefits recorded in the first three quarters of 2003 relating to the real estate investment trust (REIT) that it formed as a subsidiary of the Bank during 2003. The Company did not record any tax benefits relating to the REIT in the fourth quarter of 2003 and did not record any such benefits in 2004, 2005, or 2006.

As previously disclosed, on December 31, 2003, the California Franchise Tax Board (FTB) announced its intent to list certain transactions that in its view constitute potentially abusive tax shelters. Included in the transactions subject to this listing were transactions utilizing regulated investment companies (RICs) and real estate investment trusts (REITs). As part of the notification indicating the listed transactions, the FTB also indicated its position that it intends to disallow tax benefits associated with these transactions. While the Company continues to believe that the tax benefits recorded in three prior years with respect to its regulated investment company were appropriate and fully defensible under California law, the Company has deemed it prudent to participate in Voluntary Compliance Initiative Option 2, requiring payment of all California taxes and interest on these disputed 2000 through 2002 tax benefits, and permitting the Company to claim a refund for these years while avoiding certain potential penalties. The Company retains potential exposure for assertion of an accuracy-related penalty should the FTB prevail in its position in addition to the risk of not being successful in its refund claims. As of December 31, 2006, the Company reflected a $12.1 million net state tax receivable for the years 2000, 2001, and 2002 after giving effect to reserves for loss contingencies on the refund claims, or an equivalent of $7.9 million after giving effect to Federal tax benefits. The FTB is currently in the process of reviewing and assessing our refund claims for taxes and interest for tax years 2000 through 2002. The Company does not expect that its refund claims related to its regulated investment company will more likely than not be realized and consequently, expects to include the $7.9 million after tax amount related to its refund claim in its

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cumulative effect adjustment for Interpretation No. 48 as an adjustment to the opening balance of retained earnings as of the January 1, 2007 effective date of Interpretation No. 48.

Adverse economic conditions in California and other regions where the Bank has operations could cause us to incur losses.

Our banking operations are concentrated primarily in Southern and Northern California, and secondarily in New York, Texas, Massachusetts, Washington, and Illinois. Adverse economic conditions in these regions could impair borrowers ability to service their loans, decrease the level and duration of deposits by customers, and erode the value of loan collateral. These events could increase the amount of our non-performing assets and have an adverse effect on our efforts to collect our non-performing loans or otherwise liquidate our non-performing assets (including other real estate owned) on terms favorable to us.

Real estate securing our lending activities is also principally located in Southern and Northern California, and to a lesser extent, in New York, Texas, Massachusetts, Washington, and Illinois. The value of such collateral depends upon conditions in the relevant real estate markets. These include general or local economic conditions and neighborhood characteristics, real estate tax rates, the cost of operating the properties, governmental regulations and fiscal policies, acts of nature including earthquakes, flood and hurricanes (which may result in uninsured losses), and other factors beyond our control.

The risks inherent in construction lending may adversely affect our net income.

The risks inherent in construction lending may adversely affect our net income. Such risks include, among other things, the possibility that contractors may fail to complete, or complete on a timely basis, construction of the relevant properties; substantial cost overruns in excess of original estimates and financing; market deterioration during construction; and lack of permanent take-out financing. Loans secured by such properties also involve additional risk because such properties have no operating history. In these loans, loan funds are advanced upon the security of the project under construction, which is of uncertain value prior to completion of construction, and the estimated operating cash flow to be generated by the completed project. There is no assurance that such properties will be sold or leased so as to generate the cash flow anticipated by the borrower. Such consideration can affect the borrowers ability to repay their obligations to us and the value of our security interest in collateral.

Our use of appraisals in deciding whether to make a loan on or secured by real property does not insure the value of the real property collateral.

In considering whether to make a loan on or secured by real property, we generally require an appraisal of such property. However, the appraisal is only an estimate of the value of the property at the time the appraisal is made. If the appraisal does not reflect the amount that may be obtained upon any sale or foreclosure of the property, we may not realize an amount equal to the indebtedness secured by the property.

We face substantial competition from larger competitors.

We face substantial competition for deposits and loans, as well as other banking services, throughout our market area from the major banks and financial institutions that dominate the commercial banking industry. This may cause our cost of funds to exceed that of our competitors. Such banks and financial institutions have greater resources than us, including the ability to finance advertising campaigns and allocate their investment assets to regions of higher yield and demand. By virtue of their larger capital bases, such institutions have substantially greater lending limits than us and perform certain functions, including trust services, which are not presently offered by us. We also compete for loans and deposits, as well as other banking services, with savings and loan associations, finance companies, money market funds, brokerage houses, credit unions and non-financial institutions.

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Adverse effects of banking regulations or changes in banking regulations could adversely affect our business by increasing our expenses, limiting our activities, or altering the competitive balance.

We are regulated by significant federal and state regulation and supervision, which is primarily for the benefit and protection of our customers or which serve other public policies and not for the benefit of our stockholders. In the past, our business has been materially affected by such regulation and supervision. This trend is likely to continue in the future. Laws, regulations, or policies currently affecting us may change at any time. Regulatory authorities may also change their interpretation of existing laws and regulations. It is impossible to predict the competitive impact that any such changes would have on commercial banking in general or on our business in particular. Such changes may, among other things, increase the cost of doing business, limit permissible activities, or affect the competitive balance between banks and other financial institutions.

Adverse economic conditions in Asia could adversely affect our business.

A substantial number of our customers have economic and cultural ties to Asia and, as a result, we are likely to feel the effects of adverse economic and political conditions in Asia. U.S. and global economic policies, military tensions, and unfavorable global economic conditions may adversely impact the Asian economies. If economic conditions in Asia deteriorate, we could, among other things, be exposed to economic and transfer risk, and could experience an outflow of deposits by those of our customers with connections to Asia. Transfer risk may result when an entity is unable to obtain the foreign exchange needed to meet its obligations or to provide liquidity. This may adversely impact the recoverability of investments with or loans made to such entities. Adverse economic conditions in Asia, and in China or Taiwan in particular, may also negatively impact asset values and the profitability and liquidity of our customers who operate in this region.

Statutory restrictions on dividends and other distributions from the Bank may adversely impact us by limiting the amount of distributions the Bancorp may receive.

A substantial portion of the Bancorp s cash flow comes from dividends that the Bank pays to us. Various statutory provisions restrict the amount of dividends that the Bank can pay without regulatory approval. In addition, if the Bank were to liquidate, the Bank s creditors would be entitled to receive distributions from the assets of the Bank to satisfy their claims against the Bank before Bancorp, as a holder of the equity interest in the Bank, would be entitled to receive any of the assets of the Bank.

Our need to continue to adapt to our information technology systems to allow us to provide new and expanded services could present operational issues and require significant capital spending.

As we continue to offer internet banking and other on-line services to our customers, and continue to expand our existing conventional banking services, we will need to adapt our information technology systems to handle these changes in a way that meets constantly changing industry and regulatory standards. This can be very expensive and may require significant capital expenditures. In addition, our success will depend, among other things, on our ability to provide secure and reliable services, anticipate changes in technology, and efficiently develop and introduce services that are accepted by our customers and cost effective for us to provide. Systems failures, delays, breaches of confidentiality and other problems could harm our reputation and business.

Certain provisions of our charter, bylaws, and rights agreement could make the acquisition of our Company more difficult.

Certain provisions of our Charter, Bylaws, and Rights Agreement between us and American Stock Transfer and Trust Company, as Rights Agent, could make the acquisition of our company more difficult. These provisions include authorized but unissued shares of preferred and common stock that may be issued without stockholder approval; three classes of directors serving staggered terms; preferred share purchase rights that generally become exercisable if a person or group acquires 15% or more of our common stock or announces a

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tender offer for 15% or more of our common stock; special requirements for stockholder proposals and nominations for director; and super-majority voting requirements in certain situations including certain types of business combinations.

Terrorist attacks could adversely affect us.

Any terrorist attacks and responses to such activities could adversely affect the Company in a number of ways, including, among others, an increase in delinquencies, bankruptcies or defaults that could result in a higher level of non-performing assets, net charge-offs, and provision for loan losses.

Item 1B. Unresolved Staff Comments.

The Company has not received written comments regarding its periodic or current reports from the staff of the Securities and Exchange Commission that were issued 180 days before the end of its 2006 fiscal year and that remain unresolved.

Item 2. Properties.

Cathay General Bancorp

The Bancorp currently neither owns nor leases any real or personal property. The Bancorp uses the premises, equipment, and furniture of the Bank in exchange for payment of a management fee to the Bank.

Cathay Bank

The Bank s main corporate office and headquarter branch is located in a 26,527 square foot building in the Chinatown area of Los Angeles. The Bank owns both the building and the land upon which the building is situated. Parking is provided on a lot adjacent to the Bank s building, which is owned by the Bank. In June 2006, the Bank acquired a seven story 102,548 square foot office building in South El Monte to serve as its future headquarters building. The building is currently partially occupied by a tenant under a lease that will expire on March 31, 2007. The Bank expects to relocate to its new headquarters in 2008 after the completion of extensive renovations to the office building.

The Bank owns its branch offices in Monterey Park, Alhambra, Westminster, San Gabriel, City of Industry, Cupertino, Artesia, New York City, Flushing (2 locations), and Chicago. In addition, the Bank has certain operating and administrative departments located at 4128 Temple City Boulevard, Rosemead, California, where it owns the building and land with approximately 27,600 square feet of space.

The Bank leases certain other premises. Expiration dates of the Bank s leases range from March 2007 to December 2016. The Bank s leased offices include the former headquarter of General Bank, located at 800 West 6th Street, Los Angeles, California 90017, consisting of approximately 41,501 square feet of rentable area which includes the ground floor and the second, fourteenth, and fifteenth floors of the building. The initial lease term will expire in the year 2009, and the Bank has two five-year options to renew the lease following the expiration date of the initial term. As of December 31, 2006, the monthly base rent for the facility was $117,000. The monthly base rent is subject to change on specified dates during the 15-year initial lease term.

The proposed branch in Hong Kong will be located at 28 Queen s Road Central Hong Kong. The lease for the 3,436 square feet office commenced on December 14, 2006 and has a term of three years. The representative office in Taipei of Cathay Bank is located at Sixth Floor, Suite 3, 146 Sung Chiang Road, Taipei, Taiwan, and consists of 1,806 square feet. The lease was renewed for one year from July 1, 2006 to June 30, 2007.

As of December 31, 2006, the Bank s investment in premises and equipment totaled $72.9 million. See also Note 8 and Note 14 to the Consolidated Financial Statements.

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Item 3. Legal Proceedings.

We are not currently aware of any material pending legal proceedings, other than ordinary routine litigation incidental to the business of the Bank to which the Company or any of its subsidiaries is a party or of which any of their property is the subject.

Item 4. Submission of Matters to a Vote of Security Holders.

There were no matters submitted to a vote of security holders during the fourth quarter of 2006.

Executive Officers of Registrant.

The table below sets forth the names, ages, and positions at the Bancorp and the Bank of all executive officers of the Company as of February 15, 2007. See Part III, Item 10 Directors and Executive Officers and Corporate Governance, of this Annual Report on Form 10-K for further information regarding the executive officers of the Bancorp and the Bank.

Name	Age	Present Position and Principal Occupation During the Past Five Years
Dunson K. Cheng	62	Chairman of the Board of Directors of Bancorp and the Bank since 1994; Director and President (Chief Executive Officer) of Bancorp since 1990. President of the Bank since 1985 and Director of the Bank since 1982.
Peter Wu	58	Director, Executive Vice Chairman, and Chief Operating Officer of Bancorp and the Bank since October 20, 2003. Director of GBC Bancorp and General Bank from 1981 to October, 2003; Chairman of the Board of GBC Bancorp and General Bank from January, 2003 to October, 2003; President and Chief Executive Officer of GBC Bancorp and General Bank from January, 2001 to October, 2003.
Anthony M. Tang	53	Director of Bancorp since 1990; Executive Vice President of Bancorp since 1994; Chief Financial Officer and Treasurer of Bancorp from 1990 until June 2003. Chief Lending Officer of the Bank since 1985; Director of the Bank since 1986; Senior Executive Vice President of the Bank since December 1998.
Heng W. Chen	54	Executive Vice President and Chief Financial Officer of Bancorp since June 2003. Executive Vice President of the Bank since June 2003. Chief Financial Officer of the Bank since January 2004. Executive Vice President-Finance of City National Bank from March 2000 until June 2003.
Irwin Wong	58	Executive Vice President-Branch Administration for the Bank since 1999.
Kim R. Bingham	50	Executive Vice President Chief Credit Officer of the Bank since August 2004. First Vice President Private Banking of Mellon Bank from April 2003 to August 2004; Senior Vice President Credit Administration of City National Bank from 2002 to April 2003; Senior Vice President - Structured Finance Division of City National Bank from 2000 to 2002.
Perry P. Oei	44	Senior Vice President of Bancorp and the Bank since January 2004; General Counsel of Bancorp and the Bank since July 2001.

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PART II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Market Information

The Bancorp s common stock is listed on the NASDAQ Global Select Market under the symbol CATY. Prior to July 3, 2006, the Bancorp s common stock traded on the NASDAQ National Market. The closing price of the Company s common stock on February 15, 2007, was $35.52 per share, as reported by the NASDAQ Global Select Market. The Company does not represent that the outstanding shares may be either bought or sold at a certain price.

