CATHAY GENERAL BANCORP
Form 10-K
March 16, 2010
Table of Contents

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, 2009

¨ **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	**95-4274680**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification No.)**
777 North Broadway,	
Los Angeles, California	**90012**
(Address of principal executive offices)	**(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	The NASDAQ Stock Market LLC
Preferred Stock Purchase Rights	

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 ¨ No þ

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

Indicate by check mark 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, a non-accelerated filer or a smaller reporting company. See definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ¨ Accelerated filer þ Non-accelerated filer ¨ Smaller reporting company ¨

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ¨ No 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, 2009) was $416,843,300. 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 March 1, 2010, there were 78,506,305 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of Registrant s definitive proxy statement relating to Registrant s 2010 Annual Meeting of Stockholders which will be filed within 120 days of the fiscal year ended December 31, 2009, are incorporated by reference into Part III.

CATHAY GENERAL BANCORP

2009 ANNUAL REPORT ON FORM 10-K

TABLE OF CONTENTS

Table of Contents

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. We intend such forward-looking statements to be covered by the safe harbor provision for forward-looking statements in these provisions. All statements other than statements of historical fact are forward-looking statements for purposes of federal and state securities laws, including statements about anticipated future operating and financial performance, financial position and liquidity, growth opportunities and growth rates, growth plans, acquisition and divestiture opportunities, business prospects, strategic alternatives, business strategies, financial expectations, regulatory and competitive outlook, investment and expenditure plans, financing needs and availability and other similar forecasts and statements of expectation and statements of assumptions underlying any of the foregoing. Words such as aims, anticipates, believes, could, estimates, expects, hopes, intends, may, plans, projects, seeks, shall, should, will, predicts, potential, continue, and variations of these words and similar expressions are intended to identify these forward-looking statements. Forward-looking statements by us are based on estimates, beliefs, projections, and assumptions of management and are not guarantees of future performance. These forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from our historical experience and our present expectations or projections. Such risks and uncertainties and other factors include, but are not limited to, adverse developments or conditions related to or arising from:

- *U.S. and international economic and market conditions;*
- *market disruption and volatility;*
- *current and potential future supervisory action by bank supervisory authorities and changes in laws and regulations, or their interpretations;*
- *restrictions on dividends and other distributions by laws and regulations and by our regulators and our capital structure;*
- *credit losses and deterioration in asset or credit quality;*
- *availability of capital;*
- *potential goodwill impairment;*
- *liquidity risk;*
- *fluctuations in interest rates;*
- *past and future acquisitions;*

inflation and deflation;

success of expansion, if any, of our business in new markets;

the soundness of other financial institutions;

real estate market conditions;

our ability to compete with competitors;

the short term and long term impact of the new Basel II capital standards and the forthcoming new capital rules to be proposed for non-Basel II U.S. banks;

our ability to retain key personnel;

successful management of reputational risk;

Table of Contents

- *natural disasters and geopolitical events;*
- *general economic or business conditions in California, Asia and other regions where the Bank has operations;*
- *restrictions on compensation paid to our executives as a result of our participation in the TARP Capital Purchase Program;*
- *our ability to adapt to our information technology systems; and*
- *changes in accounting standards or tax laws and regulations.*

These and other factors are further described in this Annual Report on Form 10-K (at Item 1A in particular), the Company s other reports filed with the SEC and other filings the Company makes with the SEC from time to time. Actual results in any future period may also vary from the past results discussed in this report. Given these risks and uncertainties, readers are cautioned not to place undue reliance on any forward-looking statements, which speak to the date of this report. We have no intention and undertake no obligation to update any forward-looking statement or to publicly announce any revision of any forward-looking statement to reflect future developments or events, except as required by law.

Table of Contents

PART I

Item 1. Business.

Business of Bancorp

Overview

Cathay General Bancorp is a corporation that was organized in 1990 under the laws of the State of Delaware. We are the holding company of Cathay Bank, a California state-chartered commercial bank (Cathay Bank or the Bank), six limited partnerships investing in affordable housing investments in which the Bank is the sole limited partner, and GBC Venture Capital, Inc. We also own 100% of the common stock of five statutory business trusts created for the purpose of issuing capital securities. 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 principal place of business is currently located at 777 North Broadway, Los Angeles, California 90012, and our telephone number at that location is (213) 625-4700. In addition, certain of our administrative offices are located in El Monte, California and our address there is 9650 Flair Drive, El Monte, California 91731. Our common stock is traded on the NASDAQ Global Select Market and our trading symbol is CATY .

We are regulated as a bank holding company by the Board of Governors of the Federal Reserve System, or Federal Reserve Board. Cathay Bank is regulated as a California commercial bank by the California Department of Financial Institutions, or DFI, and the Federal Deposit Insurance Corporation, or FDIC.

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, Cathay Capital Trust II, Cathay Capital Trust III and Cathay Capital Trust IV. The Bancorp established Cathay Capital Trust I in June 2003, Cathay Statutory Trust I in September 2003, Cathay Capital Trust II in December 2003, Cathay Capital Trust III in March 2007, and Cathay Capital Trust IV in May 2007 (collectively, the Trusts) as wholly owned subsidiaries. The Trusts are statutory business trusts. 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 securities 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. 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.

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.

Table of Contents

Employees

Due to the limited nature of the Bancorp s activities as a bank holding company, 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.

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 by the FDIC, but it is not a member of the Federal Reserve System.

The Bank s head office is located in the Chinatown area of Los Angeles, at 777 North Broadway, Los Angeles, California 90012. In addition, as of December 31, 2009, the Bank had branch offices in Southern California (20 branches), Northern California (11 branches), New York (eight branches), Massachusetts (one branch), Texas (two branches), Washington (three branches), Illinois (three branch locations and one drive-through location), New Jersey (one branch), Hong Kong (one branch) and a representative office in Shanghai and in Taipei. Deposit accounts at the Hong Kong branch are not insured by the FDIC. Each branch has loan approval rights subject to the branch manager s authorized lending limits. Current activities of the 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, the 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 other security 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 commercial mortgage loans, commercial loans, Small Business Administration (SBA) loans, residential mortgage loans, real estate construction loans, equity lines of credit; and installment loans to individuals for automobile, household, and other consumer expenditures.

Through Cathay Wealth Management, the 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. These products are not insured by the FDIC.

Table of Contents

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 on an annual basis.

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.

Information concerning the carrying value, maturity distribution, and yield analysis of the Company s securities portfolio 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 5 to the Consolidated Financial Statements.

Loans

The Bank s Board of Directors and senior management establish, review, and modify the Bank s lending policies. These policies include (as applicable) an evaluation of a potential borrower s financial condition, ability to repay the loan, character, existence of secondary repayment source (such as guaranties), quality and availability of collateral, capital, leverage capacity of the borrower, regulatory guidelines, market conditions for the borrower s business or project, and prevailing economic trends and conditions. 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. Commercial mortgage loans are typically secured by first deeds of trust on commercial properties. Our commercial mortgage portfolio includes primarily commercial retail properties, shopping centers, and owner-occupied industrial facilities, and, secondarily, office buildings, multiple-unit apartments, hotels, 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. The Bank continues to focus primarily on commercial lending to small-to-medium size businesses within the Bank s geographic market areas. The Bank participates or syndicates loans, typically more than $20 million in principal amount, with other financial institutions to limit its credit exposure. 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 under the national 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.

Table of Contents

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 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. The single-family-residential mortgage loans are comprised of conforming, nonconforming, and jumbo residential mortgage loans, and are secured by first or subordinate liens on single (one-to-four) family residential properties. The Bank s products include a fixed-rate residential mortgage loan and an adjustable-rate residential mortgage loan. Mortgage loans are underwritten in accordance with the Bank s and regulatory guidelines, on the basis of the borrower s financial capabilities, independent appraisal of value of the property, historical loan quality, and other relevant factors. As of December 31, 2009, approximately 80% of the Bank s residential mortgages were for properties located in California.

Real Estate Construction Loans. 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.

Home Equity Lines of Credit. The Bank offers variable-rate home equity lines of credit that are secured by the borrower s home. 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 Bank s reference rate. Borrowers may use this line of credit for home improvement financing, debt consolidation and other personal uses.

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 types, distribution, 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 6 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 the contractual 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 generally 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, previously accrued but unpaid interest is reversed

Table of Contents

and charged against current income, and subsequent payments received are generally first applied towards the outstanding principal balance of the loan. Depending on the circumstances, management may elect to continue the accrual of interest on certain past due loans if partial payment is received 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. 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, generally six months. 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 6 to the Consolidated Financial Statements.

Non-Performing Loans and Allowance for Credit Losses. Information concerning non-performing loans, allowance for credit 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 6 and Note 7 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, 2009, 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.

The Bank s deposits are generally obtained from residents within its 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. From time to time, the Bank may offer special deposit promotions. 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, and in Note 10 to the Consolidated Financial Statements.

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, borrowing from other financial institutions, subordinated debt, and Junior Subordinated Notes. Information concerning the types, amounts, and maturity of borrowings is included in Note 11 and Note 12 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.

Table of Contents

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 15 to the Consolidated Financial Statements.

Expansion

We have engaged in expansion through acquisitions and may consider acquisitions in the future in order to compete for new deposits and loans, and to be able to serve our customers more effectively. We currently are subject to restrictions on any new branches and business lines without prior approval from the DFI and FDIC due to the memorandum we entered into with the DFI and FDIC on March 1, 2010.

Subsidiaries of Cathay Bank

Cathay Real Estate Investment Trust (CB REIT) is a real estate investment trust subsidiary of the Bank that was formed in January 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, 2009, total assets of CB REIT were consolidated with the Company and totaled approximately $1.52 billion.

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.

GB Capital Trust II (GB REIT) was incorporated in November 2001 to provide General Bank with flexibility in raising capital. As a result of our merger with GBC Bancorp in 2003, the Bank owns 100% of the voting common trust units issued by the GB REIT. At December 31, 2009, total assets of GB REIT were consolidated with the Company and were approximately $931 million.

Cathay Community Development Corporation (CCDC) is a wholly-owned subsidiary of the Bank and was incorporated in September 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. In October 2006, CCDC formed a wholly-owned subsidiary, Cathay New Asia Community Development Corporation (CNACDC), for the purpose of assuming 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. CNACDC has been certified as a community development entity and is seeking to participate in the U.S. Treasury Department s New Markets Tax Credit program.

Cathay Holdings LLC (CHLLC) was incorporated in December 2007, Cathay Holdings 2 LLC (CHLLC2) was incorporated in January 2008, and Cathay Holdings 3 LLC (CHLLC3) was incorporated in December 2008. They are wholly-owned subsidiaries of the Bank. The purpose of these subsidiaries is to hold other real estate owned in the state of Texas that was transferred from the Bank. As of December 31, 2009, CHLLC owned two properties with a carrying value of $7.1 million. CHLLC2 and CHLLC3 do not own property at December 31, 2009.