The following table sets forth the high and low closing prices as reported on the NASDAQ Global Select Market (and on the NASDAQ National Market prior to July 3, 2006) for the periods presented:

	Year Ended December 31,			
	2006		2005	
	High	Low	High	Low
First quarter	$ 38.24	$ 34.36	$ 37.99	$ 31.24
Second quarter	39.77	34.59	35.25	30.24
Third quarter	37.86	35.60	36.27	32.83
Fourth quarter	36.54	33.58	39.82	33.20

Holders

As of February 15, 2007, there were approximately 1,714 holders of record of the Bancorp s Common Stock.

Dividends

The cash dividends per share declared by quarter were as follows:

Year Ended
December 31,

	2006	2005
First quarter	$ 0.09	$ 0.09
Second quarter	$ 0.09	$ 0.09
Third quarter	$ 0.09	$ 0.09
Fourth quarter	$ 0.09	$ 0.09
Total	$ 0.36	$ 0.36

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Performance Graph

The graph and accompanying information furnished below compares the percentage change in the cumulative total stockholder return on the Company s common stock from December 31, 2001, through December 31, 2006, with the percentage change in the cumulative total return on the Standard & Poor s 500 Index (the S&P 500 Index) and the SNL Western Bank Index for the same period. The SNL Western Bank Index is a market-weighted index including every publicly traded bank and bank holding company located in Alaska, California, Hawaii, Montana, Oregon, and Washington. The Company will furnish, without charge, on the written request of any person who is a stockholder of record as of April 2, 2007, a list of the companies included in the SNL Western Bank Index. Requests for this information should be addressed to Michael M.Y. Chang, Secretary, Cathay General Bancorp, 777 North Broadway, Los Angeles, California 90012. This graph assumes the investment of $100 in the Company s common stock on December 31, 2001, and an investment of $100 in each of the S&P 500 Index and the SNL Western Bank Index on that date.

NOTE: The comparisons in the graph below are based upon historical data and are not indicative of, nor intended to forecast, the future performance or returns of the Company s common stock. Such information furnished herewith shall not be deemed to be incorporated by reference into any filing of the Company under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, and shall not be deemed to be soliciting material or to be filed under the Securities Act or the Securities Exchange Act with the Securities and Exchange Commission except to the extent that the Company specifically requests that such information be treated as soliciting material or specifically incorporates it by reference into a filing under the Securities Act or the Securities Exchange Act.

	Period Ending					
Index	**12/31/01**	**12/31/02**	**12/31/03**	**12/31/04**	**12/31/05**	**12/31/06**
Cathay General Bancorp	100.00	120.47	179.94	243.17	235.55	228.42
SNL Western Bank Index *	100.00	109.41	148.21	168.43	175.36	197.86
S & P 500 **	100.00	77.90	100.24	111.15	116.61	135.03

* Source: SNL Financial LC, Charlottesville, VA © 2007

** Source: Research Data Group, Inc.

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Unregistered Sales of Equity Securities

There were no sales of any equity securities by the Company during the period covered by this Annual Report on Form 10-K that were not registered under the Securities Act.

Issuer Purchases of Equity Securities

In April 2001, the Board of Directors approved a stock repurchase program for the Company to buy back up to $15 million of our common stock. On May 2, 2005, the Company completed the April 2001 repurchase program and repurchased a total of 830,065 shares of our common stock for $15 million, or an average price of $18.07 per share, between April 2001 and May 2005.

On March 18, 2005, the Board of Directors approved a new stock repurchase program to buy back up to an aggregate of one million shares of the Company s common stock following the completion of April 2001 stock repurchase program. During 2005, the Company repurchased 548,297 shares under the March 2005 stock repurchase program for a total cost of $18.3 million, or an average price of $33.40 per share. No shares were repurchased in 2006. As of December 31, 2006, 451,703 shares remain under the Company s March 18, 2005 stock repurchase program.

In 2005, the Company repurchased 738,542 shares for $24.5 million, or $33.18 cost per share under both the April 2001 repurchase program and the March 2005 repurchase program. No shares were repurchased in 2006. In 2007, through February 27, 2007, the Company repurchased 275,826 shares under the March 2005 repurchase program for a total cost of $9.6 million, or an average price of $34.96 per share. As of February 27, 2007, 175,877 shares remain under the Company s March 18, 2005 stock repurchase program.

Issuer Purchases of Equity Securities

Period	(a) Total Number of Shares (or Units) Purchased	(b) Average Price Paid per Share (or Unit)	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs
(October 1, 2006 October 31, 2006)	None			451,703
(November 1, 2006 November 30, 2006)	None			451,703
(December 1, 2006 December 31, 2006)	None			451,703
Total	None			451,703

In connection with the Company s acquisitions in 2006, the Company issued 1,181,164 shares of Cathay General Bancorp common stock, par value $.01 per share in exchange for 765,214 shares of Great Eastern Bank common stock that had been tendered by its shareholders for the Company s common stock. Those shares were subsequently registered by a registration statement on Form S-3 filed with the Securities and Exchange Commission.

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Item 6. Selected Financial Data.

The following table presents selected historical consolidated financial data for the Bancorp, and is derived in part from the audited consolidated financial statements of the Company. The selected historical consolidated financial data should be read in conjunction with the Consolidated Financial Statements of Cathay General Bancorp and the Notes thereto, which are included in this Annual Report on Form 10-K as well as Management s Discussion and Analysis of Financial Condition and Results of Operations.

Selected Consolidated Financial Data

	Year Ended December 31,				
	2006	**2005**	**2004**	**2003**	**2002**
	(Dollars in thousands, except share and per share data)				
Income Statement (1)					
Interest income	$ 491,518	$ 350,661	$ 274,979	$ 167,267	$ 144,061
Interest expense	212,235	110,279	60,162	40,148	39,920
Net interest income before provision/(reversal) for loan losses	279,283	240,382	214,817	127,119	104,141
Provision/(reversal) for loan losses	2,000	(500)		7,150	6,000
Net interest income after provision/(reversal) for loan losses	277,283	240,882	214,817	119,969	98,141
Securities gains (losses)	201	1,473	(3,979)	9,890	1,926
Other non-interest income	21,263	21,013	20,244	13,103	14,245
Non-interest expense	113,918	96,887	90,660	55,140	43,317
Income before income tax expense	184,829	166,481	140,422	87,822	70,995
Income tax expense	67,259	62,390	53,609	32,250	22,295
Net income	$ 117,570	$ 104,091	$ 86,813	$ 55,572	$ 48,700
Net Income per common share					
Basic	$ 2.29	$ 2.07	$ 1.74	$ 1.44	$ 1.35
Diluted	$ 2.27	$ 2.05	$ 1.72	$ 1.42	$ 1.34
Cash dividends paid per common share	$ 0.360	$ 0.360	$ 0.300	$ 0.280	$ 0.273
Weighted-average common shares					
Basic	51,234,596	50,373,076	49,869,271	38,713,728	35,982,666
Diluted	51,804,495	50,821,093	50,480,154	39,035,616	36,230,238
Statement of Condition					
Securities available-for-sale	$ 1,522,223	$ 1,217,438	$ 1,791,904	$ 1,681,251	$ 248,273
Securities held-to-maturity					459,452
Net loans (2)	5,670,873	4,574,831	3,757,464	3,229,751	1,848,078
Total assets	8,026,508	6,397,503	6,098,005	5,541,915	2,753,998
Deposits	5,675,306	4,916,350	4,595,137	4,428,081	2,314,643
Federal funds purchased and securities sold under agreements to repurchase	450,000	319,000	91,000	82,500	28,500
Advances from the Federal Home Loan Bank	714,680	215,000	545,000	258,313	50,000
Borrowings from other financial institutions	10,000	20,000		20,000	
Long-term debt	104,125	53,976	53,916	53,856	
Stockholders equity	943,074	773,617	715,993	619,296	287,961

Common Stock Data					
Shares of common stock outstanding	51,930,955	50,191,089	50,677,896	49,608,182	35,999,910
Book value per common share	$ 18.16	$ 15.41	$ 14.13	$ 12.48	$ 8.00
Profitability Ratios					
Return on average assets	1.60%	1.69%	1.51%	1.58%	1.88%
Return on average stockholders equity	13.61	14.05	13.27	15.13	18.30
Dividend payout ratio	15.67	17.44	17.19	18.15	20.13
Average equity to average assets ratio	11.76	12.05	11.38	10.42	10.27
Efficiency ratio	37.88	36.86	39.23	36.73	36.00

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(1) Includes the operating results and the acquired assets and assumed deposits and liabilities of (i) GBC Bancorp and its subsidiaries after October 20, 2003, (ii) Great Eastern Bank after April 6, 2006, and (iii) New Asia Bancorp and its subsidiaries after October 17, 2006.
(2) Net loans represent gross loans net of loan participations sold, allowance for loan losses and unamortized deferred loan fees.

Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations.

General

The following discussion is intended to provide information to facilitate the understanding and assessment of the consolidated financial condition of the Bancorp and its subsidiaries, including the Bank, the Company, and their consolidated results of operations. It should be read in conjunction with the audited consolidated financial statements and footnotes appearing elsewhere in this report.

The Bank offers a wide range of financial services. The Bank currently operates 20 branches in Southern California, 10 branches in Northern California, nine branches in New York State, one branch in Massachusetts, one branch in Houston, Texas, two branches in Washington State, three branches in Illinois, one loan production office in Dallas, Texas, and three representative offices (one in Hong Kong, one in Shanghai, China, and one in Taipei, Taiwan). The Company has filed an application to convert its Hong Kong representative office into a full service branch. The Bank is a commercial bank, servicing primarily the individuals, professionals, and small to medium-sized businesses in the local markets in which its branches are located.

Actual results in any future period may vary from the past results discussed in this report. Given these risks and uncertainties, we caution readers not to place undue reliance on any forward-looking statements, which speak as of the date hereof. We have no intention and undertake no obligation to update any forward-looking statement or to publicly announce the results of any revision of any forward-looking statement to reflect future developments or events.

The financial information presented herein includes the accounts of the Company, its subsidiaries, including the Bank, and the Bank s consolidated subsidiaries. All material transactions between these entities are eliminated.

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 consolidated 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 consolidated financial statements. Actual results may differ from these estimates under different assumptions or conditions.

Certain accounting policies involve significant judgments and assumptions by management which have a material impact on the carrying value of certain assets and liabilities; management considers such accounting policies to be critical accounting policies. The judgments and assumptions used by management are based on historical experience and other factors, which are believed to be reasonable under the circumstances.

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Management believes the following are critical accounting policies that require the most significant judgments and estimates used in the preparation of its consolidated financial statements:

Accounting for the allowance for loan losses

The determination of the amount of the provision for loan losses charged to operations reflects management s current judgment about the credit quality of the loan portfolio and takes into consideration changes in lending policies and procedures, changes in economic and business conditions, changes in the nature and volume of the portfolio and in the terms of loans, changes in the experience, ability and depth of lending management, changes in the volume and severity of past due, nonaccrual and adversely classified or graded loans, changes in the quality of the loan review system, changes in the value of underlying collateral for collateral-dependent loans, the existence and effect of any concentrations of credit and the effect of competition, legal and regulatory requirements, and other external factors. The nature of the process by which the Bank determines the appropriate allowance for loan losses requires the exercise of considerable judgment. While management utilizes its best judgment and information available, the ultimate adequacy of the allowance is dependent upon a variety of factors beyond the Bank s control, including the performance of the Bank s loan portfolio, the economy, changes in interest rates and the view of the regulatory authorities toward loan classifications. A weakening of the economy or other factors that adversely affect asset quality could result in an increase in the number of delinquencies, bankruptcies, or defaults, and a higher level of non-performing assets, net charge-offs, and provision for loan losses in future periods.

The total allowance for loan losses consists of two components: specific allowances and general allowances. To determine the adequacy of the allowance in each of these two components, the Bank employs two primary methodologies, the classification migration methodology and the individual loan review analysis methodology. These methodologies support the basis for determining allocations between the various loan categories and the overall adequacy of the Bank s allowance to provide for probable losses inherent in the loan portfolio. These methodologies are further supported by additional analysis of relevant factors such as the historical losses in the portfolio, trends in the non-performing/non-accrual loans, loan delinquencies, the volume of the portfolio, peer group comparisons, and federal regulatory policy for loan and lease losses. Other significant factors of portfolio analysis include changes in lending policies/underwriting standards, portfolio composition, and concentrations of credit, and trends in the national and local economy.

With these above methodologies, the specific allowance is for those loans internally classified and risk graded as Special Mention, Substandard, Doubtful, or Loss. Additionally, the Bank s management allocates a specific allowance for Impaired Credits, in accordance with SFAS No. 114, Accounting by Creditors for Impairment of a Loan. The level of the general allowance is established to provide coverage for management s estimate of the credit risk in the loan portfolio by various loan segments not covered by the specific allowance.

Allowances for other risks of probable loan losses have been included in the allowance for loan losses. At December 31, 2006, the Bank has set aside funds to cover the risk factors of higher energy prices on the ability of its borrowers to service their loans.

Accounting for acquisitions

Accounting for acquisitions of other financial institutions involves significant judgments and assumptions by management, which has a material impact on the carrying value of fixed rate loans and borrowings and the determination of the core deposit intangible asset and goodwill. Except for the resolution of any pre-acquisition income tax uncertainties, no additional fair value adjustments can be made after the end of the allocation period of one year.

Investment Securities

The classification and accounting for investment securities are discussed in detail in Note 1 of the consolidated financial statements presented elsewhere herein. Under SFAS No. 115, *Accounting for Certain*

Investments in Debt and Equity Securities, investment securities generally must be classified as held-to-maturity, available-for-sale, or trading. The appropriate classification is based partially on our ability to hold the securities to maturity and largely on management s intentions with respect to either holding or selling the securities. The classification of investment securities is significant since it directly impacts the accounting for unrealized gains and losses on securities. Unrealized gains and losses on trading securities flow directly through earnings during the periods in which they arise, whereas available-for-sale securities are recorded as a separate component of stockholders equity (accumulated other comprehensive income or loss) and do not affect earnings until realized. The fair values of our investment securities are generally determined by reference to quoted market prices and reliable independent sources. We are obligated to assess, at each reporting date, whether there is an "other-than-temporary" impairment to our investment securities. Such impairment must be recognized in current earnings rather than in other comprehensive income (loss). Investment securities are discussed in more detail in Note 4 to the consolidated financial statements presented elsewhere herein.

Income Taxes

The provision for income taxes is based on income reported for financial statement purposes, and differs from the amount of taxes currently payable, since certain income and expense items are reported for financial statement purposes in different periods than those for tax reporting purposes. Taxes are discussed in more detail in Note 12 to the consolidated financial statements presented elsewhere herein. Accrued taxes represent the net estimated amount due or to be received from taxing authorities. In estimating accrued taxes, we assess the relative merits and risks of the appropriate tax treatment of transactions taking into account statutory, judicial, and regulatory guidance in the context of our tax position.

The Company accounts for income taxes using the asset and liability approach, the objective of which is to establish deferred tax assets and liabilities for the temporary differences between the financial reporting basis and the tax basis of the Company s assets and liabilities at enacted tax rates expected to be in effect when such amounts are realized or settled. A valuation allowance is established for deferred tax assets if, based on the weight of available evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized. A valuation allowance is established, when necessary, to reduce the deferred tax assets to the amount that is more likely than not to be realized.

On December 31, 2003, the California Franchise Tax Board (FTB) announced its intent to list certain transactions that in its view constitute potentially abusive tax shelters. Included in the transactions subject to this listing were transactions utilizing regulated investment companies (RICs) and real estate investment trusts (REITs). As part of the notification indicating the listed transactions, the FTB also indicated its position that it intends to disallow tax benefits associated with these transactions. While the Company continues to believe that the tax benefits recorded in three prior years with respect to its regulated investment company were appropriate and fully defensible under California law, the Company has deemed it prudent to participate in Voluntary Compliance Initiative Option 2, requiring payment of all California taxes and interest on these disputed 2000 through 2002 tax benefits, and permitting the Company to claim a refund for these years while avoiding certain potential penalties. The Company retains potential exposure for assertion of an accuracy-related penalty should the FTB prevail in its position in addition to the risk of not being successful in its refund claims. As of December 31, 2006, the Company reflected a $12.1 million net state tax receivable for the years 2000, 2001, and 2002 after giving effect to reserves for loss contingencies on the refund claims, or an equivalent of $7.9 million after giving effect to Federal tax benefits. The FTB is currently in the process of reviewing and assessing our refund claims for taxes and interest for tax years 2000 through 2002. The Company does not expect that its refund claim related to its regulated investment company will more likely than not be realized and consequently, expects to include the $7.9 million after tax amount related to its refund claim in its cumulative effect adjustment for Interpretation No. 48 as an adjustment to the opening balance of retained earnings as of the January 1, 2007 effective date of Interpretation No. 48.

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Results of Operations

Overview

For the year ended December 31, 2006, the Company reported net income of $117.6 million, or $2.27 per diluted share, compared to net income of $104.1 million, or $2.05 per diluted share in 2005 and net income of $86.8 million, or $1.72 per diluted share in 2004. Strong organic loan growth and acquisitions were the main factors that contributed to these results. The return on average assets in 2006 was 1.60%, compared to 1.69% in 2005, and 1.51% in 2004. The return on average equity was 13.61% in 2006, compared to 14.05% in 2005 and 13.27% in 2004.

Highlights

Net income for 2006 was $117.6 million, or $2.27 per diluted common share, compared with $104.1 million, or $2.05 per diluted common share in 2005, an increase of 12.9%.

Net interest income increased by 16.2% from 2005 to 2006 as a result of the strong loan growth and increases in market interest rates.

Total assets increased by $1.6 billion, or 25.5%, to $8.0 billion at December 31, 2006 from year-end 2005 of $6.4 billion.

Total gross loans increased by $1.1 billion, or 23.7% to $5.7 billion at December 31, 2006, from $4.6 billion at December 31, 2005.

Deposit balances at December 31, 2006, grew to $5.7 billion, an increase of $759.0 million, or 15.4%, compared to the deposit balance of $4.9 billion at December 31, 2005.

Net charge-offs were $715,000 for 2006 compared to net charge-offs of $2.1 million in 2005.

Net income and key financial performance ratios are presented below for the three years indicated:

	2006	2005	2004
	(Dollars in thousands, except share and per share data)		
Net income	$ 117,570	$ 104,091	$ 86,813
Basic earnings per common share	$ 2.29	$ 2.07	$ 1.74
Diluted earnings per common share	$ 2.27	$ 2.05	$ 1.72
Return on average assets	1.60%	1.69%	1.51%
Return on stockholders equity	13.61%	14.05%	13.27%
Total average assets	$ 7,345,020	$ 6,146,777	$ 5,753,208
Total average stockholders equity	$ 863,641	$ 740,921	$ 654,450
Efficiency ratio	37.88%	36.86%	39.23%
Effective income tax rate	36.39%	37.48%	38.18%

Net Interest Income

Net interest income totaled $279.3 million in 2006 compared with $240.4 million in 2005. Interest income in 2006 on tax-exempt securities was $3.8 million, or $5.7 million on a tax-equivalent basis using a statutory Federal income tax rate of 35%, compared to $4.4 million, or $6.7 million on a tax-equivalent basis in 2005.

Taxable-equivalent net interest income totaled $281.2 million in 2006, compared with $242.6 million in 2005. The increase in net interest income was due to a $1.06 billion, or 18.6%, increase in average earning assets resulting primarily from increases in market rates, strong organic loan growth, and the earning assets from two acquisitions, partially offset by the decrease in the net interest margin between 2005 and 2006 as a result of the greater increases in interest rates for time deposits and wholesale borrowings.

Average loans for 2006 were $5.31 billion, which is $1.15 billion, or 27.5%, higher than 2005 due primarily to the growth in commercial real estate loans. Compared with 2005, average commercial loans increased

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$90.0 million, or 8.8%, to $1.11 billion, average residential mortgages and equity lines increased $110.3 million, or 29.4%, to $485.3 million, average commercial real estate mortgages increased $768.2 million, or 33.6%, to $3.06 billion and average construction loans increased $173.3 million, or 38.0%, to $629.0 million. Average securities were $1.39 billion, a decrease of $91.4 million, or 6.2%, due primarily to principal pay downs and maturities of securities during 2006.

Average deposits were $5.32 billion in 2006, an increase of $508.9 million, or 10.6%, from $4.81 billion in 2005 due to increases of $415.6 million in time deposits, $59.6 million in money market accounts and $58.8 million in non-interest bearing deposits. Average other borrowings increased $174.7 million to $578.2 million from $403.5 million. Securities sold under agreement to repurchase increased from $18.4 million in 2005 to $374.4 million in 2006 as another source to fund the Company s loan growth in 2006.

Taxable-equivalent interest income increased $140.5 million, or 39.8%, to $493.4 million in 2006, primarily due to continued growth in loans. The overall increase in taxable-equivalent interest income was due to increases in volume and rate which were partially offset by a change in the mix of interest-earning assets as discussed below:

Increase in volume: Average interest-earning assets increased $1.06 billion, or 18.6%, to $6.75 billion in 2006, over interest-earning assets of $5.69 billion in 2005. The increase in volume added $81.7 million to interest income and was primarily attributable to the growth in loans.

Increase in rate: The taxable-equivalent yield on interest-earning assets increased 111 basis points from 6.20% in 2005 to 7.31% in 2006. As a result of the higher interest rate environment during 2006, the yield earned on average loans increased 106 basis points from 6.84% to 7.90% in the same period. The yield earned on average taxable securities increased 74 basis points from 4.33% in 2005 to 5.07% in 2006. The increase in rates increased interest income by $58.8 million.

Change in the mix of interest-earnings assets: Average gross loans, which generally have a higher yield than other types of investments, comprised 78.7% of total average interest-earning assets in 2006 and increased from 73.2% in 2005. Average securities comprised 20.6% of total average interest-bearing assets in 2006 and decreased from 26.0% in 2005.

Interest expense increased by $101.9 million to $212.2 million in 2006 compared with $110.3 million in 2005. The overall increase in interest expense was due to increases in rate and volumes as discussed below:

Increase in volume: Average interest-bearing liabilities increased $993.1 million in 2006, due primarily to the growth of time deposits of $415.6 million, securities sold under agreement to repurchase of $355.9 million and FHLB advances and other borrowings of $174.6 million.

Increase in rate: As a result of the higher interest rate environment during 2006, the average cost of interest bearing liabilities increased 140 basis points from 2.38% in 2005 to 3.78% in 2006.

Change in the mix of interest-bearing liabilities. Average FHLB advances and other borrowing of $578.2 million increased to 10.3% of total interest-bearing liabilities in 2006 compared to 8.7% in 2005. In addition, average securities under agreement to repurchase of $374.4 million increased to 6.7% of total interest-bearing liabilities in 2006 compared to 0.4% in 2005. Offsetting these increases, average interest bearing deposits of $4.6 billion decreased to 81.1% of total interest-bearing liabilities in 2006 compared to 88.8% in 2005, due in part to decreases in average interest-bearing demand and savings deposits.

The Company s taxable-equivalent net interest margin, defined as taxable-equivalent net interest income to average interest-earning assets, decreased 9 basis points to 4.17% in 2006 from 4.26% in 2005 primarily as a result of the repricing of time deposits to market interest rates and increased reliance on more expensive wholesale borrowings.

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Net interest income totaled $240.4 million in 2005 compared with $214.8 million in 2004. Interest income in 2005 on tax-exempt securities was $4.4 million, or $6.7 million on a tax-equivalent basis using a statutory Federal income tax rate of 35%, compared to $4.2 million, or $6.4 million on a tax-equivalent basis in 2004.

Taxable-equivalent net interest income totaled $242.6 million in 2005, compared with $217.0 million in 2004. The increase in net interest income was due to a 7.2% increase in average earning assets resulting primarily from strong organic loan growth, partially offset by a decrease of securities available-for-sale, as well as an improvement in the net interest margin between 2004 and 2005.

Average loans for 2005 were $4.17 billion, which was $642.7 million, or 18.3%, higher than 2004 due primarily to the growth in commercial real estate loans. Compared with December 31, 2004, balances, commercial loans increased $155.0 million, or 16.2%, to $1.11 billion, residential mortgages and equity lines increased $99.6 million, or 30.0%, to $431.3 million, commercial real estate mortgages increased $471.4 million, or 22.2%, to $2.60 billion and construction loans increased $87.4 million, or 21.2%, to $500.0 million. Average securities were $1.48 billion, a decrease of $264.6 million, or 15.2%, due primarily to the sale of $243.2 million of securities and $302.0 million pay-downs from mortgage-backed securities and calls of municipal bonds and other securities during 2005.

Average deposits were $4.81 billion in 2005, an increase of $315.6 million, or 7.0%, from $4.49 billion in 2004 due to business development efforts and promotions. Average FHLB advances and other borrowings decreased $2.9 million to $403.5 million from $406.4 million. Average federal funds purchased and securities sold under agreement to repurchase increased from $53.8 million in 2004 to $62.4 million in 2005.

Taxable-equivalent interest income increased $75.7 million, or 27.3%, to $352.9 million in 2005, primarily due to continued growth in loans. The overall increase in taxable-equivalent interest income was due to increases in volume and rate which were partially offset by a change in the mix of interest-earning assets as discussed below:

Increase in volume: Average interest-earning assets increased $383.0 million, or 7.21%, to $5.69 billion in 2005, over interest-earning assets of $5.31 billion in 2004. The increase in volume added $28.8 million to interest income and was primarily attributable to the growth in loans.

Increase in rate: The taxable-equivalent yield on interest-earning assets increased 98 basis points from 5.22% in 2004 to 6.20% in 2005. As a result of the higher interest rate environment during 2005, the yield earned on average loans increased 116 basis points from 5.68% to 6.84% in the same period. The yield earned on average taxable securities increased from 4.24% in 2004 to 4.33% in 2005. The increase in rates increased interest income by $46.9 million.

Change in the mix of interest-earnings assets: Average gross loans, which generally has a higher yield than other types of investments, comprised 73.2% of total average interest-bearing assets compared with 66.4% in 2004. Average securities comprised 26.0% of total average interest-bearing assets which decreased from 32.9% in 2004.

Interest expense increased by $50.1 million to $110.3 million in 2005 compared with $60.2 million in 2004. The overall increase in interest expense was due to an increase in rate and an increase in volume time deposits as discussed below:

Increase in volume: Average interest-bearing liabilities increased $282.6 million in 2005, due primarily to the growth of time deposits.

Increase in rate: As a result of the higher interest rate environment during 2005, the average cost of interest bearing liabilities increased 99 basis points from 1.39% in 2004 to 2.38% in 2005.

Change in the mix of interest-bearing liabilities. Average time deposits of $2.93 billion comprised 63.3% of total interest-bearing liabilities in 2005 compared to 58.1% in 2004. Total average savings accounts, NOW accounts, and money market accounts decreased to 25.4% of total interest-bearing liabilities in 2005 compared to 30.1% in 2004.

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The Company s taxable-equivalent net interest margin, defined as taxable-equivalent net interest income to average interest-earning assets, increased 17 basis points to 4.26% in 2005 from 4.09% in 2004 primarily as a result of the increases in the prevailing prime rate, the Company s overall asset sensitive interest rate position in a period of increasing interest rates, and the decrease in securities as a proportion of earning assets.