Table of Contents

Competition

We face substantial competition for deposits, loans and for other banking services, as well as acquisitions, 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. These banks and financial institutions have greater resources than we do, including the ability to finance advertising campaigns and allocate their investment assets to regions of higher yield and demand and make acquisitions. By virtue of their larger capital bases, they have substantially greater lending limits than we do 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, brokerage houses, insurance companies, mortgage companies, credit unions, credit card companies and other financial and non-financial institutions and entities. The recent consolidation of certain competing financial institutions and the conversion of certain investment banks to bank holding companies have increased the level of competition among financial services companies and may adversely affect our ability to market our products and services.

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 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 the loan on a participation or syndication basis with correspondent banks. The Bank also assists customers requiring other services not offered by the Bank to obtain these services from its correspondent banks.

In California, one larger Chinese-American bank competes 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 .

Employees

As of December 31, 2009, the Bank and its subsidiaries employed approximately 986 persons, including 361 banking officers. None of the employees are represented by a union. We believe that our employer-employee relations are good.

Available Information

We file annual, quarterly, and current reports, proxy statements and other information with the United States Securities and Exchange Commission (the SEC). Our SEC filings are available to the public over the Internet at the SEC s website at www.sec.gov and on the investor relations page of our website at www.cathaygeneralbancorp.com. The content of our website is not incorporated into and is not a part of this Annual Report on Form 10-K. You may also read and copy any document we file with the SEC at its public reference facilities at 100 F Street N.E., Washington, D.C. 20549. You can also obtain copies of the documents upon the payment of a duplicating fee to the SEC. Please call the SEC at 1-800-SEC-0330 for further information on the operation of the public reference facilities. You may also request a copy of the documents, at no cost, by writing or telephoning us at: Cathay General Bancorp, 9650 Flair Drive, El Monte, California 91731, (626) 279-3286.

Regulation and Supervision

General

The Bancorp and the Bank are subject to significant regulation and restrictions by federal and state laws and regulatory agencies. This regulation is intended primarily for the protection of depositors and the deposit insurance fund, and secondarily for the stability of the U.S. banking system. It is not intended for the benefit of stockholders of financial institutions. 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. From time to time, federal and state legislation is enacted which may have the effect of materially increasing the cost of doing business, limiting or expanding permissible activities, or affecting the competitive balance between banks and other financial services providers.

Recent Developments

In response to the recent economic downturn and financial industry instability, legislative and regulatory initiatives have been, and will likely continue to be, introduced and implemented, which could substantially intensify the regulation of the financial services industry (including a possible comprehensive overhaul of the financial institutions regulatory system, the creation of a new consumer financial protection agency, and enhanced supervisory attention and potential new restrictions on executive compensation arrangements). We cannot predict whether or when potential legislation or new regulations will be enacted, and if enacted, the effect that new legislation or any implemented regulations and supervisory policies would have on our financial condition and results of operations. Moreover, especially in the current economic environment, bank regulatory agencies have been very aggressive in responding to concerns and trends identified in examinations, and this has resulted in the increased issuance of enforcement actions to financial institutions requiring action to address credit quality, liquidity and risk management and capital adequacy, as well as other safety and soundness concerns.

Through its authority under the Emergency Economic Stabilization Act of 2008 (the EESA), as amended by the American Recovery and Reinvestment Act of 2009 (the ARRA), the U.S. Treasury (Treasury) implemented the TARP Capital Purchase Program (the TARP CPP), a program designed to bolster eligible healthy institutions by injecting capital into these institutions. We participated in the CPP so that we could continue to lend and support our current and prospective clients, especially during this unstable economic environment. Under the terms of our participation, we received $258 million in exchange for the issuance of preferred stock and a warrant to purchase common stock and thereby became subject to various requirements, including certain restrictions on paying dividends on our common stock and repurchasing our equity securities, unless the Treasury has consented. Additionally, in order to participate in the CPP, we were required to adopt certain standards for executive compensation and corporate governance. The Company does not plan to repay the $258 million TARP fund in the foreseeable future.

On December 17, 2009, we entered into a memorandum of understanding with Federal Reserve Bank of San Francisco (the FRB SF) under which we agreed that we will not, without the FRB SF s prior written approval, (i) receive any dividends or any other form of payment or distribution representing a reduction of capital from the Bank, or (ii) declare or pay any dividends, make any payments on trust preferred securities, or make any other capital distributions. Under the memorandum, we agreed to submit to the FRB SF for review and approval a plan to maintain sufficient capital at the Bancorp on a consolidated basis and at the Bank, a dividend policy for the Bancorp, a plan to improve management of our liquidity position and funds management practices, and a liquidity policy and contingency funding plan for the Bancorp. As part of our compliance with the memorandum, on January 22, 2010, we submitted to the FRB SF a Three-Year Capital and Strategic Plan that updates a previously submitted plan and establishes, among other things, targets for our Tier 1 risk-based capital ratio, total risk-based capital ratio, Tier 1 leverage capital ratio and tangible common risk-based ratio, each of which, where applicable, are above the minimum requirements for a well-capitalized institution. In addition, we agreed to notify the FRB SF prior to effecting certain changes to our senior executive officers and board of directors and we are limited and/or prohibited, in certain circumstances, in our ability to enter into contracts to pay and to make golden parachute severance and indemnification payments. We also agreed in the memorandum that we will not, without the prior written approval of the FRB SF, directly or indirectly, (i) incur, renew, increase or guaranty any debt, (ii) issue any additional trust preferred securities, or (iii) purchase, redeem, or otherwise acquire any stock.

On March 1, 2010, the Bank entered into a memorandum of understanding with the DFI and the FDIC pursuant to which the Bank is required to develop and implement, within specified time periods, plans satisfactory to the DFI and the FDIC to reduce commercial real estate concentrations, to enhance and to improve the quality of the stress testing of the Bank s loan portfolio, and to revise the Bank s loan policy in connection therewith; to develop and adopt a strategic plan addressing improved profitability and capital ratios and to reduce the Bank s overall risk profile; to develop and adopt a capital plan; to develop and implement a plan to improve asset quality, including the methodology for calculating the loss reserve allocation and evaluating its adequacy; and to develop and implement a plan to reduce dependence on wholesale funding. In addition, the Bank is required to report progress to the DFI and FDIC on a quarterly basis. The Bank is also subject to a restriction on dividends from the Bank to the Bancorp and is required to maintain adequate allowance for loan and lease losses and is subject to restrictions on any new branches and business lines without prior approval. The Bank is required to notify the FDIC and the DFI prior to effecting certain changes to our senior executive officers and board of directors and is limited and/or prohibited, in certain circumstances, in its ability to enter into contracts to pay and to make golden parachute severance and indemnification payments; and is required to retain management and directors acceptable to the DFI and the FDIC. The Board has resolved to establish a Compliance Committee to, among other things, review the Company s management and governance and consider making recommendations for improvement. No assurance can be given that our current management and directors are acceptable to the DFI or the FDIC or that we will be able to retain or engage management or directors who are acceptable to the DFI and the FDIC. Additionally, there can be no assurance that we will not be subject to further supervisory action or regulatory proceedings.

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 (Federal Reserve). It is also subject to supervision and examination by the Federal Reserve and its authority to:

- Require periodic reports and such additional information as the Federal Reserve may require;
- Require bank holding companies to maintain increased levels of capital (See Capital Adequacy Requirements below);
- Require that bank holding companies serve as a source of financial and managerial strength to subsidiary banks and commit resources as necessary to support each subsidiary bank;
- Restrict the ability of bank holding companies to obtain dividends on other distributions from their subsidiary banks;
- Terminate an activity or terminate control of or liquidate or divest certain subsidiaries, affiliates or investments if the Federal Reserve believes the activity or the control of the subsidiary or affiliate constitutes a significant risk to the financial safety, soundness or stability of any bank subsidiary;

Require the prior approval of senior executive officer or director changes;

Table of Contents

Regulate provisions of certain bank holding company debt, including the authority to impose interest ceilings and reserve requirements on such debt and require prior approval to purchase or redeem securities in certain situations;

Approve acquisitions and mergers with banks and consider certain competitive, management, financial or other factors in granting these approvals in addition to similar California or other state banking agency approvals which may also be required.

The Federal Reserve s view is 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. See Prompt Corrective Action Provisions below.

A bank holding company is generally required to give the Federal Reserve 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.

Restrictions on Activities

Subject to prior notice or Federal Reserve approval, bank holding companies may generally engage in, or acquire shares of companies engaged in, activities determined by the Federal Reserve to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. Bank holding companies which elect and retain financial holding company status pursuant to the Gramm-Leach-Bliley Act of 1999 (GLBA) may engage in these nonbanking activities and broader securities, insurance, merchant banking and other activities that are determined to be financial in nature or are incidental or complementary to activities that are financial in nature without prior Federal Reserve approval. In order to elect and retain financial holding company status, all depository institution subsidiaries of a bank holding company must be well capitalized, well managed, and, except in limited circumstances, be in satisfactory compliance with the Community Reinvestment Act (CRA), which requires banks to help meet the credit needs of the communities in which they operate. Failure to sustain compliance with these requirements or correct any non-compliance within a fixed time period could lead to divestiture of subsidiary banks or require all activities to conform to those permissible for a bank holding company. The Bancorp has not elected financial holding company status and has not engaged in any activities determined by the Federal Reserve to be financial in nature or incidental or complementary to activities that are financial in nature.

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, DFI.

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.

12

Sarbanes-Oxley Act

The Bancorp is subject to the accounting oversight and corporate governance requirements of the Sarbanes-Oxley Act of 2002, including, among other things, required executive certification of financial presentations, increased requirements for board audit committees and their members, and enhanced disclosure of controls and procedures and internal control over financial reporting.

Bank Regulation

As a California commercial bank whose deposits are insured by the FDIC, the Bank is subject to regulation, supervision, and regular examination by the DFI and the FDIC, and must comply with applicable regulations of the Federal Reserve. Specific federal and state laws and regulations which are applicable to banks regulate, among other things, the scope of their business, their investments, their reserves against deposits, the timing of the availability of deposited funds, their activities relating to dividends, investments, loans, the nature and amount of and collateral for certain loans, borrowings, capital requirements, certain check-clearing activities, branching, and mergers and acquisitions. California banks are also subject to statutes and regulations including Federal Reserve Regulation O and Federal Reserve Act Sections 23A and 23B and Regulation W, which restrict or limit loans or extensions of credit to insiders , including officers directors and principal shareholders, and loans or extension of credit by banks to affiliates or purchases of assets from affiliates, including parent bank holding companies, except pursuant to certain exceptions and terms and conditions at least as favorable to those prevailing for comparable transactions with unaffiliated parties.