The following table sets forth information concerning average interest-earning assets, average interest-bearing liabilities, and the yields and rates paid on those assets and liabilities. Average outstanding amounts included in the table are daily averages.

Interest-Earning Assets and Interest-Bearing Liabilities

	2006 Average Balance	Interest Income/ Expense (4)	Average Yield/ Rate (1)(2)	2005 Average Balance	Interest Income/ Expense (4)	Average Yield/ Rate (1)(2)	2004 Average Balance	Interest Income/ Expense (4)	Average Yield/ Rate (1)(2)
				(Dollars in thousands)					
Interest-Earning Assets:									
Commercial loans	$ 1,109,144	$ 90,182	8.13%	$ 1,019,101	$ 66,517	6.53%	$ 939,777	$ 47,794	5.09%
Residential mortgage	485,287	29,130	6.00	374,988	21,155	5.64	294,927	15,925	5.40
Commercial mortgage	3,057,523	238,227	7.79	2,289,288	159,244	6.96	1,940,717	113,567	5.85
Real estate construction loans	628,989	60,890	9.68	455,704	37,512	8.23	329,564	22,383	6.79
Other loans and leases	29,621	1,025	3.46	26,220	680	2.59	17,590	440	2.50
Loans and leases (1)	5,310,564	419,454	7.90	4,165,301	285,108	6.84	3,522,575	200,109	5.68
Taxable securities	1,304,325	66,071	5.07	1,376,068	59,584	4.33	1,637,791	69,372	4.24
Tax-exempt securities (3)	83,349	5,706	6.85	103,026	6,653	6.46	105,893	6,441	6.08
Federal Home Loan Bank stock	32,475	1,594	4.91	29,237	965	3.30	24,071	1,016	4.22
Federal funds sold & securities purchased under agreement to resell	4,340	195	4.49	8,005	237	2.96	12,424	104	0.84
Interest-bearing deposits	15,091	380	2.52	9,517	368	3.87	5,419	151	2.79
Total interest-earnings assets	$ 6,750,144	$ 493,400	7.31	$ 5,691,154	$ 352,915	6.20	$ 5,308,173	$ 277,193	5.22
Non-interest earning assets									
Cash and due from banks	99,986			89,211			95,403		
Other non-earning assets	571,887			440,071			427,618		
Total non-interest earning assets	671,873			529,282			523,021		
Less: Allowance for loan losses	(63,955)			(62,098)			(66,883)		
Deferred loan fees	(13,042)			(11,561)			(11,103)		
Total Assets	$ 7,345,020			$ 6,146,777			$ 5,753,208		
Interest-Bearing Liabilities:									
Interest-bearing demand	237,113	2,796	1.18	245,904	1,492	0.61	267,188	709	0.27
Money market	599,210	16,145	2.69	539,642	7,537	1.40	616,970	4,878	0.79
Savings	374,570	3,416	0.91	390,787	1,992	0.51	421,959	1,325	0.31
Time deposits	3,344,931	137,734	4.12	2,929,365	81,587	2.79	2,522,845	42,923	1.70
Total interest-bearing deposit	4,555,824	160,091	3.51	4,105,698	92,608	2.26	3,828,962	49,835	1.30
Federal funds purchased	43,407	2,195	5.06	43,981	1,481	3.37	18,391	313	1.70
Securities sold under agreement to repurchase	374,356	15,683	4.19	18,449	626	3.39	35,384	851	2.41
FHLB advances and other borrowings	578,181	28,903	5.00	403,534	12,031	2.98	406,432	6,697	1.65
Long-term debt	66,907	5,363	8.02	53,944	3,533	6.55	53,885	2,466	4.58

Total interest-bearing liabilities	5,618,675	212,235	3.78	4,625,606	110,279	2.38	4,343,054	60,162	1.39
Non-interest bearing liabilities:									
Demand deposits	761,991			703,185			664,329		
Other liabilities	100,713			77,065			91,375		
Stockholders equity	863,641			740,921			654,450		
Total liabilities and stockholders equity	$ 7,345,020			$ 6,146,777			$ 5,753,208		
Net interest spread (4)			3.53%			3.82%			3.83%
Net interest income (4)		$ 281,165			$ 242,636			$ 217,031	
Net interest margin (4)			4.17%			4.26%			4.09%

(1) Yields and amounts of interest earned include loan fees. Non-accrual loans are included in the average balance.
(2) Calculated by dividing net interest income by average outstanding interest-earning assets.
(3) The average yield has been adjusted to a fully taxable-equivalent basis for certain securities of states and political subdivisions and other securities held using a statutory Federal income tax rate of 35%.
(4) Net interest income, net interest spread, and net interest margin on interest-earning assets have been adjusted to a fully taxable-equivalent basis using a statutory Federal income tax rate of 35%.

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Taxable-Equivalent Net Interest Income Changes Due to Rate and Volume(1)

	2006 - 2005 Increase/(Decrease) in Net Interest Income Due to:			2005 - 2004 Increase/(Decrease) in Net Interest Income Due to:		
	Change in Volume	Change in Rate	Total Change	Change in Volume	Change in Rate	Total Change
	(In thousands)					
Interest-Earning Assets						
Deposits with other banks	$ 168	$ (156)	$ 12	$ 143	$ 74	$ 217
Federal funds sold and securities purchased under agreement to resell	(135)	93	(42)	(49)	182	133
Taxable securities	(3,230)	9,717	6,487	(11,302)	1,514	(9,788)
Taxable-exempt securities (2)	(1,329)	382	(947)	(178)	390	212
Federal Home Loan Bank Stock	117	512	629	194	(245)	(51)
Loans	86,127	48,219	134,346	40,036	44,963	84,999
Total increase in interest income	81,718	58,767	140,485	28,844	46,878	75,722
Interest-Earning Liabilities						
Interest-bearing demand accounts	(55)	1,359	1,304	(61)	844	783
Money market accounts	914	7,694	8,608	(677)	3,336	2,659
Savings accounts	(86)	1,510	1,424	(104)	771	667
Time deposits	12,841	43,306	56,147	7,806	30,858	38,664
Federal funds purchased	(20)	734	714	686	482	1,168
Securities sold under agreement to repurchase	14,876	181	15,057	(497)	272	(225)
FHLB advances and other borrowings	6,581	10,291	16,872	(48)	5,382	5,334
Long-term debt	947	883	1,830	3	1,064	1,067
Total increase in interest expense	35,998	65,958	101,956	7,108	43,009	50,117
Change in net interest income	$ 45,720	$ (7,191)	$ 38,529	$ 21,736	$ 3,869	$ 25,605

(1) Changes in interest income and interest expense attributable to changes in both volume and rate have been allocated proportionately to changes due to volume and changes due to rate.

(2) The amount of interest earned on certain securities of states and political subdivisions and other securities held have been adjusted to a fully taxable-equivalent basis, using a statutory Federal income tax rate of 35%.

Provision for Loan Losses

The provision for loan losses represents the charge against current earnings that is determined by management, through a credit review process, as the amount needed to maintain an allowance for loan losses that management believes to be sufficient to absorb loan losses inherent in the Bank s loan portfolio. The provision for loan losses was $2.0 million in 2006 compared with negative $500,000 in 2005 and zero in 2004. As a result of the strong growth in loans during 2006, the Bank recorded a $2.0 million provision for loan losses during 2006. Net charge-offs for 2006 were $715,000, or 0.01% of average loans, compared to net charge-offs of $2.1 million, or 0.05% of average loans, during 2005 and compared to net charge-offs of $2.9 million or 0.08% of average loans during 2004.

Non-interest Income

Non-interest income was $21.5 million for 2006, $22.5 million for 2005, and $16.3 million for 2004. Non-interest income includes depository service fees, letters of credit commissions, securities sales, loan sales, and other sources of fee income. These other fee-based services include, among other things, wire transfer fees, safe

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deposit fees, fees on loan-related activities, fee income from the Company s Wealth Management division, and foreign exchange fees.

The decrease of $1.0 million, or 4.5%, from 2005 to 2006 in non-interest income was primarily due to the following items:

Net securities gains of $1.5 million in 2005 compared to net securities gains of $0.2 million in 2006;

Gains on sale of premises and equipment of $958,000 in 2005 due to the sale of the land and building for a closed branch compared to none during 2006;

Depository service fees decreased $828,000 primarily due to the reclassification of certain wire transfer fees from depository service fees to other operating income in 2006; and

The above decreases were partially offset by increases (due mainly to the acquisition of Great Eastern Bank) of $1.2 million, or 29.1%, in letter of credit commissions, of $531,000, or 13.9% in wire transfer commissions, of $357,000, or 25.2%, in safe deposit box commission and an increase of $258,000, or 44.1%, in cashier check rebate commissions.

The increase of $6.2 million, or 38.3%, from 2004 to 2005 in non-interest income was primarily due to the following items:

Net securities gains of $1.5 million in 2005 compared to net securities losses of $4.0 million in 2004. In 2004, the Company recorded a non-cash charge of $5.5 million, or $3.2 million net of tax, for other-than-temporary impairment on perpetual floating-rate preferred securities issued by government sponsored enterprises compared to other-than-temporary impairment charges of $142,000 during 2005;

Gains on sale of premises and equipment increased $934,000 in 2005 due to the sale of the land and building for a closed branch;

An increase in other operating income of $1.2 million, or 13.3%, to $10.2 million in 2005 from $9.0 million in 2004 due primarily to increases in the valuation of the Company s portfolio of warrants of $706,000, investment services commission income of $509,000, and higher cashier check commissions of $354,000; and

The above increases were offset by a decrease of $550,000, or 11.6%, in letter of credit commissions in 2005 due primarily to lower letter of credit volumes and the amortization during 2005 of all standby letter of credit fees received, whereas, prior to 2005 only fees above $10,000 were amortized; and by a decrease of $819,000, or 12.7%, in depository service fees in 2005 due to decreases in wire transfer charges and the increases in short term interest rates which resulted in lower account analysis fees collected from depositors.

In 2000 and 2001, the Bank purchased three issues of preferred stock issued by Freddie Mac with a total par value of $20.0 million and one issue of preferred stock issued by Fannie Mae with a total par value of $5.0 million. These securities have a perpetual life and after an initial fixed rate period, the dividend on each issue of preferred stock is repriced based on a spread over a specific index such as LIBOR or the two-year Treasury Note. Based on an evaluation of the length of time and extent to which the market value of these preferred stock securities have been less than market and the financial condition and near-term prospects of the issuers, the Bank recorded other-than-temporary impairment charges of $5.5 million in 2004, $115,000 in 2005 and $35,000 in 2006 to write down the value of these securities to market.

Non-interest Expense

Non-interest expense includes expenses related to salaries and benefits of employees, occupancy expenses, marketing expenses, computer and equipment expenses, amortization of core deposit intangibles, and other operating expenses. Non-interest expense totaled $113.9 million in 2006, compared with $96.9 million in 2005 and $90.7 million in 2004. The increase of $17.0 million, or 17.6%, in non-interest expense in 2006 compared to

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2005 was primarily due to the mergers with Great Eastern Bank and New Asia Bancorp, and a combination of the following:

- an increase of $9.9 million, or 18.9%, in salaries and employee benefits primarily due to mergers;
- an increase of $1.3 million in occupancy expense due primarily to increases in depreciation expenses, property taxes and utility expenses primarily due to mergers;
- an increase of $873,000 in computer and equipment expense primarily due to depreciation expenses and system conversion charges related to the conversion of the customers of Great Eastern Bank and New Asia Bancorp to the Company s computer system;
- an increase of $971,000 in marketing expenses mainly due to increases in donation, sponsorship and promotion expenses;
- an increase of $642,000 in OREO expenses due to higher levels of OREO in 2006;
- an increase of $1.3 million in expenses for the operation of affordable housing projects due to additional investments that were made in affordable housing projects;
- an increase of $575,000 in amortization of core deposit intangibles due to mergers; and
- an increase of $1.8 million of other operating expenses, or 24.8%, primarily due to increases in printing, supplies and postage expenses.

The efficiency ratio, defined as non-interest expense divided by the sum of net interest income before provision for loan losses plus non-interest income, increased to 37.88% in 2006 compared with 36.86% in 2005 due primarily to the higher percentage increase in non-interest expenses compared to the percentage increase in total revenues from 2005 to 2006.

Non-interest expense totaled $96.9 million in 2005, compared with $90.7 million in 2004. The increase of $6.2 million, or 6.9%, in non-interest expense in 2005 compared to 2004 was primarily a combination of the following:

- an increase of $3.4 million, or 7.0%, in salaries and employee benefits, due primarily to an increase of $3.8 million from stock option expense and $2.5 million from annual salary adjustments for the Company s employees and the hiring of additional employees which were partially offset by higher deferred loan origination costs of $2.8 million;
- an increase of $748,000 in occupancy expense due primarily to the addition of new branches, an adjustment in 2005 for prior period lease expenses of $230,000, and writeoff of leasehold improvements for two branches closed during 2005;
- an increase of $1.0 million in professional expense, due to external auditing expenses and professional expense related to testing of the Company s internal control over financial reporting and higher consulting fees related to improvements in the Bank s Bank Secrecy Act procedures;

- an increase of $1.1 million in expenses for the operation of affordable housing projects due to additional investments that were made in affordable housing projects; and

- an increase of $621,000 in amortization of core deposit intangibles of which $338,000 was an adjustment recorded in 2005 to accelerate the amortization in prior periods.

The efficiency ratio, defined as non-interest expense divided by the sum of net interest income before provision for loan losses plus non-interest income, improved to 36.86% in 2005 compared with 39.23% in 2004 due primarily to the stronger growth in revenues as compared to expenses from 2004 to 2005 as well as the securities losses recorded in 2004.

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Income Tax Expense

The effective tax rate was 36.4% for 2006 and 37.5% for 2005. The decrease in effective tax rate was primarily due to a lower composite state income tax rate.

The effective tax rate was 37.5% for 2005 and 38.2% for 2004. The effective tax rate for 2005 decreased from 2004 because state income taxes were lower in 2005 as a percentage of pretax income because of higher tax benefits recognized related to California enterprise zone tax deductions and a higher percentage of taxable income apportioned to lower tax rate jurisdictions and an increase in low income housing tax credits.

On December 31, 2003, the California Franchise Tax Board (FTB) announced its intent to list certain transactions that in its view constitute potentially abusive tax shelters. Included in the transactions subject to this listing were transactions utilizing regulated investment companies (RICs) and real estate investment trusts (REITs). As part of the notification indicating the listed transactions, the FTB also indicated its position that it intends to disallow tax benefits associated with these transactions. While the Company continues to believe that the tax benefits recorded in three prior years with respect to RIC were appropriate and fully defensible under California law, the Company has deemed it prudent to participate in Voluntary Compliance Initiative Option 2, requiring payment of all California taxes and interest on these disputed 2000 through 2002 tax benefits, and permitting the Company to claim a refund for these years while avoiding certain potential penalties. The Company retains potential exposure for assertion of an accuracy-related penalty should the FTB prevail in its position in addition to the risk of not being successful in its refund claims. As of December 31, 2006, the Company reflected a $12.1 million net state tax receivable for the years 2000, 2001, and 2002 after giving effect to reserves for loss contingencies on the refund claims, or an equivalent of $7.9 million after giving effect to Federal tax benefits. The FTB is currently in the process of reviewing and assessing our refund claims for taxes and interest for tax years 2000 through 2002. The Company does not expect that its refund claim related to its regulated investment company will more likely than not be realized and consequently, expects to include the $7.9 million after tax amount related to its refund claim in its cumulative effect adjustment for Interpretation No. 48 as an adjustment to the opening balance of retained earnings as of the January 1, 2007 effective date of Interpretation No. 48.

The Company s tax returns are open for audits by the Internal Revenue Service back to 2003 and by the Franchise Tax Board of the State of California back to 2000. The Company is currently under audit by the Internal Revenue Service for the years 2004 and 2005 and by the California Franchise Tax Board for the years 2000 to 2002. From time to time, there may be differences in opinions with respect to the tax treatment accorded transactions. When, and if, such differences occur and the related tax effects become probable and estimable, such amounts will be recognized. See discussion above in Part I Item 1A Risk Factors of this Annual Report on Form 10-K.

Review of Financial Condition

Total assets increased by $1.6 billion, or 25.5%, to $8.0 billion at December 31, 2006, compared with total assets of $6.4 billion at December 31, 2005. The increase in total assets was due primarily to growth in loans, increases in investment securities and the mergers with Great Eastern Bank and New Asia Bancorp funded by growth of deposits and borrowings.

Securities

Securities represented 18.96% of total December 31, 2006 assets compared with 19.03% of December 31, 2005 total assets. The fair value of securities available-for-sale (AFS) at December 31, 2006, was $1.52 billion compared with $1.22 billion at December 31, 2005. Securities available-for-sale are carried at fair value and had a net unrealized loss of $21.4 million at December 31, 2006, compared with a net unrealized loss $22.9 million at December 31, 2005.

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The following table summarizes the carrying value of our portfolio of securities for each of the past two years:

	As of December 31,	
	2006	2005
	(In thousands)	
Securities Available-for-Sale:		
U.S. treasury securities	$ 993	$
U.S. government sponsored entities	361,499	182,876
State and municipal securities	55,532	66,444
Mortgage-backed securities	534,767	606,903
Commercial mortgage-backed securities	19,966	28,768
Collateralized mortgage obligations	245,626	287,069
Asset-backed securities	780	1,192
Corporate bonds	205,937	6,908
Preferred stock of government sponsored entities	22,010	21,090
Equity securities		14,173
Foreign corporate bonds	75,113	2,015
Total	$ 1,522,223	$ 1,217,438

The table below shows the fair value and unrealized losses as of December 31, 2006, on the temporarily impaired securities in the Company s available-for-sale securities portfolio. The Company has the ability and intent to hold these debt securities for a period of time sufficient for a recovery of cost. Unrealized losses for securities with unrealized losses for less than twelve months represent 0.2% of the historical cost, and unrealized losses for securities with unrealized losses for twelve months and more represent 2.8% of the historical cost and generally resulted from increases in interest rates from the date that these securities were purchased. All of these securities are investment grade. At December 31, 2006, management believes the impairment detailed in the table below is temporary and accordingly no impairment loss has been recognized in the Company s consolidated statements of income.

Temporarily Impaired Securities at December 31, 2006

	Less than 12 months		12 months or longer		Total	
Description of securities	Fair Value	Unrealized losses	Fair Value	Unrealized losses	Fair Value	Unrealized losses
			(In thousands)			
U.S. treasury securities	$ 993	$ 1	$	$	$ 993	$ 1
U.S. government sponsored entities	204,386	336	133,433	3,220	337,819	3,556
State and municipal securities	3,631	29	2,349	51	5,980	80
Mortgage-backed securities	3,305	20	465,800	15,050	469,105	15,070
Commercial mortgage-backed securities			19,966	588	19,966	588
Collateralized mortgage obligations			242,190	6,417	242,190	6,417
Asset-backed securities			780	3	780	3
Corporate bonds	50,693	308	4,919	88	55,612	396

Foreign corporate bonds	24,988	13			24,988	13
Total	$ 287,996	$ 707	$ 869,437	$ 25,417	$ 1,157,433	$ 26,124

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The following table summarizes the number of issuances of the temporarily impaired available-for-sale securities as of December 31, 2006:

Temporarily Impaired Securities at December 31, 2006

Description of securities	Less than 12 months Number of Issuances	12 months or longer Number of Issuances	Total Number of Issuances
U.S. treasury securities	1		1
U.S. government sponsored entities	29	10	39
State and municipal securities	7	5	12
Mortgage-backed securities	7	77	84
Commercial mortgage-backed securities		3	3
Collateralized mortgage obligations		39	39
Asset-backed securities		2	2
Corporate bonds	3	1	4
Foreign corporate bonds	1		1
Total	48	137	185

The scheduled maturities and taxable-equivalent yields by security type are presented in the following tables:

Securites Available-for-Sale Portfolio Maturity Distribution and Yield Analysis:

	As of December 31, 2006				
	One Year or Less	After One Year to Five Years	After Five Years to Ten Years	Over Ten Years	Total
			(Dollars in thousands)		
Maturity Distribution:					
U.S. treasury securities	$ 993	$	$	$	$ 993
U.S. government sponsored entities	49,194	311,127	1,002	176	361,499
State and municipal securities	459	6,474	29,276	19,323	55,532
Mortgage-backed securities (1)	311	26,929	2,801	504,726	534,767
Commercial mortgage-backed securities (1)		657		19,309	19,966
Collateralized mortgage obligations (1)	16		10,269	235,341	245,626
Asset-backed securities (1)				780	780
Corporate bonds	5,919		200,018		205,937
Preferred stock of government sponsored entities (2)				22,010	22,010
Foreign corporate bonds			75,113		75,113
Total	$ 56,892	$ 345,187	$ 318,479	$ 801,665	$ 1,522,223

Weighted-Average Yield:					
U.S. treasury securities	3.67%	0.00%	0.00%	0.00%	3.67%
U.S. government sponsored entities	2.73	4.81	3.50	2.00	4.52
State and municipal securities (3)	8.37	7.24	6.82	6.48	6.76
Mortgage-backed securities (1)	5.37	4.99	5.97	4.58	4.61
Commercial mortgage-backed securities (1)		3.98		4.07	4.07
Collateralized mortgage obligations (1)	4.58		4.56	4.76	4.75
Asset-backed securities (1)				2.94	2.94
Corporate bonds	3.17		8.63		8.48
Preferred stock of government sponsored entities				7.05	7.05
Foreign corporate bonds			9.03		9.03
Total	2.86%	4.87%	8.39%	4.67%	5.43%

(1) Securities reflect stated maturities and do not reflect the impact of anticipated prepayments.
(2) There is no stated maturity for equity securities.
(3) Weighted average yield has been adjusted to a fully-taxable equivalent basis.

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Loans

Loans represented 78.7% of average interest-earning assets during 2006 compared with 73.2% during 2005. Gross loans, increased by $1.1 billion, an increase of 23.7%, to $5.75 billion at year-end 2006 compared with $4.65 billion at year-end 2005. The growth was primarily attributable to the following:

Commercial mortgage loans increased $635.9 million, or 24.5%, to $3.23 billion at year-end 2006, compared to $2.60 billion at year-end 2005 due primarily to strong loan originations and the mergers with Great Eastern Bank and New Asia Bancorp. Total commercial mortgage loans accounted for 56.1% of gross loans at year-end 2006 compared to 55.7% at year-end 2005. Commercial mortgage loans include primarily commercial retail properties, shopping centers, and owner-occupied industrial facilities, and, secondarily, office buildings, multiple-unit apartments, and multi-tenanted industrial properties, and are typically secured by first deeds of trust on such commercial properties. In addition, the Bank provides medium-term commercial real estate loans secured by commercial or industrial buildings where the owner either uses the property for business purposes or derives income from tenants.

Commercial loans increased $133.4 million, or 12.0%, to $1.24 billion at December 31, 2006, compared to $1.11 billion at December 31, 2005. Commercial loans consist primarily of short-term loans (normally with a maturity of one year or less) to support general business purposes, or to provide working capital to businesses in the form of lines of credit, trade-finance loans, loans for commercial purposes secured by cash, and SBA loans.

Real estate construction loans increased $185.2 million, or 37.0%, to $685.2 million at year-end 2006 compared to $500.0 million at year-end 2005.

Total residential mortgage loans and equity lines increased by $143.1 million or 33.2%, to $574.4 million at year-end 2006, compared to $431.3 million at year-end 2005, primarily due to strong new loan originations for single family mortgage loans and the acquisition of New Asia Bancorp.

The Company s lending activities are predominantly in the states of California, New York, Texas, Washington, Massachusetts, and Illinois, although it has some loans to domestic clients who are engaged in international trade.

The classification of loans by type as of December 31 for each of the past five years is presented below:

Loan Type and Mix

	Amount Outstanding as of December 31,				
	2006	2005	2004	2003	2002
	(Dollars in thousands)				
Type of Loans					
Commercial loans	$ 1,243,756	$ 1,110,401	$ 955,377	$ 956,382	$ 563,675
Residential mortgage loans and equity lines	574,422	431,289	331,727	262,954	231,371

Commercial mortgage loans	3,226,658	2,590,752	2,119,349	1,715,434	943,391
Real estate construction loans	685,206	500,027	412,611	359,339	122,773
Installment loans	13,257	13,662	10,481	11,452	15,570
Other loans	4,247	1,684	2,443	860	447
Gross loans	5,747,546	4,647,815	3,831,988	3,306,421	1,877,227
Less:					
Allowance for loan losses	(64,689)	(60,251)	(62,880)	(65,808)	(24,543)
Unamortized deferred loan fees	(11,984)	(12,733)	(11,644)	(10,862)	(4,606)
Net loans	$ 5,670,873	$ 4,574,831	$ 3,757,464	$ 3,229,751	$ 1,848,078

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The loan maturities in the table below are based on contractual maturities. As is customary in the banking industry, loans that meet sound underwriting criteria can be renewed by mutual agreement between the Company and the borrower. Because the Company is unable to estimate the extent to which its borrowers will renew their loans, the table is based on contractual maturities. As a result, the data shown below should not be viewed as an indication of future cash flows. As a result of short term interest rates rising above longer term interest rates, a higher proportion of the Company s commercial mortgage loans at December 31, 2006, were fixed rate loans compared to the prior year.

Contractual Maturity of Loan Portfolio

	Within One Year	One to Five Years	Over Five Years	Total
		(In thousands)		
Commercial loans				
Floating rate	$ 642,696	$ 185,785	$ 44,568	$ 873,049
Fixed rate	302,747	60,403	7,557	370,707
Residential mortgage loans and equity lines				
Floating rate	556	1,481	168,646	170,683
Fixed rate	2,400	19,418	381,921	403,739
Commercial mortgage loans				
Floating rate	399,219	467,705	388,938	1,255,862
Fixed rate	33,652	825,572	1,111,572	1,970,796
Real estate construction loans				
Floating rate	558,532	100,745	2,602	661,879
Fixed rate	15,889	5,905	1,533	23,327
Installment loans				
Floating rate				
Fixed rate .	11,057	2,200		13,257
Other loans				
Floating rate				
Fixed rate	4,247			4,247
Total Loans	$ 1,970,995	$ 1,669,214	$ 2,107,337	$ 5,747,546
Floating rate	$ 1,601,003	$ 755,716	$ 604,754	$ 2,961,473
Fixed rate	369,992	913,498	1,502,583	2,786,073
Total Loans	1,970,995	1,669,214	2,107,337	5,747,546
Allowance for loan losses				(64,689)
Unamortized deferred loan fees				(11,984)
Net loans				$ 5,670,873

Deposits

The Bank primarily uses customer deposits to fund its operations, and to a lesser extent borrowings in the form of securities sold under agreements to repurchase, advances from the Federal Home Loan Bank, and other borrowings. The Bank s deposits are generally obtained from residents within the Bank s geographic market area. The Bank utilizes traditional marketing methods to attract new customers and deposits, by offering a wide variety of products and services and utilizing various forms of advertising media. Although the vast majority of the Bank s deposits are retail in nature, the Bank does engage in certain wholesale activities, primarily accepting time deposits from political subdivisions and public agencies. The Bank considers wholesale deposits to be an alternative borrowing source rather than a customer relationship and, as such, their levels are determined by management s decisions as to the most economic funding sources. At December 31, 2006, the Bank had brokered-deposits which totaled $247.2 million, or 4.4% of total deposits, and public deposits which totaled $325.1 million, or 5.7% of total deposits.