The Bank, as a California state-chartered bank, is subject to primary supervision and examination by the DFI, as well as the FDIC. Under the Federal Deposit Insurance Act (FDI Act) and the California Financial Code, California state chartered commercial banks may generally engage in any activity permissible for national banks. Therefore, the Bank may form subsidiaries to engage in the many so-called closely related to banking or nonbanking activities commonly conducted by national banks in operating subsidiaries or subsidiaries of bank holding companies. Further, pursuant to amendments enacted by GLBA, California banks may conduct certain financial activities in a subsidiary to the same extent as may a national bank, provided the bank is and remains well-capitalized, well-managed and in satisfactory compliance with the CRA. The Bank currently has no financial subsidiaries.

Supervision and Enforcement Authority

The federal and California regulatory structure gives the bank regulatory agencies extensive discretion in connection with their supervisory and enforcement activities and examination policies, including policies with respect to the classification of assets and the establishment of adequate loan loss reserves for regulatory purposes. The regulatory agencies have adopted guidelines to assist in identifying and addressing potential safety and soundness concerns before an institution s capital becomes impaired. The guidelines establish operational and managerial standards generally relating to: (1) internal controls, information systems, and internal audit systems; (2) loan documentation; (3) credit underwriting; (4) interest-rate exposure; (5) asset growth and asset quality; and (6) compensation, fees, and benefits. Further, the regulatory agencies have adopted safety and soundness guidelines for asset quality and for evaluating and monitoring earnings to ensure that earnings are sufficient for the maintenance of adequate capital and reserves. If, as a result of an examination, the DFI or the FDIC should determine that the financial condition, capital resources, asset quality, earnings prospects, management, liquidity, or other aspects of the Bank s operations are unsatisfactory or that the Bank or its management is violating or has violated any law or regulation, the DFI and the FDIC, and separately the FDIC as insurer of the Bank s deposits, have residual authority to:

Require affirmative action to correct any conditions resulting from any violation or practice;

Direct an increase in capital and the maintenance of higher specific minimum capital ratios, which may preclude the Bank from being deemed well capitalized and restrict its ability to accept certain brokered deposits;

Restrict the Bank s growth geographically, by products and services, or by mergers and acquisitions;

Enter into or issue informal or formal enforcement actions, including memoranda of understanding, written agreements and consent or cease and desist orders or prompt corrective action orders to take corrective action and cease unsafe and unsound practices;

Require prior approval of senior executive officer or director changes; remove officers and directors and assess civil monetary penalties; and

Take possession of and close and liquidate the Bank or appoint the FDIC as receiver.

The Bank operates branches and/or loan production offices in California, New York, Illinois, Massachusetts, Texas, Washington and New Jersey. While the DFI 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 jurisdictions are subject to local laws, including consumer protection laws. The Bank also operates a branch in Hong Kong and a representative office in Taipei and in Shanghai. The operations of these offices (and limits on the scope of their activities) and the Hong Kong branch are subject to local law in those jurisdictions in addition to regulation and supervision by the DFI and the Federal Reserve.

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. The FDIC insures our customer deposits through the Deposit Insurance Fund (the DIF) up to prescribed limits for each depositor. Pursuant to the EESA, the maximum deposit insurance amount has been increased from $100,000 to $250,000 through the end of 2013. The amount of FDIC assessments paid by each DIF member institution is based on its relative risk of default as measured by regulatory capital ratios and other supervisory factors. During 2008 and 2009, there have been higher levels of bank failures which has dramatically increased resolution costs of the FDIC and depleted the deposit insurance fund. In order to maintain a strong funding position and restore reserve ratios of the deposit insurance fund, the FDIC has increased assessment rates of insured institutions and may continue to do so in the future. As of December 31, 2009, the Bank s assessment rate was between 5 and 7 cents per $100 in assessable deposits. On November 12, 2009, the FDIC adopted a requirement for institutions to prepay in 2009 their estimated quarterly risk-based assessments for the fourth quarter of 2009 and for all of 2010, 2011, and 2012.

We are generally unable to control the amount of premiums that we are required to pay for FDIC insurance. If there are additional bank or financial institution failures or if the FDIC otherwise determines, we may be required to pay even higher FDIC premiums than the recently increased levels. These announced increases and any future increases in FDIC insurance premiums may have a material and adverse affect on our earnings. Further, all FDIC-insured institutions are required to pay assessments to the FDIC to fund interest payments on bonds issued by the Financing Corporation (FICO), an agency of the Federal government established to recapitalize the predecessor to the DIF.

The FDIC implemented two temporary programs under the Temporary Liquidity Guaranty Program (TLGP) to provide deposit insurance for the full amount of most non-interest bearing transaction accounts through June 30, 2010 and to guarantee certain unsecured debt of financial institutions and their holding companies through June 2012 and the Deposit Guarantee Program. The Bank is participating in the deposit insurance program. On October 20, 2009, the FDIC established a limited, six-month emergency guarantee facility whereby, certain participating entities, including the Bank, can apply to the FDIC for permission to issue FDIC-guaranteed debt during the period starting October 31, 2009 through April 30, 2010. The FDIC charges systemic risk special assessments to depository institutions that participate in the TLGP. The Company and the Bank have elected to participate in the Debt Guarantee Program, but do not expect to issue any debt under the program.

Table of Contents

The FDIC may terminate a depository institution s deposit insurance upon a finding that the institution s financial condition is unsafe or unsound or that the institution has engaged in unsafe or unsound practices that pose a risk to the DIF or that may prejudice the interest of the bank s depositors. The termination of deposit insurance for a bank would also result in the revocation of the bank s charter by the DFI.

Capital Adequacy Requirements

The federal banking agencies have adopted risk-based capital guidelines for bank holding companies and banks that are expected 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, such as loans, and those recorded as off-balance sheet items, such as commitments, letters of credit and recourse arrangements. Under these capital guidelines, banking organizations are required to maintain certain minimum capital ratios, which are obtained by dividing its qualifying capital by its total risk-adjusted assets and off-balance sheet items. In general, the dollar amounts of assets and certain off-balance sheet items are risk-adjusted and assigned to various risk categories. Qualifying capital is classified depending on the type of capital:

Tier 1 capital consists of common equity, retained earnings, qualifying non-cumulative perpetual preferred stock, a limited amount of qualifying cumulative perpetual preferred stock and minority interests in the equity accounts of consolidated subsidiaries (including trust-preferred securities), less goodwill and certain other intangible assets. Qualifying Tier 1 capital may consist of trust-preferred securities, subject to certain criteria and quantitative limits for inclusion of restricted core capital elements in Tier 1 capital.

Tier 2 capital includes, among other things, hybrid capital instruments, perpetual debt, mandatory convertible debt securities, qualifying term subordinated debt, preferred stock that does not qualify as Tier 1 capital a limited amount of allowance for loan and lease losses.

Tier 3 capital consists of qualifying unsecured subordinated debt.

Under the capital guidelines, there are three fundamental capital ratios: a total risk-based capital ratio, a Tier 1 risk-based capital ratio and a Tier 1 leverage ratio. To be deemed well capitalized a bank must have a total risk-based capital ratio, a Tier 1 risk-based capital ratio and a Tier 1 leverage ratio of at least ten percent, six percent and five percent, respectively. There is currently no Tier 1 leverage requirement for a holding company to be deemed well-capitalized. At December 31, 2009, the respective capital ratios of the Bancorp and the Bank exceeded the minimum percentage requirements to be deemed well-capitalized . As of December 31, 2009, the Bank s total risk-based capital ratio was 15.03% and its Tier 1 risk-based capital ratio was 9.15%. As of December 31, 2009, the Bancorp s Total Risk-Based Capital ratio was 15.43% and its Tier 1 risk-based capital ratio was 13.55%. The federal banking agencies may change existing capital guidelines or adopt new capital guidelines in the future and have required many banks and bank holding companies subject to enforcement actions to maintain capital ratios in excess of the minimum ratios otherwise required to be deemed well capitalized, in which case institutions may no longer be deemed well capitalized and may therefore be subject to restrictions on taking brokered deposits.

The current risk-based capital guidelines which apply to the Company and the Bank are based upon the 1988 capital accord of the International Basel Committee on Banking Supervision, a committee of central banks and bank supervisors and regulators from the major industrialized countries that develops broad policy guidelines for use by each country s supervisors in determining the supervisory policies they apply. A new international accord, referred to as Basel II, became mandatory for large or core international banks outside the U.S. in 2008 (total assets of $250 billion or more or consolidated foreign exposures of $10 billion or more) and emphasizes internal assessment of credit, market and operational risk, as well as supervisory assessment and market discipline in determining minimum capital requirements. It is optional for other banks. The Basel Committee is currently reconsidering regulatory-capital standards, supervisory and risk-management requirements and additional disclosures to further strengthen the Basel II framework in response to recent worldwide economic

15

Table of Contents

developments. It is expected the Basel Committee may reinstitute a minimum leverage ratio requirement. The U.S. banking agencies have indicated separately that they will retain the minimum leverage requirement for all U.S. banks. It also is possible that a new tangible common equity ratio standard will be added.

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, 2009, the Bank s leverage capital ratio was 9.35%, and the Bancorp s leverage capital ratio was 9.64%, both ratios exceeding regulatory minimums.

Prompt Corrective Action Provisions

The federal banking agencies have issued regulations pursuant to the FDI Act defining five categories in which an insured depository institution will be placed, based on the level of its capital ratios: well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. A bank that may otherwise meet the minimum requirements to be classified as well-capitalized, adequately capitalized, or undercapitalized may be treated instead as though it were in the next lower capital category if the appropriate federal banking agency, after notice and opportunity for hearing, determines that unsafe or unsound condition, or an unsafe or unsound practices, warrants such treatment. Under the prompt corrective action regulations, 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 pay dividends; require divestiture of holding company affiliates that pose a significant risk to the bank; or require divestiture of the undercapitalized subsidiary bank. At each successive lower-capital category, an insured bank may be subject at the agencies discretion to more restrictions under the agencies prompt corrective action regulations, including restrictions on the bank s activities, and operational practices or the ability to pay dividends.

Dividends

Holders of the Bancorp s common stock and preferred stock are entitled to receive dividends as and when declared by the board of directors out of funds legally available therefor 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.

Our recently adopted capital management and dividend policy as part of our Three-Year Capital and Strategic Plan includes a policy to refrain from paying dividends in excess of $.01 per share per quarter, except when covered by operating earnings beginning in 2011. The amount of future dividends will depend on earnings,

16

financial condition, capital requirements and other factors, and will be determined by our board of directors in accordance with the capital management and dividend policy.

It is the Federal Reserve s policy that bank holding companies should generally pay dividends on common stock only out of income available over the past year, and only if prospective earnings retention is consistent with the organization s expected future needs and financial condition. It is also the Federal Reserve s policy that bank holding companies should not maintain dividend levels that undermine their ability to be a source of strength to its banking subsidiaries. Additionally, in consideration of the current financial and economic environment, the Federal Reserve has indicated that bank holding companies should carefully review their dividend policy and has discouraged payment ratios that are at maximum allowable levels unless both asset quality and capital are very strong.