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The Bank s total deposits increased $759.0 million, or 15.4%, from $4.92 billion at year-end 2005 to $5.68 billion at December 31, 2006. Time deposits of $100,000 or more increased $210.6 million, or 8.7%, and time deposits under $100,000 increased $366.2 million, or 57.1%, during 2006, primarily due to the $247.2 million increase from brokered-deposits and the $74.9 million increase in public deposits as well as a number of special deposit promotions during 2006.

The following table displays the deposit mix for the past three years:

Deposit Mix

	Year Ended December 31,					
	2006		2005		2004	
	Amount	Percentage	Amount	Percentage	Amount	Percentage
	(Dollars in thousands)					
Demand accounts	$ 781,492	13.8%	$ 726,722	14.8%	$ 674,791	14.7%
NOW accounts	239,589	4.2	240,885	4.9	253,767	5.5
Money market accounts	657,689	11.6	523,076	10.6	588,526	12.8
Saving accounts	358,827	6.3	364,793	7.4	418,041	9.1
Time deposits under $100,000	1,007,637	17.8	641,411	13.1	539,811	11.7
Time deposits of $100,000 or more	2,630,072	46.3	2,419,463	49.2	2,120,201	46.2
Total	$ 5,675,306	100.0%	$ 4,916,350	100.0%	$ 4,595,137	100.0%

Average total deposits grew $508.9 million, or 10.6%, to $5.32 billion during 2006 compared with average total deposits of $4.81 billion in 2005.

The following table displays average deposits and rates for the past five years:

Average Deposits and Average Rates

	2006		2005		2004		2003		2002	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
	(Dollars in thousands)									
Demand	$ 761,991	%	$ 703,185	%	$ 664,329	%	$ 357,731	%	$ 274,568	%
NOW accounts	237,113	1.18	245,904	0.61	267,188	0.27	179,290	0.27	139,589	0.31

Money market accounts	599,210	2.69	539,642	1.40	616,970	0.79	292,952	0.73	154,414	0.99
Saving accounts	374,570	0.91	390,787	0.51	421,959	0.31	327,336	0.30	271,286	0.50
Time deposits	3,344,931	4.12	2,929,365	2.79	2,522,845	1.70	1,665,114	1.76	1,372,854	2.43
Total	$ 5,317,815	3.01%	$ 4,808,883	1.93%	$ 4,493,291	1.11%	$ 2,822,423	1.17%	$ 2,212,711	1.66%

Management considers the Bank s time deposits of $100,000 or more (Jumbo CDs) to be generally less volatile than other wholesale funding sources primarily because:

approximately 67.3% of the Bank s Jumbo CDs have been on deposit with the Bank for two years or more;

the Jumbo CD portfolio is widely-held with 11,396 individual accounts averaging approximately $201,689 per account owned by 7,264 individual depositors as of December 31, 2006; and

the ratio of relatively higher percentage of Jumbo CDs to total deposits exists in most of the Asian-American banks in our California market because of higher savings rate within the communities we serve.

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Management monitors the Jumbo CD portfolio to identify any changes in the deposit behavior in the market and of the customers the Bank is serving.

Of our Jumbo CDs, 95.9% mature within one year as of year-end 2006. The following tables display time deposits of $100,000 or more by maturity:

Time Deposits of $100,000 or More by Maturity

	At December 31, 2006
	(In thousands)
Less than three months	$ 1,047,038
Three to six months	1,043,522
Six to twelve months	432,046
Over one year	107,466
Total	$ 2,630,072

The following table displays time deposits with remaining term of more than one year at December 31, 2006:

Maturities of Time Deposits with a Remaining Term

of More Than One Year for Each

of the Five Years Following December 31, 2006

	(In thousands)
2008	$ 142,947
2009	15,777
2010	155
2011	662
2012	17

Borrowings

Borrowings include securities sold under agreements to repurchase, federal funds purchased, funds obtained as advances from the Federal Home Loan Bank (FHLB) of San Francisco, and borrowings from other financial institutions.

In addition to the four long-term transactions totaling $200.0 million for five years entered into in 2005, in January and February 2006, the Bank entered into four long-term transactions involving the sale of securities under repurchase agreements totaling $200.0 million for five years. The rates are all initially floating rate for the first year at the three-month LIBOR minus 100 basis points. Thereafter, the rates are fixed for the remainder of the term. After the initial one year period, the counterparties have the right to terminate the transaction at par at the first anniversary date and quarterly thereafter At December 31, 2006, $200.0 million of these repurchase agreements bear fixed interest rates ranging from 4.35% to 4.52% and the remaining $200.0 million of these repurchase agreements, if not called, will bear fixed interest rates ranging from 4.42% to 4.79%.

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The table below provides comparative data for securities sold under agreements to repurchase:

	December 31,		
	2006	2005	2004
	(Dollars in thousands)		
Average amount outstanding during the year (1)	$ 374,356	$ 18,449	$ 35,384
Maximum amount outstanding at month-end (2)	445,000	200,000	54,000
Balance, December 31,	400,000	200,000	15,000
Rate at year-end	4.40%	3.41%	2.15%
Weighted average interest rate for the year	4.19%	3.39%	2.41%

(1) Average balances were computed using daily averages.
(2) Highest month-end balances were July in 2006, December in 2005, and May in 2004.

Advances from the FHLB increased $499.7 million to $714.7 million at December 31, 2006, from $215.0 million at December 31, 2005. Of the FHLB advances outstanding at December 31, 2006, $566.0 million will mature in 2007, $3.5 million will mature in 2008, and the remaining $145.2 million will mature in year 2011. These advances are non-callable with fixed interest rates, with a weighted average rate of 5.40% at December 31, 2006 and of 4.29% at December 31, 2005.

On May 31, 2005, the Bancorp entered into a $30.0 million 364-day unsecured revolving loan agreement with a commercial bank bearing an interest rate of LIBOR plus 90 basis points and a commitment fee of 12.5 basis points on unused commitments. On September 29, 2006, in conjunction with the issuance of subordinated debt discussed below, this loan was further amended to reduce the commitment to $10.0 million after October 31, 2006. At December 31, 2006, $10.0 million was outstanding with a weighted average rate of 6.26% under this loan compared to $20.0 million outstanding with a weighted average rate of 5.18% at December 31, 2005.

On September 29, 2006, the Bank issued $50.0 million in subordinated debt in a private placement transaction. The debt has a maturity term of 10 years, is unsecured and bears interest at a rate of LIBOR plus 110 basis points. As of December 31, 2006, $50.0 million was outstanding with a rate of 6.46% under this note. The subordinated debt qualifies as Tier 2 capital for regulatory reporting purpose and is included as a component of long-term debt in the consolidated balance sheet.

Junior Subordinated Notes

The Company established special purpose trusts in 2003 for the purpose of issuing Guaranteed Preferred Beneficial Interests in its Subordinated Debentures to outside investors (Capital Securities). The proceeds from the issuance of the Capital Securities as well as the Company s purchase of the common stock of the special purpose trusts were invested in Junior Subordinated Notes of the Bancorp (Junior Subordinated Notes). The trusts exist for the sole purpose of issuing the Capital Securities and investing in Junior Subordinated Notes. Subject to some limitations, payment of distributions out of the monies held by the trusts and payments on liquidation of the trusts, or the redemption of the Capital Securities, are guaranteed by the Company to the extent the trusts have funds on hand at such time. The obligations of the Company under the guarantees and the Junior Subordinated Notes are subordinate and junior in right of payment to all indebtedness of the Company and will be structurally subordinated to all liabilities and obligations of the Company s subsidiaries. The Bancorp has the right to defer payments of interest on the Junior Subordinated Notes at any time or from time to time for a period of up to twenty consecutive quarterly periods with respect to each deferral period. Under the terms of the Junior Subordinated Notes, the Bancorp may not, with certain exceptions, declare or pay any dividends or distributions on its capital stock or purchase or acquire any of its capital stock if the Bancorp has deferred payment of interest on any Junior Subordinated Notes.

As of December 31, 2006, the total Junior Subordinated Notes issued by the Company totaled $54.1 million. The trusts are not consolidated with the Company in accordance with an accounting pronouncement that took effect in December 2003.

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Off-Balance-Sheet Arrangements, Commitments, Guarantees, and Contractual Obligations

The following table summarizes the Company s contractual obligations and commitments to make future payments as of December 31, 2006. Payments for deposits and borrowings do not include interest. Payments related to leases are based on actual payments specified in the underlying contracts. Loan commitments and standby letters of credit are presented at contractual amounts; however, since many of these commitments are expected to expire unused or only partially used, the total amounts of these commitments do not necessarily reflect future cash requirements.

	Payment Due by Period				
	1 year or less	More than 1 year but less than 3 years	3 years or more but less than 5 years	5 years or more	Total
	(Dollars in thousands)				
Contractual obligations:					
Federal funds purchased	$ 50,000	$	$	$	$ 50,000
Securities sold under agreements to repurchase (1)			400,000		400,000
Advances from the Federal Home Loan Bank	566,000	3,500	145,180		714,680
Other borrowings	10,000			19,981	29,981
Long-term debt				104,125	104,125
Operating leases	7,123	11,392	6,238	7,282	32,035
Deposits with stated maturity dates	3,478,151	158,724	817	17	3,637,709
	4,111,274	173,616	552,235	131,405	4,968,530
Other commitments:					
Commitments to extend credit	1,346,400	600,099	24,598	207,543	2,178,640
Standby letters of credit	69,466	11,826			81,292
Commercial letter of credit	79,803				79,803
Bill of lading guarantees	223				223
Total contractual obligations and other commitments	$ 5,607,166	$ 785,541	$ 576,833	$ 338,948	$ 7,308,488

(1) These repurchase agreements have a final maturity of five years but are callable on a quarterly basis after one year.

In the normal course of business, the Company enters into various transactions, which, in accordance with U.S. generally accepted accounting principles, are not included in its consolidated balance sheet. The Company enters into these transactions to meet the financing needs of its customers. These transactions include commitments to extend credit and standby letters of credit, which involve, to varying degrees, elements of credit risk and interest rate risk in excess of the amounts recognized in the consolidated balance sheets.

Loan Commitments. The Company enters into contractual commitments to extend credit, normally with fixed expiration dates or termination clauses, at specified rates and for specific purposes. Substantially all of the Company s commitments to extend credit are contingent upon customers maintaining specific credit standards at the time of loan funding. The Company minimizes its exposure to loss under these commitments by subjecting them to credit approval and monitoring procedures. Management assesses the credit risk associated with certain commitments to extend credit in determining the level of the allowance for loan losses. Loan commitments outstanding at December 31, 2006, are included in the table above.

Standby Letters of Credit. Standby letters of credit are written conditional commitments issued by the Company to guarantee the performance of a customer to a third party. In the event the customer does not perform in accordance with the terms of agreement with the third party, the Company would be required to fund the commitment. The maximum potential amount of future payments the Company could be required to make is represented by the contractual amount of the commitment. If the commitment is funded, the Company would be entitled to seek reimbursement from the customer. The Company s policies generally require that standby letter of credit arrangements contain security and debt covenants similar to those contained in loan agreements. Standby letters of credit outstanding at December 31, 2006, are included in the table above.

Capital Resources

Stockholders Equity

We obtain capital primarily from retained earnings, the issuance of additional common stock and, to a lesser extent, through our Dividend Reinvestment Plan and stock option exercises. Stockholders equity of $943.1 million at December 31, 2006, was up $169.5 million, or 21.9%, compared to $773.6 million at December 31, 2005. The increase in stockholders equity was due to $117.6 million from net income less payments of dividends on common stock of $18.4 million, issuance of 1,472,329 common shares valued at $55.2 million for a portion of the purchase price for Great Eastern Bank and New Asia Bancorp, proceeds from exercise of stock options of $3.3 million, tax benefit of $0.8 million from the exercise of stock options, reinvestment of dividends of $2.6 million, amortization of unearned compensation of $7.6 million and a decrease of $0.8 million from lower unrealized losses on securities. The Company paid common stock dividends of $0.36 per common share in 2006 and $0.36 per common share in 2005.

On April 6, 2001, the Board of Directors approved a stock repurchase program of up to $15 million of our common stock. On May 2, 2005, the Company completed the April 2001 repurchase plan under which it had repurchased a total of 830,065 common shares between April 2001 to May 2005 for a total cost of $15.0 million, or an average of $18.07 per share.

On March 18, 2005, the Company announced that its Board of Directors had approved a new stock repurchase program to buy back up to an aggregate of one million shares of the Company s common stock following the completion of the April 2001 stock repurchase program. During 2005, the Company repurchased 548,297 shares for a total cost of $18.3 million at an average price of $33.40 per share under its March 18, 2005 repurchase program. As of December 31, 2006, 451,703 shares remain under the Company s March 18, 2005, stock repurchase program.