The Bancorp is further currently restricted as to the payment of dividends by the memorandum of understanding with the FRB SF. As a result of losses incurred in the second, third and fourth quarters of 2009, we were expected to so inform and consult with the Federal Reserve supervisory staff prior to declaring or paying any dividends and we have agreed under the memorandum of understanding with the FRB SF that we will not, without the FRB SF s prior written approval, declare or pay any dividends, make any payments on trust preferred securities, or make any other capital distributions. As a result of losses incurred in the second, third and fourth quarters of 2009, we were expected to so inform and consult with the Federal Reserve supervisory staff prior to declaring or paying any dividends and we have agreed under the memorandum of understanding with the FRB SF that we will not, without the FRB SF s prior written approval, declare or pay any dividends, make any payments on trust preferred securities, or make any other capital distributions. On February 5, 2010, Bancorp received Federal Reserve approval to make payments on our Series B Preferred Stock and Junior Subordinated Securities. There can be no assurance that our regulators will approve such payments or dividends in the future.

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 which currently further restrict the ability of the Bank to declare and pay dividends, 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 the Bancorp 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 DFI 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.

Under the terms of the TARP CPP, for so long as any preferred stock issued under the TARP CPP remains outstanding, the Bancorp is prohibited from increasing dividends on its common stock, and from making certain repurchases of equity securities, including its common stock, without the Treasury s consent until the third anniversary of the Treasury s investment or until the Treasury has transferred all of the preferred stock it purchased under the TARP CPP to third parties. As long as the preferred stock issued to the Treasury is outstanding, dividend payments and repurchases or redemptions relating to certain equity securities, including the Bancorp s common stock, are also prohibited until all accrued and unpaid dividends are paid on such preferred stock, subject to certain limited exceptions. See the sections Capital Resources and Liquidity of the Management s Discussion and Analysis of Financial Condition and Results of Operations in Item 7 of this Annual Report on Form 10-K.

The terms of our Series B Preferred Stock and Junior Subordinated Securities also limit our ability to pay dividends on our common stock. If we are not current in our payment of dividends on our Series B Preferred Stock or in our payment of interest on our Junior Subordinated Securities, we may not pay dividends on our common stock. See Risk Factors Risks Relating to Our Common Stock The terms of our outstanding

17

preferred stock limit our ability to pay dividends on and repurchase our common stock and there can be no assurance of any future dividends on our common stock generally. and Risk Factors Risks Relating to Our Common Stock Our outstanding debt securities restrict our ability to pay dividends on our capital stock.

The Bank is subject to a restriction on dividends it may pay to the Bancorp under its memorandum of understanding with the DFI and the FDIC. Under the memorandum of understanding the Bancorp entered into with the FRB SF, we agreed that we will not, without the FRB SF s prior written approval, receive any dividends or any other form of payment or distribution representing a reduction of capital from the Bank. In our Three-Year Capital and Strategic Plan, we indicate the Bank will not pay a dividend to us in 2010.

Operations and Consumer Compliance Laws

The Bank must comply with numerous federal anti-money laundering and consumer protection statutes and implementing regulations, including the USA PATRIOT Act of 2001, the Bank Secrecy Act, the CRA, the Equal Credit Opportunity Act, the Truth in Lending Act, the National Flood Insurance Act and various federal and state privacy protection laws. Noncompliance with these laws could subject the Bank to lawsuits and could also result in administrative penalties, including, fines and reimbursements. The Bank and the Company are also subject to federal and state laws prohibiting unfair or fraudulent business practices, untrue or misleading advertising and unfair competition.

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.

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). There can be no assurance that the FHLB will pay dividends at the same rate it has paid in the past, or that it will pay any dividends in the future.

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.

Table of Contents

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.

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 also 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, 2009. These assessments are included in Item 9A, Controls and Procedures, below.

Regulation of Non-bank Subsidiaries

Non-bank subsidiaries are subject to additional or separate regulation and supervision by other state, federal and self-regulatory bodies. Additionally, any foreign-based subsidiaries would also be subject to foreign laws and regulations.

Item 1A. Risk Factors.

Difficult economic and market conditions have adversely affected our industry.

Dramatic declines in the housing market, with decreasing home prices and increasing delinquencies and foreclosures, have negatively impacted the credit performance of mortgage and construction loans and resulted in significant write-downs of assets by many financial institutions. General downward economic trends, reduced availability of commercial credit and increasing unemployment have negatively impacted the credit performance of commercial and consumer credit, resulting in additional write-downs. Concerns over the stability of the financial markets and the economy have resulted in decreased lending by financial institutions to their customers and to each other. This economic decline, market turmoil and tightening of credit has led to increased commercial and consumer deficiencies, lack of customer confidence, increased market volatility and widespread reduction in general business activity. Financial institutions have experienced decreased access to deposits and borrowings. The resulting economic pressure on consumers and businesses and the lack of confidence in the financial markets may adversely affect our business, financial condition, results of operations and stock price. A worsening of these conditions would likely exacerbate the adverse effects of these difficult market conditions on us and others in the financial institutions industry. In particular, we may face the following risks in connection with these events:

We potentially face increased regulation of our industry, including changes by Congress or federal regulatory agencies to the banking and financial institutions regulatory regime and heightened legal standards and regulatory requirements or expectations imposed in connection with the Emergency Economic Stabilization Act of 2008, or the EESA, and the American Recovery and Reinvestment Act of 2008, or the ARRA or other legislation that may be adopted in the future. Compliance with such regulation may increase our costs and limit our ability to pursue business opportunities.

The process we use to estimate losses inherent in our credit exposure requires difficult, subjective and complex judgments, including forecasts of economic conditions and how these economic conditions might impair the ability of our borrowers to repay their loans. The level of uncertainty concerning economic conditions may adversely affect the accuracy of our estimates which may, in turn, impact the reliability of the process.

We may be required to pay significantly higher deposit insurance premiums to the FDIC because market developments have significantly depleted the insurance fund of the FDIC and reduced the ratio of reserves to insured deposits.

Our banking operations are concentrated primarily in California, and secondarily in New York, Texas, Massachusetts, Washington, Illinois, New Jersey, and Hong Kong. Adverse economic conditions in these regions in particular 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 conditions include the effects of the current general decline in real estate sales and prices in many markets across the United States, the current economic recession, and higher rates of unemployment. These conditions 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, if at all, and could also cause a decline in demand for our products and services, or a lack of growth or a decrease in deposits, any of which may cause us to incur losses, adversely affect our capital, and hurt our business.

We are subject to a memorandum of understanding with the Federal Reserve Bank of San Francisco, or the FRB SF, and the Bank is subject to a memorandum of understanding with the California DFI and the FDIC and we may be subject to further supervisory action by bank supervisory authorities that could have a material negative effect on our business, financial condition, and the value of our common stock.

Under federal and state laws and regulations pertaining to the safety and soundness of insured depository institutions, the DFI and the Federal Reserve Board, and separately the FDIC as insurer of the Bank s deposits, have authority to compel or restrict certain actions if the Bank s capital should fall below adequate capital standards as a result of operating losses, or if its regulators otherwise determine that it has insufficient capital or has engaged in unsafe or unsound practices. Among other matters, the corrective actions may include, but are not limited to, requiring us and/or the Bank to enter into informal or formal enforcement orders, including memoranda of understanding, written agreements, supervisory letters, commitment letters, and consent or cease and desist orders to take corrective action and refrain from unsafe and unsound practices; removing officers and directors and assessing civil monetary penalties; and taking possession of and closing and liquidating the Bank. As a result of losses incurred to date, we entered into a memorandum of understanding with the FRB SF in December 2009. Under the memorandum, we agreed to submit to the FRB SF for review and approval a plan to maintain sufficient capital at the Company on a consolidated basis and at the Bank, a dividend policy for the Bancorp, a plan to improve management of our liquidity position and funds management practices, and a liquidity policy and contingency funding plan for the Bancorp. As part of our compliance with the memorandum, on January 22, 2010, we submitted a Three-Year Capital and Strategic Plan to the FRB SF which updated a previously submitted plan. In addition, we have agreed that we will not, without the FRB SF s prior written approval, (i) receive any dividends or any other form of payment or distribution representing a reduction of capital from the Bank, or (ii) declare or pay any dividends, make any payments on trust preferred securities, or make any other capital distributions. We further agreed to notify the FRB SF prior to effecting certain changes to our senior executive officers and board of directors and we are limited and/or prohibited, in certain circumstances, in our ability to enter into contracts to pay and to make golden parachute severance and indemnification payments.

On March 1, 2010, the Bank entered into the memoranda of understanding with the DFI and the FDIC. Under that memorandum, we are required, among other things, to develop and implement plans to reduce commercial real estate concentrations, to improve our capital ratios and to reduce the Bank s overall risk profile; to develop and implement a plan to improve asset quality; and to develop and implement a plan to reduce dependence on wholesale funding. We may need to take significant action to comply with these requirements, including selling assets during adverse market conditions, raising additional capital and limiting or ceasing offering profitable products and services, which could have a material adverse effect on our business and our financial condition. In addition, we are required to retain management and directors acceptable to the DFI and the FDIC. No assurance can be given that our current management and directors are acceptable to the DFI or the FDIC, that we will be able to retain or engage management and directors who are acceptable to the DFI or the FDIC or that we will be able to meet the requirements of the memoranda in a timely manner.

If we were unable to meet the requirements of the memorandum with the FRB SF or the DFI and the FDIC in a timely manner, we could become subject to additional supervisory action, including a cease and desist order. If our banking supervisors were to take such additional supervisory action, we could, among other things, become subject to significant restrictions on our ability to develop any new business, as well as restrictions on our existing business, and we could be required to raise additional capital, dispose of certain assets and liabilities within a prescribed period of time, or both. The terms of any such supervisory action could have a material negative effect on our business, our financial condition and the value of our common stock. Additionally, there can be no assurance that we will not be subject to further supervisory action or regulatory proceedings.

U.S. and international financial markets and economic conditions could adversely affect our liquidity, results of operations, and financial condition.

The cost and availability of funds may be adversely affected by illiquid credit markets and the demand for our products and services may decline as our borrowers and customers realize the impact of an economic slowdown and recession. In view of the concentration of our operations and the collateral securing our loan portfolio in Northern and Southern California, we may be particularly susceptible to the adverse economic conditions in the State of California. In addition, the severity and duration of these adverse conditions are unknown and may exacerbate our exposure to credit risk and adversely affect the ability of borrowers to perform under the terms of their lending arrangements with us.

We may be required to make additional provisions for loan losses and charge off additional loans in the future, which could adversely affect our results of operations.

At December 31, 2009, our allowance for loan losses totaled $211.9 million and we had net charge-offs of approximately $219.3 million for the fiscal year ended on that date. There has been a significant slowdown in the real estate market in portions of Los Angeles, San Diego, Riverside, and San Bernardino counties and the Central Valley of California where many of our commercial real estate and construction loan customers are based. This slowdown reflects declining prices and excess inventories of homes to be sold, which has contributed to financial strain on home builders and suppliers. In addition, the Federal Reserve Board and other government officials have expressed concerns about the commercial real estate lending concentrations of financial institutions and the ability of commercial real estate borrowers to perform pursuant to the terms of their loans. As of December 31, 2009, we had approximately $4.7 billion in commercial real estate and construction loans. Continuing deterioration in the real estate market generally and in the commercial real estate and residential building segments in particular could result in additional loan charge offs and provisions for loan losses in the future, which could have a material adverse effect on our financial condition, net income, and capital.

Table of Contents

The allowance for credit losses is an estimate of probable credit losses. Actual credit losses in excess of the estimate could adversely affect our results of operations and capital.

A significant source of risk arises from the possibility that we could sustain losses because borrowers, guarantors, and related parties may fail to perform in accordance with the terms of their loans and leases. The underwriting and credit monitoring policies and procedures that we have adopted to address this risk may not prevent unexpected losses that could have a material adverse effect on our business, financial condition, results of operations, and cash flows. The allowance for credit losses is based on management s estimate of the probable losses from our credit portfolio. If actual losses exceed the estimate, the excess losses could adversely affect our results of operations and capital. Such excess losses could also lead to larger allowances for credit losses in future periods, which could in turn adversely affect results of operations 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 credits, 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 credit losses in excess of present or future levels of the allowance for credit losses.

We are subject to extensive laws and regulations and supervision, and may become subject to future laws and regulations and supervision, if any, that may be enacted, that could limit or restrict our activities, may hamper our ability to increase our assets and earnings and could adversely affect our profitability.

We operate in a highly regulated industry and are or may become subject to regulation by federal, state and local governmental authorities and various laws, regulations, regulatory guidelines, and judicial and administrative decisions imposing requirements or restrictions on part or all of our operations, capitalization, payment of dividends, mergers and acquisitions, investments, loans and interest rates charged, interest rates paid on deposits, and locations of offices. Also, we are or may become to subject to examination, supervision, and comprehensive regulation by various federal, state, and local authorities with regard to compliance with such laws and regulations. Because our business is highly regulated, the laws, rules, regulations and supervisory guidance and policies applicable to us are subject to regular modification and change. Perennially, various laws, rules and regulations are proposed, which, if adopted, could impact our operations or could substantially and adversely affect our ability to operate profitably by making compliance much more difficult or expensive, restricting our ability to originate or sell loans or further restricting the amount of interest or other charges or fees earned on loans or other products. 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. See Regulation and Supervision section in Part I- Item 1- of this Annual Report on Form 10-K.

We may experience goodwill impairment.

If our estimates of goodwill fair value change due to changes in our businesses or other factors, we may determine that impairment charges are necessary. Estimates of fair value are determined based on a complex model using cash flows and company comparisons. If management s estimates of future cash flows are inaccurate, the fair value determined could be inaccurate and impairment may not be recognized in a timely manner.

Liquidity risk could impair our ability to fund operations and jeopardize our financial condition.

Liquidity is essential to our business. An inability to raise funds through deposits, borrowings, the sale of loans, and other sources could have a material adverse effect on our liquidity. Our access to funding sources in amounts adequate to finance our activities could be impaired by factors that affect us specifically or the financial services industry in general. Factors that could detrimentally impact our access to liquidity sources include a decrease in the level of our business activity due to a market downturn or adverse regulatory action against us. Our ability to acquire deposits or borrow could also be impaired by factors that are not specific to us, such as a severe disruption of the financial markets or negative views and expectations about the prospects for the financial services industry as a whole as the recent turmoil faced by banking organizations in the domestic and worldwide credit markets deteriorates.

Our business is subject to interest rate risk and fluctuations in interest rates could reduce our net interest income and adversely affect our business.

A substantial portion of our income is derived from the differential, or spread , between the interest earned on loans, investment securities and other interest-earning assets, and the interest paid on deposits, borrowings and other interest-bearing liabilities. 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 our interest-earning assets and interest-bearing liabilities 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 re-pricing 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.

We have engaged in expansion through acquisitions and may consider additional acquisitions in the future, which could negatively affect our business and earnings.

We have engaged in expansion through acquisitions and may consider acquisitions in the future. There are risks associated with any 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, if any, 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.

In addition, our ability to grow may be limited if we cannot make acquisitions. We compete with other financial institutions with respect to proposed acquisitions. We cannot predict if or when we will be able to identify and attract acquisition candidates or make acquisitions on favorable terms.

Table of Contents

We may in the future engage in FDIC-assisted transactions, which could present additional risks to our business.

In the current economic environment, and subject to any requisite regulatory consent, we may potentially be presented with opportunities to acquire the assets and liabilities of failed banks in FDIC-assisted transactions. These acquisitions involve risks similar to acquiring existing banks even though the FDIC might provide assistance to mitigate certain risks such as sharing in exposure to loan losses and providing indemnification against certain liabilities of the failed institution. However, because these acquisitions are structured in a manner that would not allow us the time normally associated with preparing for and evaluating an acquisition, including preparing for integration of an acquired institution, we may face additional risks if we engage in FDIC-assisted transactions. These risks include, among other things, the loss of customers, strain on management resources related to collection and management of problem loans and problems related to integration of personnel and operating systems. If we engage in FDIC assisted transactions, we may not be successful in overcoming these risks or any other problems encountered in connection with these transactions. Our inability to overcome these risks could have an adverse effect on our ability to achieve our business strategy and maintain our market value and profitability.

Moreover, even if we were inclined to participate in an FDIC-assisted transaction, there are no assurances that the FDIC would allow us to participate or what the terms of such transaction might be or whether we would be successful in acquiring the bank or assets that we are seeking. We may be required to raise additional capital as a condition to, or as a result of, participation in an FDIC-assisted transaction. Any such transactions and related issuances of stock may have a dilutive effect on earnings per share and share ownership.

Furthermore, to the extent we are allowed to, and choose to, participate in FDIC-assisted transactions, we may face competition from other financial institutions with respect to the proposed FDIC-assisted transactions. To the extent that our competitors are selected to participate in FDIC-assisted transactions, our ability to identify and attract acquisition candidates and/or make acquisitions on favorable terms may be adversely affected.

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 our operations 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.

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. We currently have operations in six other states (New York, Texas, Washington, Massachusetts, Illinois, and New Jersey) and in Hong Kong. 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 expenses and operational difficulties arising from, among other things, our ability to attract sufficient business in new markets, to manage operations in noncontiguous market areas, to comply with all of the various local laws and regulations, 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; the incurring 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 loan portfolio is largely secured by real estate, which has adversely affected and may continue to adversely affect our results of operations.

A downturn in our real estate markets has hurt our business because many of our loans are secured by real estate. The real estate collateral securing our borrowers obligations is principally located in California, and to a lesser extent, in New York, Texas, Massachusetts, Washington, Illinois, and New Jersey. The value of such collateral depends upon conditions in the relevant real estate markets. These include general or local economic conditions and neighborhood characteristics, unemployment rates, real estate tax rates, the cost of operating the properties, governmental regulations and fiscal policies, and acts of nature including earthquakes, floods, and hurricanes (which may result in uninsured losses), and other factors beyond our control. The current general decline in real estate sales and prices in many markets across the United States could reduce the value of our collateral such that we may not be able to realize an amount upon a foreclosure sale equal to the indebtedness secured by the property. Continued declines in real estate sales and prices coupled with the current economic recession and an associated increase in unemployment will result in higher than expected loan delinquencies or problem assets, a decline in demand for our products and services, or a lack of growth or a decrease in deposits, which may cause us to incur losses, adversely affect our capital, and hurt our business.

The risks inherent in construction lending may continue to affect adversely our results of operations. 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. The current general decline in real estate sales and prices across the United States, the decline in demand for residential real estate, recession, higher rates of unemployment, and reduced availability of mortgage credit, are all factors that can adversely affect the borrowers ability to repay their obligations to us and the value of our security interest in collateral, and thereby adversely affect our results of operations and financial results.

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

In considering whether to make a loan secured by real property, we require an appraisal of the property. However, an 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, loans, and for other banking services, as well as acquisitions, 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. These banks and financial institutions have greater resources than we do, including the ability to finance advertising campaigns and allocate

25

Table of Contents

their investment assets to regions of higher yield and demand and make acquisitions. By virtue of their larger capital bases, they have substantially greater lending limits than we do 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, brokerage houses, insurance companies, mortgage companies, credit unions, credit card companies and other financial and non-financial institutions and entities. The recent consolidation of certain competing financial institutions and the conversion of certain investment banks to bank holding companies has increased the level of competition among financial services companies and may adversely affect our ability to market our products and services.

The short term and long term impact of the new Basel II capital standards and the forthcoming new capital rules to be proposed for non-Basel II U.S. banks is uncertain.

As a result of the recent deterioration in the global credit markets and the potential impact of increased liquidity risk and interest rate risk, it is unclear what the short term impact of the implementation of Basel II may be or what impact a pending alternative standardized approach to Basel II for non-Basel II U.S. banks may have on the cost and availability of different types of credit and the potential compliance costs of implementing the new capital standards.

We are dependent on key personnel and the loss of one or more of those key personnel may materially and adversely affect our prospects.

Competition for qualified employees and personnel in the banking industry is intense and there are a limited number of qualified persons with knowledge of, and experience in, the communities that we serve. The process of recruiting personnel with the combination of skills and attributes required to carry out our strategies is often lengthy. Our success depends to a significant degree upon our ability to attract and retain qualified management, loan origination, finance, administrative, marketing and technical personnel and upon the continued contributions of our management and personnel. In particular, our success has been and continues to be highly dependent upon the abilities of key executives, and certain other employees.

On March 1, 2010, the Bank entered into a memorandum of understanding with the DFI and the FDIC pursuant to which we are required to retain management and directors acceptable to the DFI and the FDIC. No assurance can be given that our current management or directors are acceptable to the DFI or the FDIC or that we will be able to retain or engage management or directors who are acceptable to the DFI and the FDIC. If we are unable to retain such management and directors, we may be subject to further supervisory action that could have a material adverse effect on our business, financial condition, and the value of our common stock.

Managing reputational risk is important to attracting and maintaining customers, investors and employees.

Threats to our reputation can come from many sources, including adverse sentiment about financial institutions generally, unethical practices, employee misconduct, failure to deliver minimum standards of service or quality, compliance deficiencies, and questionable or fraudulent activities of our customers. We have policies and procedures in place that seek to protect our reputation and promote ethical conduct, but these policies and procedures may not be fully effective. Negative publicity regarding our business, employees, or customers, with or without merit, may result in the loss of customers, investors, and employees, costly litigation, a decline in revenues and increased governmental regulation.