During 2005, the Company repurchased 738,542 shares for $24.5 million, at an average price of $33.18 per share under both the April 2001 repurchase program and the March 2005 repurchase program. There were no shares repurchased in 2006. In 2007, through February 27, 2007, the Company repurchased 275,826 shares for a total cost of $9.6 million at an average price of $34.96 per share. As of February 27, 2007, 175,877 shares remain under the Company s March 18, 2005, stock repurchase program.

Under California State banking law, the Bank may not without regulatory approval pay a cash dividend which exceeds the lesser of the Bank s retained earnings or its net income for the last three fiscal years, less any cash distributions made during that period. The amount of retained earnings available for cash dividends to Bancorp immediately after December 31, 2006, is restricted to approximately $211.3 million under this regulation.

Capital Adequacy

Management seeks to retain the Company s capital at a level sufficient to support future growth, protect depositors and stockholders, and comply with various regulatory requirements.

The primary measure of capital adequacy is based on the ratio of risk-based capital to risk-weighted assets. At year-end 2006, Tier 1 risk-based capital ratio of 9.40%, total risk-based capital ratio of 11.00%, and Tier 1 leverage capital ratio of 8.98%, continued to place the Company in the well capitalized category, which is defined as institutions with Tier 1 risk-based capital ratio equal to or greater than six percent, total risk-based capital ratio equal to or greater than ten percent, and Tier 1 leverage capital ratio equal to or greater than five percent. The comparable ratios for 2005 were Tier 1 risk-based capital ratio of 10.61%, total risk-based capital ratio of 11.72%, and Tier 1 leverage capital ratio of 9.80%.

Cathay Real Estate Investment Trust, of which 100% of the common stock is owned by Cathay Bank, sold $4.4 million during 2003 and $4.2 million during 2004 of its 7.0% Series A Non-Cumulative preferred stock to accredited investors. During 2005, the Trust repurchased $131,000 of its preferred stock. This preferred stock qualifies as Tier 1 capital under current regulatory guidelines.

A table displaying the Company s and the Bank s capital and leverage ratios at year-end 2006 and 2005 is included in Note 21 to the Consolidated Financial Statements.

Risk Elements of the Loan Portfolio

Non-performing Assets

Non-performing assets include loans past due 90 days or more and still accruing interest, non-accrual loans, and other real estate owned. The Company s policy is to place loans on non-accrual status if interest and principal or either interest or principal is past due 90 days or more, or in cases where management deems the full collection of principal and interest unlikely. After a loan is placed on non-accrual status, any current year unpaid accrued interest is reversed against current income and any unpaid accrued interest from prior year is reversed against the allowance for loan losses. Thereafter, any payment is generally first applied towards the principal balance. Depending on the circumstances, management may elect to continue the accrual of interest on certain past due loans if partial payment is received and/or the loan is well collateralized and in the process of collection. The loan is generally returned to accrual status when the borrower has brought the past due principal and interest payments current and, in the opinion of management, the borrower has demonstrated the ability to make future payments of principal and interest as scheduled.

Management reviews the loan portfolio regularly for problem loans. During the ordinary course of business, management becomes aware of borrowers that may not be able to meet the contractual requirements of the loan agreements. Such loans are placed under closer supervision with consideration given to placing the loan on non-accrual status, the need for an additional allowance for loan losses, and (if appropriate) partial or full charge-off.

Our non-performing assets increased $17.7 million, or 98.8%, to $35.6 million at year-end 2006 compared to $17.9 million at year-end 2005. The increase in non-performing assets was primarily due to a $5.3 million increase in other real estate owned, a $6.5 million increase in non-accrual loans, including $2.3 million in loans acquired from New Asia Bank, and a $5.9 million increase in accruing loans past due 90 days or more as a result of one loan which was renewed after December 31, 2006, and which is expected to be paid off in full by March 31, 2007.

As a percentage of gross loans plus other real estate owned, our non-performing assets increased to 0.62% at year-end 2006 from 0.39% at year-end 2005. The non-performing loan coverage ratio, defined as the allowance for loan losses to non-performing loans, decreased to 213.28% at year-end 2006, from 336.50% at year-end 2005.

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The following table presents the breakdown of total non-accrual, past due, and restructured loans for the past five years:

Non-accrual, Past Due and Restructured Loans

	December 31,				
	2006	2005	2004	2003	2002
	(Dollars in thousands)				
Accruing loans past due 90 days or more	$ 8,008	$ 2,106	$ 3,260	$ 5,916	$ 2,468
Non-accrual loans	22,322	15,799	19,211	32,959	4,124
Total non-performing loans	30,330	17,905	22,471	38,875	6,592
Real estate acquired in foreclosure	5,259			400	653
Total non-performing assets	$ 35,589	$ 17,905	$ 22,471	$ 39,275	$ 7,245
Troubled debt restructurings (1)	955	3,088	1,006	5,808	5,266
Non-performing assets as a percentage of gross loans and other real estate owned at year-end	0.62%	0.39%	0.59%	1.19%	0.39%
Allowance for loan losses as a percentage of non-performing loans	213.28%	336.50%	279.83%	169.28%	372.31%

(1) Troubled debt restructurings accrue interest at their restructured terms.

The effect of non-accrual loans and troubled debt restructurings on interest income for the past five years is presented below:

	2006	2005	2004	2003	2002
	(In thousands)				
Non-accrual Loans					
Contractual interest due	$ 1,851	$ 1,308	$ 1,692	$ 1,019	$ 321
Interest recognized	851	157	546	624	34
Net interest foregone	$ 1,000	$ 1,151	$ 1,146	$ 395	$ 287
Troubled Debt Restructurings					
Contractual interest due	$ 100	$ 187	$ 101	$ 315	$ 338
Interest recognized	92	149	93	262	258
Net interest foregone	$ 8	$ 38	$ 8	$ 53	$ 80

During the fourth quarter 2006, the Company recognized $1.47 million of interest income, which is not reflected in the table above for 2006 amounts, from the full payoff of a loan that had been on nonaccrual status since 2004. As of December 31, 2006, there were no commitments to lend additional funds to those borrowers whose loans have been restructured, were considered impaired, or were on non-accrual status.

Non-accrual Loans

Non-accrual loans were $22.3 million at year-end 2006 and $15.8 million at year-end 2005. Non-accrual loans at December 31, 2006, consisted of fifteen commercial loans totaling $14.4 million and thirteen commercial mortgage loans totaling $7.9 million. The comparable numbers for 2005 were $9.9 million in seventeen commercial loans and $5.9 million in four commercial mortgage loans.

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The following tables present the type of properties securing the loans and the type of businesses the borrowers engaged in under commercial mortgage and commercial non-accrual loan categories as of the dates indicated:

	December 31, 2006		December 31, 2005	
	Real Estate (1)	Commercial	Real Estate (1)	Commercial
	(In thousands)			
Type of Collateral				
Single/Multi-family residence	$ 7,111	$ 180	$	$
Commercial real estate	674	1,265	5,857	2,044
Land	113			
UCC		12,779		7,796
Unsecured		200		102
Total	$ 7,898	$ 14,424	$ 5,857	$ 9,942

(1) Real estate includes commercial mortgage loans, real estate construction loans, and residential mortgage loans and equity lines.

	December 31, 2006		December 31, 2005	
	Real Estate (1)	Commercial	Real Estate (1)	Commercial
	(In thousands)			
Type of Business				
Real estate development	$ 6,651	$	$ 3,817	$
Wholesale/Retail	130	8,631	2,040	2,056
Food/Restaurant	282	3,126		2,214
Import/Export		2,667		5,672
Other	835			
Total	$ 7,898	$ 14,424	$ 5,857	$ 9,942

(1) Real estate includes commercial mortgage loans, real estate construction loans, and residential mortgage loans and equity lines.

Troubled Debt Restructurings

A troubled debt restructuring is a formal restructure of a loan when the lender, for economic or legal reasons related to the borrower s financial difficulties, grants a concession to the borrower. The concessions may be granted in various forms, including reduction in the stated interest rate, reduction in the loan balance or accrued interest, and extension of the maturity date.

Troubled debt restructurings, excluding those on non-accrual status, decreased $2.1 million to $1.0 million from a single borrower at December 31, 2006, compared to $3.1 million at December 31, 2005. At December 31, 2006, the restructured loans were performing under their revised terms.

Impaired Loans

A loan is considered impaired when it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement based on current circumstances and events. The assessment for impairment occurs when and while such loans are on non-accrual, or the loan has been restructured. Those loans less than our defined selection criteria, generally the loan amount less than $100,000, are treated as a homogeneous portfolio. If loans meeting the defined criteria are not collateral dependent, we measure the impairment based on the present value of the expected future cash flows discounted at the loan s

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effective interest rate. If loans meeting the defined criteria are collateral dependent, we measure the impairment by using the loan s observable market price or the fair value of the collateral. If the measurement of the impaired loan is less than the recorded amount of the loan, we then recognize impairment by creating or adjusting an existing valuation allowance with a corresponding charge to the provision for loan losses.

We identified impaired loans with a recorded investment of $22.3 million at year-end 2006, compared to $15.8 million at year-end 2005. The average balance of impaired loans was $20.5 million in 2006 and $15.6 million in 2005. Interest collected on impaired loans totaled $0.9 million in 2006 and $0.2 million in 2005.

The following table presents impaired loans and the related allowance as of the dates indicated:

	At December 31,	
	2006	2005
	(In thousands)	
Balance of impaired loans with no allocated allowance	$ 10,522	$ 15,676
Balance of impaired loans with an allocated allowance	11,800	123
Total recorded investment in impaired loans	$ 22,322	$ 15,799
Amount of the allowance allocated to impaired loans	$ 4,310	$ 16

The impaired loans included in the table above are comprised of $14.4 million in commercial loans and $7.9 million in real estate loans as of December 31, 2006, and comprised of $9.9 million commercial loans and $5.9 million in real estate loans as of December 31, 2005.

Loan Concentration

We experienced no loan concentrations to multiple borrowers in similar activities that exceeded 10% of total loans as of December 31, 2006. See Part I Item 1A Rick Factors above in this Annual Report on Form 10-K for a discussion of some of the factors that may affect the matters discussed in this Section.

Allowance for Loan Losses

The Bank s maintains the allowance for loan losses at a level that is considered to be equal to the estimated and known risks in the loan portfolio. With this risk management objective, the Bank s management has an established monitoring system that is designed to identify impaired and potential problem loans, and to permit periodic evaluation of impairment and the adequacy level of the allowance for loan losses in a timely manner.

In addition, our Board of Directors has established a written loan policy that includes a loan review and control system which it believes should be effective in ensuring that the Bank maintains an adequate allowance for loan losses. The Board of Directors provides oversight for the allowance evaluation process, including quarterly evaluations, and determines whether the allowance is adequate to absorb losses in the loan portfolio. The determination of the amount of the allowance for loan losses and the provision for loan losses is based on management s current judgment about the credit quality of the loan portfolio and takes into consideration known relevant internal and external factors that affect collectibility when determining the appropriate level for the allowance for loan losses. The nature of the process by which the Bank determines the appropriate allowance for loan losses requires the exercise of considerable judgment. Additions to the allowance for loan losses are made by charges to the provision for loan losses. While management utilizes its best judgment and information available, the ultimate adequacy of the allowance is dependent upon a variety of factors beyond the Bank s control, including the performance of the Bank s loan portfolio, the economy, changes in interest rates, and the view of the regulatory authorities toward loan classifications. Identified credit exposures that are determined to be uncollectible are charged against the allowance for loan losses. Recoveries of previously charged off amounts, if any, are credited to the allowance for loan losses. A weakening of the economy or other factors that adversely affect asset quality could result in an increase in the number of delinquencies, bankruptcies, or defaults, and a higher level of non-performing assets, net charge-offs, and provision for loan losses in future periods. See Part I Item 1A Rick Factors in this Annual Report on Form 10-K for additional factors that could cause actual results to differ materially from forward-looking statements or historical performance.

The following table sets forth the information relating to the allowance for loan losses, charge-offs, and recoveries for the past five years:

Allowance for Loan Losses

	Amount Outstanding as of December 31,				
	2006	**2005**	**2004**	**2003**	**2002**
	(Dollars in thousands)				
Balance at beginning of year	$ 60,251	$ 62,880	$ 65,808	$ 24,543	$ 23,973
Provision/(reversal) for loan losses	2,000	(500)		7,150	6,000
Charge-offs:					
Commercial loans	(1,985)	(5,176)	(8,334)	(364)	(5,663)
Real estate loans	(3)		(1,366)	(485)	(163)
Installment loans and other loans	(42)	(39)	(28)	(7)	(150)
Total charge-offs	(2,030)	(5,215)	(9,728)	(856)	(5,976)
Recoveries:					
Commercial loans	1,243	2,850	6,702	799	242
Real estate loans	41	212	49	47	268
Installment loans and other loans	31	24	49	77	36
Total recoveries	1,315	3,086	6,800	923	546
Allowance from acquisitions	3,153			34,048	
Balance at end of year	$ 64,689	$ 60,251	$ 62,880	$ 65,808	$ 24,543
Average loans outstanding during year ended	$ 5,310,564	$ 4,165,301	$ 3,522,575	$ 2,233,529	$ 1,752,444
Ratio of net charge-offs to average loans outstanding during the year	0.01%	0.05%	0.08%	%	0.31%
Provision for loan losses to average loans outstanding during the year	0.04%	%	%	0.32%	0.34%
Allowance to non-performing loans at year-end	213.28%	336.50%	279.83%	169.28%	372.31%
Allowance to gross loans at year-end	1.13%	1.30%	1.64%	1.99%	1.31%

Our allowance for loan losses consists of the following:

Specific allowance: For impaired loans, we provide specific allowances based on an evaluation of impairment, and for each criticized loan, we allocate a portion of the general allowance to each loan based on a loss percentage assigned. The percentage assigned depends on a number of factors including loan classification, the current financial condition of the borrowers and guarantors, the prevailing value of the underlying collateral, charge-off history, management s knowledge of the portfolio, and general economic conditions.