Natural disasters and geopolitical events beyond our control could adversely affect us.

Natural disasters such as earthquakes, wildfires, extreme weather conditions, hurricanes, floods, and other acts of nature and geopolitical events involving terrorism or military conflict could adversely affect our business operations and those of our customers and cause substantial damage and loss to real and personal property. These natural disasters and geopolitical events could impair our borrowers ability to service their loans, decrease the level and duration of deposits by customers, erode the value of loan collateral, and result in an increase in the amount of our non-performing loans and a higher level of non-performing assets (including real estate owned), net charge-offs, and provision for loan losses, which could adversely affect our earnings.

Adverse 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. In addition, in 2007, we opened a branch in Hong Kong. U.S. and global economic policies, military tensions, and unfavorable global economic conditions may adversely impact the Asian economies. Pandemics and other public health crises or concerns over the possibility of such crises could create economic and financial disruptions in the region. 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.

Because of our participation in the TARP Capital Purchase Program, we are subject to several restrictions including restrictions on compensation paid to our executives.

Pursuant to the terms of the Purchase Agreement between us and the U.S. Treasury, or the Purchase Agreement, under which we sold $258 million of our Fixed Rate Cumulative Perpetual Preferred Stock, Series B, with a liquidation preference of $1,000 per share, or the Series B Preferred Stock, we adopted certain standards for executive compensation and corporate governance. These standards generally apply to our Chief Executive Officer, Chief Financial Officer and the three next most highly compensated executive officers. The standards include (1) ensuring that incentive compensation for senior executive officers does not encourage unnecessary and excessive risks that threaten the value of the financial institution; (2) required clawback of any bonus or incentive compensation paid to a senior executive officer based on statements of earnings, gains or other criteria that are later proven to be materially inaccurate; (3) prohibition on making golden parachute payments to senior executives; and (4) agreement not to deduct for tax purposes executive compensation in excess of $500,000 for each senior executive. In particular, the change to the deductibility limit on executive compensation will likely increase the overall cost of our compensation programs in future periods.

The adoption of the ARRA on February 17, 2009, and interim final regulations thereunder effective June 15, 2009, have imposed certain new executive compensation and corporate expenditure limits on all current and future TARP recipients, including the Company, until the institution has repaid the U.S. Treasury, which is now permitted under the ARRA without penalty and without the need to raise new capital, subject to the U.S. Treasury s consultation with the recipient s appropriate regulatory agency. The executive compensation standards are in many respects more stringent than those that continue in effect under the TARP Capital Purchase Program and those previously proposed by the U.S. Treasury. The new standards include (but are not limited to) (i) prohibitions on bonuses, retention awards and other incentive compensation, other than restricted stock or restricted stock unit grants for up to one-third of an employee s total annual compensation, which grants cannot vest for a period of at least two years and can be liquidated during the TARP period only in proportion to the repayment of the TARP investment at 25% increments, (ii) prohibitions on golden parachute payments for departure from a company or change in control of the company, (iii) an expanded clawback of bonuses, retention awards, and incentive compensation if payment is based on materially inaccurate statements of earnings, revenues, gains or other criteria, (iv) prohibitions on compensation plans that encourage manipulation of reported earnings, (v) retroactive review of bonuses, retention awards and other compensation previously provided by TARP recipients if found by the U.S. Treasury to be inconsistent with the purposes of TARP or otherwise contrary to the public interest, (vi) required establishment of a company-wide policy regarding excessive or luxury expenditures, and (vii) inclusion in a participant s proxy statements for annual shareholder meetings of a nonbinding Say on Pay shareholder vote on the compensation of executives.

Table of Contents

Our information systems may experience an interruption or breach in security.

We rely heavily on communications and information systems to conduct our business. Any failure, interruption, or breach in security of these systems could result in failures or disruptions in our customer relationship management, general ledger, deposit, loan and other systems. While we have policies and procedures designed to prevent or limit the effect of the failure, interruption, or security breach of our information systems, there can be no assurance that any such failures, interruptions, or security breaches will not occur or, if they do occur, that they will be adequately addressed. The occurrence of any failures, interruptions or security breaches of our information systems could damage our reputation, result in a loss of customer business, subject us to additional regulatory scrutiny, or expose us to civil litigation and possible financial liability, any of which could have a material adverse effect on our financial condition and results of operations.

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 restated certificate of incorporation, as amended, our restated bylaws, as amended, and the 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 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.

Our financial results could be adversely affected by changes in accounting standards or tax laws and regulations.

From time to time, the Financial Accounting Standards Board and the SEC will change the financial accounting and reporting standards that govern the preparation of our financial statements. In addition, from time to time, federal and state taxing authorities will change the tax laws, regulations, and their interpretations. These changes and their effects can be difficult to predict and can materially and adversely impact how we record and report our financial condition and results of operations.

The price of our common stock may fluctuate significantly, and this may make it difficult for you to sell shares of common stock owned by you at times or at prices you find attractive.

The trading price of our common stock may fluctuate widely as a result of a number of factors, many of which are outside our control. In addition, the stock market is subject to fluctuations in the share prices and trading volumes that affect the market prices of the shares of many companies. These broad market fluctuations could adversely affect the market price of our common stock. Among the factors that could affect our stock price are:

actual or anticipated quarterly fluctuations in our operating results and financial condition;

changes in revenue or earnings estimates or publication of research reports and recommendations by financial analysts;

Table of Contents

failure to meet analysts revenue or earnings estimates;

speculation in the press or investment community;

strategic actions by us or our competitors, such as acquisitions or restructurings;

acquisitions of other banks or financial institutions, through FDIC-assisted transactions or otherwise;

actions by institutional shareholders;

fluctuations in the stock price and operating results of our competitors;

general market conditions and, in particular, developments related to market conditions for the financial services industry;

fluctuations in the stock price and operating results of our competitors;

proposed or adopted regulatory changes or developments;

anticipated or pending investigations, proceedings, or litigation that involve or affect us;

successful management of reputational risk; and

domestic and international economic factors unrelated to our performance.

The stock market and, in particular, the market for financial institution stocks, has experienced significant volatility. As a result, the market price of our common stock may be volatile. In addition, the trading volume in our common stock may fluctuate more than usual and cause significant price variations to occur. The trading price of the shares of our common stock and the value of our other securities will depend on many factors, which may change from time to time, including, without limitation, our financial condition, performance, creditworthiness and prospects, future sales of our equity or equity related securities, and other factors identified above in Forward-Looking Statements . The capital and credit markets have been experiencing volatility and disruption. In 2009, the volatility and disruption had reached unprecedented levels. In some cases, the markets have produced downward pressure on stock prices and credit availability for certain issuers without regard to those issuers underlying financial strength. A significant decline in our stock price could result in substantial losses for individual stockholders and could lead to costly and disruptive securities litigation.

Statutory restrictions and restrictions by our regulators on dividends and other distributions from the Bank may adversely impact us by limiting the amount of distributions the Bancorp may receive. State laws and our regulators may restrict our ability to pay dividends.

A substantial portion of 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. Also, the Bank is subject to a restriction on dividends it may pay to Bancorp under a memorandum of understanding with the DFI and the FDIC. Under the memorandum of understanding we entered into with the FRB SF, we agreed that we will not, without the FRB SF s prior written approval, receive any dividends or any other form of payment or distribution representing a reduction of capital from the Bank. In our Three-Year Capital and Strategic Plan we submitted to the FRB SF, we indicated the Bank will not pay a dividend to us in 2010. In addition, we adopted a capital management and dividend policy as part of the Capital Plan in which we adopted a policy to refrain from paying dividends in excess of $.01 per share per quarter, except when covered by operating earnings beginning in 2011.

The Federal Reserve Board has previously issued Federal Reserve Supervision and Regulation Letter SR-09-4 that states that bank holding companies are expected to inform and consult with Federal Reserve supervisory staff prior to declaring and paying a dividend that exceeds earnings for the period for which the dividend is being paid. As a result of losses incurred in the second, third, and fourth quarters of 2009, we were expected to so inform and consult with the Federal Reserve supervisory staff prior to declaring or paying any dividends and we have agreed under the memorandum of understanding with the FRB SF that we will not, without the FRB SF s prior written approval, declare or pay any dividends, make any payments on trust preferred securities, or make any other capital distributions. There can be no assurance that our regulators will approve the payment of such dividends.

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.

The ability of the Bank to pay dividends to us is limited by various regulations and statutes, including California law, and the ability of us to pay dividends on our outstanding stock is limited by various regulations and statutes, including Delaware law.

The terms of our outstanding preferred stock limit our ability to pay dividends on and repurchase our common stock and there can be no assurance of any future dividends on our common stock generally.

In connection with the Purchase Agreement between us and the U.S. Treasury, we issued a warrant to purchase up to 1,846,374 shares of our common stock, or the Warrant, which provides that prior to the earlier of (i) December 5, 2011, and (ii) the date on which all of the shares of the Series B Preferred Stock have been redeemed by us or transferred by the U.S. Treasury to third parties, we may not, without the consent of the U.S. Treasury, (a) increase the cash dividend on our common stock above $.105 per share, the amount of the last quarterly cash dividend per share declared prior to October 14, 2008, or (b) subject to limited exceptions, redeem, repurchase or otherwise acquire shares of our common stock or preferred stock other than the Series B Preferred Stock. In addition, we are unable to pay any dividends on our common stock unless we are current in our dividend payments on the Series B Preferred Stock.

The Federal Reserve Board has previously issued Federal Reserve Supervision and Regulation Letter SR-09-4 that states that bank holding companies are expected to inform and consult with Federal Reserve supervisory staff prior to declaring and paying a dividend that exceeds earnings for the period for which the dividend is being paid. As a result of losses incurred in the second, third, and fourth quarters of 2009, we were expected to so inform and consult with the Federal Reserve supervisory staff prior to declaring or paying any dividends and we have agreed under the memorandum of understanding with the FRB SF that we will not, without the FRB SF s prior written approval, (i) receive any dividends or any other form of payment or distribution representing a reduction of capital from the Bank, or (ii) declare or pay any dividends, make any payments on trust preferred securities, or make any other capital distributions. The Bancorp and the Bank are also each subject to additional statutory and regulatory restrictions on paying dividends.

The restrictions described above, together with the potentially dilutive impact of the Warrant, described below, could have a negative effect on the value of our common stock. Moreover, holders of our common stock are entitled to receive dividends only when, as and if declared by our Board of Directors. Although we have historically paid cash dividends on our common stock, we are not required to do so and our Board of Directors could reduce or eliminate our common stock dividend in the future. Commencing with the second quarter of 2009, our board reduced our common stock dividend to $.08 per share. In the third and fourth quarters of 2009, our board further reduced our dividend to $.01 per share. There can be no assurance that we will be able to pay dividends in the future.

Our outstanding preferred stock impacts net income available to our common stockholders and earnings per common share, and the Warrant as well as other potential issuances of equity securities may be dilutive to holders of our common stock.

The dividends declared and the accretion on discount on our outstanding preferred stock will reduce the net income available to common stockholders and our earnings per common share. Our outstanding preferred stock will also receive preferential treatment in the event of our liquidation, dissolution, or winding up. Additionally,

the ownership interest of the existing holders of our common stock will be diluted to the extent the Warrant is

Table of Contents

exercised. The 1,846,374 shares of common stock underlying the Warrant represent approximately 2.8% of the shares of our common stock outstanding as of December 31, 2009 (including the shares issuable upon exercise of the Warrant in total shares outstanding). Although the U.S. Treasury has agreed not to vote any of the shares of common stock it receives upon exercise of the Warrant, a transferee of any portion of the Warrant or of any shares of common stock acquired upon exercise of the Warrant is not bound by this restriction. In addition, to the extent options to purchase common stock under our stock option plans are exercised, holders of our common stock will incur additional dilution.

We are not restricted from issuing additional common stock or preferred stock, including any securities that are convertible into or exchangeable for, or that represent the right to receive, common stock or preferred stock or any substantially similar securities. If we sell additional equity or convertible debt securities, these sales could result in increased dilution to our stockholders. See We may need to raise additional capital which may dilute the interests of holders of our common stock or otherwise have an adverse effect on their investment.

The issuance of additional shares of preferred stock could adversely affect holders of common stock, which may negatively impact your investment.

Our board of directors is authorized to issue additional classes or series of preferred stock without any action on the part of the stockholders. The board of directors also has the power, without stockholder approval, to set the terms of any such classes or series of preferred stock that may be issued, including voting rights, dividend rights and preferences over the common stock with respect to dividends or upon the liquidation, dissolution, or winding up of our business and other terms. If we issue preferred stock in the future that has a preference over the common stock with respect to the payment of dividends or upon liquidation, dissolution or winding up, or if we issue preferred stock with voting rights that dilute the voting power of the common stock, the rights of holders of the common stock or the market price of the common stock could be adversely affected.

Our outstanding debt securities restrict our ability to pay dividends on our capital stock.

In June 2003, Cathay Capital Trust I issued $20,619,000 of Floating Rate Trust Preferred Securities. In September 2003, Cathay Statutory Trust I issued $20,619,000 of Floating Rate Trust Preferred Securities. In December 2003, Cathay Capital Trust II issued $12,887,000 of Floating Rate Trust Preferred Securities. In March 2007, Cathay Capital Trust III issued $46,392,000 of Floating Rate Trust Preferred Securities. In May 2007, Cathay Capital Trust IV issued $20,619,000 of Floating Rate Trust Preferred Securities. These securities are collectively referred to herein as the Trust Preferred Securities. Payments to investors in respect of the Trust Preferred Securities are funded by distributions on certain series of securities issued by us, with similar terms to the relevant series of Trust Preferred Securities, which we refer to as the Junior Subordinated Securities. In addition, in September 2006, the Bank issued $50,000,000 in subordinated debt in a private placement, which we refer to as the Bank Subordinated Securities. If we are unable to pay interest in respect of the Junior Subordinated Securities (which will be used to make distributions on the Trust Preferred Securities), or if any other event of default occurs, then we will generally be prohibited from declaring or paying any dividends or other distributions, or redeeming, purchasing or acquiring, any of our capital securities, including the common stock, during the next succeeding interest payment period applicable to any of the Junior Subordinated Securities.

If the Bank is unable to pay interest in respect of the Bank Subordinated Securities, or if any other event of default has occurred and is continuing on the Bank Subordinated Securities, then the Bank will be prohibited from declaring or paying dividends or other distributions, or redeeming, purchasing or acquiring, any of its capital stock, during the next succeeding interest payment applicable to the Bank Subordinated Securities. As a result, the Bank will be prohibited from making dividend payments to us, which, in turn could affect our ability to pay dividends on our capital securities, including the common stock.

Moreover, any other financing agreements that we enter into in the future may limit our ability to pay cash dividends on our capital stock, including the common stock. In the event that any other financing agreements in the future restrict our ability to pay dividends in cash on the common stock, we may be unable to pay dividends in cash on the common stock unless we can refinance amounts outstanding under those agreements.

We may need to raise additional capital which may dilute the interests of holders of our common stock or otherwise have an adverse effect on their investment.

If economic conditions continue to deteriorate, particularly in the California commercial real estate and residential real estate markets where our business is concentrated, we may need to raise even more capital to support any additional provisions for loan losses and loan charge-offs. In addition, we may need to raise more capital to meet other regulatory requirements, if our losses are higher than expected and we believe that we may breach the target capital ratios in our Three-Year Capital and Strategic Plan, or to participate in FDIC-assisted transactions. There can be no assurances that we would succeed in raising any such additional capital, and any capital we obtain may dilute the interests of holders of our common stock, or otherwise have an adverse effect on their investment.

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 not less than 180 days before the end of its 2009 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 at 777 North Broadway, Los Angeles, California 90012 and at 9650 Flair Drive, El Monte, California 91731 in exchange for payment of a management fee to the Bank.

Cathay Bank

The Bank s head office 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. In January 2009, the Bank moved certain of its administrative offices to a seven-story 102,548 square foot office building located at 9650 Flair Drive, El Monte, California 91731. The Bank also owns this building and land in El Monte.

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 June 2010 to December 2016. Our Hong Kong branch is located at 28 Queen s Road Central Hong Kong. The lease for the 3,436 square foot office commenced on December 16, 2006 and will expire in December 2012. Our representative office in Shanghai is located at Room 2610-A, 1515 Nanjing Road West, Kerry Centre, Shanghai, China, and consists of 869 square feet. The lease was renewed for three years from May 2009 to May 2012. The representative office in Taipei 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 2009 to June 2010.

As of December 31, 2009, the Bank s investment in premises and equipment totaled $108.6 million. See Note 9 and Note 15 to the Consolidated Financial Statements.

Table of Contents

Item 3. Legal Proceedings.

The Company and its subsidiaries and their property are not currently a party or subject to any material pending legal proceeding.

Item 4. Reserved.

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 March 1, 2010.

Name	Age	Present Position and Principal Occupation During the Past Five Years
Dunson K. Cheng	65	Chairman of the Board of Directors of Bancorp and the Bank since 1994; Director, President, and Chief Executive Officer of Bancorp since 1990. President of the Bank since 1985 and Director of the Bank since 1982.
Peter Wu	61	Director, Executive Vice Chairman, and Chief Operating Officer of Bancorp and the Bank since October 20, 2003.
Anthony M. Tang	56	Director of Bancorp since 1990; Executive Vice President of Bancorp since 1994; 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	57	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.
Irwin Wong	61	Executive Vice President-Branch Administration of the Bank since 1999.
Kim R. Bingham	53	Executive Vice President and Chief Credit Officer of the Bank since August 2004.
Perry P. Oei	47	Senior Vice President of Bancorp and the Bank since January 2004; General Counsel of Bancorp and the Bank since July 2001.

Table of Contents

PART II

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

Market Information

Our common stock is listed on the NASDAQ Global Select Market under the symbol CATY. Prior to July 3, 2006, our common stock traded on the NASDAQ National Market. The closing price of our common stock on March 1, 2010, was $9.75 per share, as reported by the NASDAQ Global Select Market.

The following table sets forth the high and low closing prices as reported on the NASDAQ Global Select Market for the periods presented:

	Year Ended December 31,			
	2009		2008	
	High	Low	High	Low
First quarter	$ 23.32	$ 7.50	$ 27.61	$ 20.23
Second quarter	16.00	9.15	21.94	10.69
Third quarter	11.46	8.09	29.25	10.49
Fourth quarter	10.06	7.27	24.98	15.98

Holders

As of March 1, 2010, there were approximately 1,784 holders of record of our common stock.

Dividends

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

	Year Ended December 31,	
	2009	2008
First quarter	$ 0.105	$ 0.105
Second quarter	0.080	0.105
Third quarter	0.010	0.105
Fourth quarter	0.010	0.105
Total	$ 0.205	$ 0.420

Performance Graph

The graph and accompanying information furnished below compares the percentage change in the cumulative total stockholder return on our common stock from December 31, 2004, through December 31, 2009, 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. We will furnish, without charge, on the written request of any person who is a stockholder of record as of the record date for the 2010 annual meeting of the stockholders, 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 our common stock on December 31, 2004, and an investment of $100 in each of the S&P 500 Index and the SNL Western Bank Index on that date.

Table of Contents

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 our common stock. Such information furnished herewith shall not be deemed to be incorporated by reference into any of our filings 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	**12/31/04**	**12/31/05**	**12/31/06**	**12/31/07**	**12/31/08**	**12/31/09**
Cathay General Bancorp	100.00	96.87	93.93	72.99	67.17	21.68
SNL Western Bank	100.00	104.11	117.48	98.12	95.54	87.73
S&P 500	100.00	104.91	121.48	128.16	80.74	102.11

Source: SNL Financial LC, Charlottesville, VA © 2010

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

As of December 31, 2009, Bancorp may repurchase up to 622,500 shares of common stock under the November 2007 stock repurchase program, subject to limitations included in the EESA. No shares were repurchased in 2008 and in 2009.

Table of Contents

Item 6. Selected Financial Data.