General allowance: The unclassified portfolio is segmented on a group basis. Segmentation is determined by loan type and by identifying risk characteristics that are common to the groups of loans. The allowance is provided to each segmented group based on the group s historical loan loss experience, the trends in delinquency and non-accrual, and other significant factors, such as national and local economy, trends and conditions, strength of management and loan staff, underwriting standards, and the concentration of credit.

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The total allowance for loan losses consists of the above two components: specific and general. To determine the adequacy of the allowance in each of these two components, the Bank employs two primary methodologies, the classification migration methodology and the individual loan review analysis methodology. These methodologies support the basis for determining allocations between the various loan categories and the overall adequacy of the Bank s allowance to provide for probable losses inherent in the loan portfolio. These methodologies are further supported by additional analysis of relevant factors such as the historical losses in the portfolio, trends in the non-performing/non-accrual loans, loan delinquencies, the volume of the portfolio, peer group comparisons, and federal regulatory policy for loan and lease losses. Other significant factors of portfolio analysis include changes in lending policies/underwriting standards, portfolio composition, and concentrations of credit, and trends in the national and local economy.

With these above methodologies, the specific allowance is for those loans internally classified and risk graded as Special Mention, Substandard, Doubtful, or Loss. Additionally, the Bank s management allocates a specific allowance for Impaired Credits, in accordance with SFAS No. 114, Accounting by Creditors for Impairment of a Loan. The level of the general allowance is established to provide coverage for management s estimate of the credit risk in the loan portfolio by various loan segments not covered by the specific allowance.

The table set forth below reflects management s allocation of the allowance for loan losses by loan category and the ratio of each loan category to the total loans as of the dates indicated:

Allocation of Allowance for Loan Losses

	As of December 31,									
	2006		2005		2004		2003		2002	
	Amount	Percentage of Loans in Each Category to to Average Gross Loans	Amount	Percentage of Loans in Each Category to to Average Gross Loans	Amount	Percentage of Loans in Each Category to to Average Gross Loans	Amount	Percentage of Loans in Each Category to to Average Gross Loans	Amount	Percentage of Loans in Each Category to to Average Gross Loans
	(Dollars in thousands)									
Type of Loans:										
Commercial loans	$ 35,569	20.9%	$ 33,401	24.5%	$ 33,712	26.8%	$ 34,277	29.2%	$ 11,812	29.7%
Residential mortgage loans and equity lines	1,510	9.1	1,055	9.0	1,346	8.4	1,090	10.7	1,466	13.3
Commercial mortgage loans	22,160	57.6	20,516	55.0	20,949	55.1	17,458	52.0	8,458	47.3
Real Estate construction loans	5,431	11.8	5,265	10.9	6,838	9.4	12,899	7.6	2,610	8.8
Installment loans	10	0.3	10	0.3	17	0.2	61	0.5	181	0.9
Other loans	9	0.3	4	0.3	18	0.1	23	0.0	16	0.0
Total	$ 64,689	100.0%	$ 60,251	100.0%	$ 62,880	100.0%	$ 65,808	100.0%	$ 24,543	100.0%

The increase in the allowance allocated to commercial loans resulted from the increase in the level of non-accrual and problem loans during 2006. Commercial loans by collateral type comprised 64.6% of impaired loans and 64.6% of non-accrual loans and 17.9% of loans over 90 days still on accrual status at December 31, 2006. Commercial loans also comprised 62.9% of impaired loans, 62.9% of non-accrual loans, and 100% of loans over 90 days still on accrual status at December 31, 2005.

Allowance allocated to residential mortgage loans and equity lines also increased from $1.1 million at December 31, 2005, to $1.5 million at December 31, 2006, due to the increase in loan volume in this category.

The increase in the allowance allocated to commercial real estate mortgages from $20.5 million at December 31, 2005, to $22.2 million at December 31, 2006, was due to the strong growth in commercial real estate mortgages during 2006. Loan losses have been nominal during the past five years in this category. The overall allowance decreased to

0.7% of total commercial real estate mortgages at December 31, 2006, compared to 0.8% of total commercial real estate mortgages at December 31, 2005 due to improved credit quality.

The allocated allowance for construction loans was $5.3 million, or 1.0%, of construction loans at December 31, 2005, compared to $5.4 million, or 0.9%, of construction loans at December 31, 2006 primarily as the result of the growth in the construction loan portfolio. At December 31, 2006, two construction loans totaling $5.8 million were on non-accrual status and three construction loans totaling $6.3 million were past due 90 days and still accruing interest. At December 31, 2005, there were no construction loans on non-accrual status and no construction loan was past due 90 days and still accruing interest.

Allowances for other risks of probable loan losses amounting to $2.5 million as of December 31, 2006, compared to $4.3 million as of December 31, 2005, have been included in the allocations above. At December 31, 2006, the Bank has set aside funds to cover the risk factors of higher energy prices on the ability of its borrowers to service their loans. During 2006, management determined the other component of other portfolio risk identified at December 31, 2005, the lifting of textile quotes on Chinese manufacturers and the impact of the increased competition on the Bank s borrowers in the textile industry, was no longer required since this portfolio risk has now been captured in the Bank s loan grading system. Also, see Part I Item 1A Risk Factors above in this Annual Report Form 10-K for additional factors that could cause actual results to differ materially from forward-looking statements or historical performance.

Liquidity

Liquidity is our ability to maintain sufficient cash flow to meet maturing financial obligations and customer credit needs, and to take advantage of investment opportunities as they are presented in the marketplace. Our principal sources of liquidity are growth in deposits, proceeds from the maturity or sale of securities and other financial instruments, repayments from securities and loans, federal funds purchased, securities sold under agreements to repurchase, and advances from the FHLB. At year-end 2006, our liquidity ratio (defined as net cash, short-term and marketable securities to net deposits and short-term liabilities) increased to 15.4%, compared to 13.5% at year-end 2005.

To supplement its liquidity needs, the Bank maintains a total credit line of $241.0 million for federal funds with three correspondent banks as well as master agreements with brokerage firms for the sale of securities subject to repurchase. The Bank is also a shareholder of the FHLB, which enables the Bank to have access to lower-cost FHLB financing when necessary. At December 31, 2006, the Bank had an approved credit line with the FHLB of San Francisco totaling $1.0 billion. The total advances outstanding with the FHLB of San Francisco at December 31, 2006, were $710.2 million. Advances from FHLB are non-callable and bear fixed rates of interest. These borrowings are secured by loans and securities. See Note 10 to the Consolidated Financial Statements.

Liquidity can also be provided through the sale of liquid assets, which consist of federal funds sold, securities purchased under agreements to resell, and securities available-for-sale. At December 31, 2006, such assets at fair value totaled $1.52 billion, with $884.8 million pledged as collateral for borrowings and other commitments. The remaining $637.4 million was available as additional liquidity or to be pledged as collateral for additional borrowings.

Approximately 95.6% of our time deposits mature within one year or less as of December 31, 2006. Management anticipates that there may be some outflow of these deposits upon maturity due to the keen competition in the Bank s marketplace. However, based on our historical runoff experience, we expect the outflow will not be significant and can be replenished through our normal growth in deposits. Management believes all the above-mentioned sources will provide adequate liquidity for the next twelve months to the Bank to meet its operating needs.

The Bancorp obtains funding for its activities primarily through dividend income contributed by the Bank, proceeds from the issuance of the Bancorp common stock through our Dividend Reinvestment Plan and exercise of stock options. Dividends paid to the Bancorp by the Bank are subject to regulatory limitations. The business activities of the Bancorp consist primarily of the operation of the Bank with limited activities in other investments. Management believes the Bancorp s liquidity generated from its prevailing sources is sufficient to meet its operational needs.

Also, see Note 14 to the Consolidated Financial Statements.

Recent Accounting Pronouncements

See Note 1 Summary of Significant Accounting Policies in the accompanying notes to consolidated financial statements included elsewhere in this report for details of recent accounting pronouncements and their expected impact on the Company s consolidated financial statements.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk.

Market Risk

Market risk is the risk of loss from adverse changes in market prices and rates. The principal market risk to the Company is the interest rate risk inherent in our lending, investing, and deposit taking activities, due to the fact that interest-earning assets and interest-bearing liabilities do not re-price at the same rate, to the same extent, or on the same basis.

We monitor and manage our interest rate risk through analyzing the re-pricing characteristics of our loans, securities, and deposits on an on-going basis. The primary objective is to minimize the adverse effects of changes in interest rates on our earnings, and ultimately the underlying market value of equity, while structuring our asset-liability composition to obtain the maximum spread. Management uses certain basic measurement tools in conjunction with established risk limits to regulate its interest rate exposure. Due to the limitation inherent in any individual risk management tool, we use a simulation model to measure and quantify the impact to our profitability as well as to estimate changes to the market value of our assets and liabilities.

We use a net interest income simulation model to measure the extent of the differences in the behavior of the lending and funding rates to changing interest rates, so as to project future earnings or market values under alternative interest rate scenarios. Interest rate risk arises primarily through the Company s traditional business activities of extending loans and accepting deposits. Many factors, including economic and financial conditions, movements in interest rates, and consumer preferences affect the spread between interest earned on assets and interest paid on liabilities. The net interest income simulation model is designed to measure the volatility of net interest income and net portfolio value, defined as net present value of assets and liabilities, under immediate rising or falling interest rate scenarios in 25 basis points increments.

Although the modeling is very helpful in managing interest rate risk, it does require significant assumptions for the projection of loan prepayment rates on mortgage related assets, loan volumes and pricing, and deposit and borrowing volume and pricing, that might prove inaccurate. Because these assumptions are inherently uncertain, the model cannot precisely estimate net interest income, or precisely predict the effect of higher or lower interest rates on net interest income. Actual results will differ from simulated results due to the timing, magnitude, and frequency of interest rates changes, the differences between actual experience and the assumed volume, changes in market conditions, and management strategies, among other factors. The Company monitors its interest rate sensitivity and attempts to reduce the risk of a significant decrease in net interest income caused by a change in interest rates.

We establish a tolerance level in our policy to define and limit interest income volatility to a change of plus or minus 15% when the hypothetical rate change is plus or minus 200 basis points. When the net interest rate simulation projects that our tolerance level will be met or exceeded, we seek corrective action after considering,

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among other things, market conditions, customer reaction, and the estimated impact on profitability. At December 31, 2006, if interest rates were to increase instantaneously by 100 basis points, the simulation indicated that our net interest income over the next twelve months would decrease by 0.5%, and if interest rates were to increase instantaneously by 200 basis points, the simulation indicated that our net interest income over the next twelve months would decrease by 1.9%. Conversely, if interest rates were to decrease instantaneously by 100 basis points, the simulation indicated that our net interest income over the next twelve months would decrease by 1.3%, and if interest rates were to decrease instantaneously by 200 basis points, the simulation indicated that our net interest income over the next twelve months would decrease by 3.4%.

Our simulation model also projects the net economic value of our portfolio of assets and liabilities. We have established a tolerance level to value the net economic value of our portfolio of assets and liabilities in our policy to a change of plus or minus 15% when the hypothetical rate change is plus or minus 200 basis points. At December 31, 2006, if interest rates were to increase instantaneously by 200 basis points, the simulation indicated that the net economic value of our portfolio of assets and liabilities would decrease by 13.9%, and conversely, if interest rates were to decrease instantaneously by 200 basis points, the simulation indicated that the net economic value of our assets and liabilities would increase by 15.7%, which is just slightly in excess of our policy limit of 15%.

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Quantitative Information About Interest Rate Risk

The following table shows the carrying value of our financial instruments that are sensitive to changes in interest rates, categorized by expected maturity, as well as the instruments total fair values at December 31, 2006, and 2005. For assets, expected maturities are based on contractual maturity. For liabilities, we use our historical experience and decay factors to estimate the deposit runoffs of interest-bearing transactional deposits. We use certain assumptions to estimate fair values and expected maturities which are described in Note 16 to the Consolidated Financial Statements. Off-balance sheet commitments to extend credit, letters of credit, and bill of lading guarantees represent the contractual unfunded amounts. Off-balance sheet financial instruments represent fair values. The results presented may vary if different assumptions are used or if actual experience differs from the assumptions used.

	Average Interest rate	Expected Maturity Date at December 31,						December 31, 2006		December 31, 2005	
		2007	2008	2009	2010	2011	Thereafter	Total	Fair Value	Total	Fair Value
	(Dollars in thousands)										
Interest-Sensitive Assets:											
Mortgage-backed securities and collateralized mortgage obligations	4.64%	$ 100,117	$ 92,333	$ 69,526	$ 59,827	$ 52,348	$ 426,208	$ 800,359	$ 800,359	$ 922,740	$ 922,740
Other available for sale securities	6.31	56,564	47,947	145,438	20,522	103,694	347,699	721,864	721,864	294,698	294,698
Gross loans receivable:											
Commercial	8.10	945,443	105,470	79,246	25,181	36,290	52,126	1,243,756	1,244,366	1,110,401	1,110,322
Residential Mortgage	6.11	2,956	1,906	4,155	5,718	9,120	550,567	574,422	562,351	431,289	427,507
Commercial Mortgage	7.55	432,871	275,636	276,314	365,505	375,824	1,500,508	3,226,658	3,203,155		