The following table presents our selected historical consolidated financial data, and is derived in part from our audited consolidated financial statements. The selected historical consolidated financial data should be read in conjunction with the Consolidated Financial Statements 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,				
	2009	2008	2007	2006	2005
	(Dollars in thousands, except share and per share data)				
Income Statement (1)					
Interest income	$ 528,731	$ 589,951	$ 615,271	$ 491,518	$ 350,661
Interest expense	246,039	294,804	305,750	212,235	110,279
Net interest income before provision/(reversal) for loan losses	282,692	295,147	309,521	279,283	240,382
Provision/(reversal) for credit losses	307,000	106,700	11,000	2,000	(500)
Net interest (loss)/income after provision/(reversal) for credit losses	(24,308)	188,447	298,521	277,283	240,882
Securities gains/(losses)	55,644	(5,971)	810	201	1,473
Other non-interest income	23,010	24,878	26,677	21,263	21,013
Non-interest expense	183,037	136,676	128,745	113,315	96,284
(Loss)/Income before income tax expense	(128,691)	70,678	197,263	185,432	167,084
Income tax (benefit)/expense	(61,912)	19,554	71,191	67,259	62,390
Net (loss)/income	(66,779)	51,124	126,072	118,173	104,694
Less: net income attributable to noncontrolling interest	(611)	(603)	(603)	(603)	(603)
Net (loss)/income attributable to Cathay General Bancorp	(67,390)	50,521	125,469	117,570	104,091
Dividends on preferred stock	(16,338)	(1,140)			
Net (loss)/income attributable to stockholders	$ (83,728)	$ 49,381	$ 125,469	$ 117,570	$ 104,091
Net (loss)/income attributable to common stockholders per common share Basic	$ (1.59)	$ 1.00	$ 2.49	$ 2.29	$ 2.07
Diluted	$ (1.59)	$ 1.00	$ 2.46	$ 2.27	$ 2.05
Cash dividends paid per common share	$ 0.205	$ 0.420	$ 0.405	$ 0.360	$ 0.360
Weighted-average common shares					
Basic	52,629,159	49,414,824	50,418,303	51,234,596	50,373,076
Diluted	52,629,159	49,529,793	50,975,449	51,804,495	50,821,093
Statement of Condition					
Investment securities	$ 3,550,114	$ 3,083,817	$ 2,347,665	$ 1,522,223	$ 1,217,438
Net loans (2)	6,678,914	7,340,181	6,608,079	5,675,342	4,578,644
Loans held for sale	54,826				
Total assets	11,588,232	11,582,639	10,402,532	8,030,977	6,401,316

Deposits	7,505,040	6,836,736	6,278,367	5,675,306	4,916,350
Federal funds purchased and securities sold under agreements to repurchase	1,557,000	1,662,000	1,432,025	450,000	319,000
Advances from the Federal Home Loan Bank	929,362	1,449,362	1,375,180	714,680	215,000
Borrowings from other financial institutions	26,532	19,500	8,301	10,000	20,000
Long-term debt	171,136	171,136	171,136	104,125	53,976
Total equity	1,312,744	1,301,387	980,419	951,574	782,117
Common Stock Data					
Shares of common stock outstanding	63,459,590	49,508,250	49,336,187	51,930,955	50,191,089
Book value per common share	$ 16.49	$ 20.90	$ 19.70	$ 18.16	$ 15.41
Profitability Ratios					
Return on average assets	-0.58%	0.47%	1.38%	1.60%	1.69%
Return on average stockholders equity	(5.20)	4.91	13.28	13.61	14.05
Dividend payout ratio	n/m	42.02	16.36	15.67	17.44
Average equity to average assets ratio	11.29	9.58	10.37	11.76	12.05
Efficiency ratio	50.65	43.52	38.20	37.68	36.63

36

Table of Contents

(1) Includes the operating results and the acquired assets and assumed deposits and liabilities of (i) Great Eastern Bank after April 6, 2006, (ii) New Asia Bancorp and its subsidiaries after October 17, 2006, and (iii) United Heritage Bank after March 30, 2007.
(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 and results of operations of the Bancorp and its subsidiaries. It should be read in conjunction with the audited consolidated financial statements and notes appearing elsewhere in this Annual Report on Form 10-K.

The Bank offers a wide range of financial services. It currently operates 20 branches in Southern California, 11 branches in Northern California, eight branches in New York State, one branch in Massachusetts, two branches in Texas, three branches in Washington State, three branches in Illinois, one branch in New Jersey, one branch in Hong Kong and two representative offices (one in Shanghai, China, and one in Taipei, Taiwan). The Bank is a commercial bank, servicing primarily individuals, professionals, and small to medium-sized businesses in the local markets in which its branches are located.

The financial information presented herein includes the accounts of the Bancorp, 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.

Management believes the following are critical accounting policies that require the most significant judgments and estimates used in the preparation of the 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, non-accrual 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 we determine the appropriate allowance for loan losses requires the exercise of considerable judgment. The allowance is increased by the provision for loan losses and decreased by charge-offs when management believes the uncollectibility of a loan is confirmed. Subsequent recoveries, if any, are credited to the allowance. 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, we employ two primary methodologies, the individual loan review analysis methodology and the classification migration methodology. These methodologies support the basis for determining allocations between the various loan categories and the overall adequacy of our 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, and environmental factors which include trends in delinquency and non-accrual, and other significant factors, such as the national and local economy, the volume and composition of the portfolio, strength of management and loan staff, underwriting standards, and the concentration of credit.

The Bank s management allocates a specific allowance for Impaired Credits, in accordance with Accounting Standard Codification (ASC) 310-10-35. For non-Impaired Credits, a general allowance is established for those loans internally classified and risk graded Pass, Minimally Acceptable, Special Mention, or Substandard based on historical losses in the specific loan portfolio and a reserve based on environmental factors determined for that loan group. 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 allowance for credit losses is discussed in more detail in Allowance for Credit Losses below.

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. Pre-acquisition contingencies are to be recognized at fair value, unless it is a non-contractual contingency that is not likely to materialize, in which case, nothing should be recognized in purchase accounting and, instead, that contingency would be subject to the probable and estimable recognition criteria of ASC Topic 450, Accounting for Contingencies.

Investment Securities

The classification and accounting for investment securities are discussed in detail in Note 1 to the Consolidated Financial Statements presented elsewhere herein. Under ASC 320, formerly SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, investment securities 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. ASC Topic 320 requires us to assess whether we have the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. Other-than-temporary impairment related to credit losses will be recognized in earnings. Other-than-temporary impairment related to all other factors will be recognized in other comprehensive income.

38

Table of Contents

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 13 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.

We account 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 our 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.

Goodwill and Goodwill Impairment

Goodwill represents the excess of costs over fair value of assets of businesses acquired. ASC Topic 805, formerly SFAS No. 141, *Business Combinations (Revised 2007)*, requires an entity to recognize the assets, liabilities and any non-controlling interest at fair value as of the acquisition date. Contingent consideration is required to be recognized and measured at fair value on the date of acquisition rather than at a later date when the amount of that consideration may be determinable beyond a reasonable doubt. ASC Topic 805 also requires an entity to expense acquisition-related costs as incurred rather than allocating such costs to the assets acquired and liabilities assumed. Pre-acquisition contingencies are to be recognized at fair value, unless it is a non-contractual contingency that is not likely to materialize, in which case, nothing should be recognized in purchase accounting and, instead, that contingency would be subject to the probable and estimable recognition criteria of ASC Topic 450, Accounting for Contingencies. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but instead are tested for impairment at least annually in accordance with the provisions of ASC Topic 350, formerly SFAS No. 142. SFAS No. 142 also requires that intangible assets with estimable useful lives be amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with ASC Topic 360, formerly SFAS No. 144, *Accounting for Impairment or Disposal of Long-Lived Assets.*

Our policy is to assess goodwill for impairment at the reporting unit level on an annual basis or between annual assessments if a triggering event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. Impairment is the condition that exists when the carrying amount of goodwill exceeds its implied fair value. Accounting standards require management to estimate the fair value of each reporting unit in making the assessment of impairment at least annually.

The impairment testing process conducted by us begins by assigning net assets and goodwill to our three reporting units- Commercial Lending, Retail Banking, and East Coast Operations. We then complete step one of the impairment test by comparing the fair value of each reporting unit (as determined based on the discussion below) with the recorded book value (or carrying amount) of its net assets, with goodwill included in the computation of the carrying amount. If the fair value of a reporting unit exceeds its carrying amount, goodwill of that reporting unit is not considered impaired, and step two of the impairment test is not necessary. If the carrying amount of a reporting unit exceeds its fair value, step two of the impairment test is performed to determine the amount of impairment. Step two of the impairment test compares the carrying amount of the reporting unit s goodwill to the implied fair value of that goodwill. The implied fair value of goodwill is computed by assuming all assets and liabilities of the reporting unit would be adjusted to the current fair value, with the offset as an adjustment to goodwill. This adjusted goodwill balance is the implied fair value used in step two. An impairment charge is recognized for the amount by which the carrying amount of goodwill exceeds its implied fair value.

Table of Contents

Results of Operations

Overview

For the year ended December 31, 2009, we reported net loss attributable to common stockholders of $83.7 million, or $1.59 per share, compared to net income attributable to common stockholders of $49.4 million, or $1.00 per diluted share in 2008 and net income attributable to common stockholders of $125.5 million, or $2.46 per diluted share in 2007. The $133.1 million, or 270%, decline in net income from 2008 to 2009 was primarily the results of an increase of $200.3 million in the provision for credit losses. The return on average assets in 2009 was negative 0.58%, decreasing from 0.47% in 2008, and 1.38% in 2007. The return on average equity was negative 5.20% in 2009, decreasing from 4.91% in 2008 and 13.28% in 2007.

Highlights

Net loss attributable to common stockholders for 2009 was $83.7 million, a decrease of $133.1 million, or 270%, from 2008.

Loss per share for 2009 was $1.59, a decrease of 259% compared with diluted earnings per share of $1.00 for 2008.

In 2009, the Company raised $119.4 million in additional capital, net of professional expenses, through the sale of 13.9 million shares of common stock.

Total deposits increased by $668.3 million, or 9.8%, to $7.5 billion at December 31, 2009, from $6.8 billion at December 31, 2008.

Net (loss)/income available to common stockholders and key financial performance ratios are presented below for the three years indicated:

	2009	2008	2007
	(Dollars in thousands, except share and per share data)		
Net (loss)/income	$ (67,390)	$ 50,521	$ 125,469
Dividends on preferred stock	(16,338)	(1,140)	
Net (loss)/income available to common stockholders	$ (83,728)	$ 49,381	$ 125,469
Basic (loss)/earnings per common share	$ (1.59)	$ 1.00	$ 2.49
Diluted (loss)/earnings per common share	$ (1.59)	$ 1.00	$ 2.46
Return on average assets	-0.58%	0.47%	1.38%
Return on average stockholders equity	-5.20%	4.91%	13.28%
Total average assets	$ 11,544,807	$ 10,736,130	$ 9,111,671
Total average equity	$ 1,303,575	$ 1,036,789	$ 953,028
Efficiency ratio	50.65%	43.52%	38.20%
Effective income tax rate	48.11%	27.67%	36.09%

Net Interest Income

Net interest income declined $12.5 million, or 4.2%, from $295.1 million in 2008 to $282.7 million in 2009. Taxable-equivalent net interest income, using a statutory Federal income tax rate of 35%, totaled $283.1 million in 2009, compared with $296.4 million in 2008. Interest income on tax-exempt securities was $788,000, or $1.2 million on a tax-equivalent basis in 2009 compared to $2.9 million, or $4.2 million on a tax-equivalent basis in 2008. The decrease was due primarily to the increases in interest expense paid for securities sold under agreements to repurchase as a result of the expiration of initial below market interest rate periods. Between 2005 and 2008, the Bank increased its securities portfolio and funded these securities by entering into a number of long term securities sold under agreements to repurchase transactions to increase net interest income. Average non-interest bearing deposits remained steady between quarters since the Bank s customer base consistently prefers to maintain deposits in the form of certificates of deposit.

Average loans for 2009 were $7.27 billion, which is $51.6 million, or 0.7%, higher than 2008 due primarily to the growth in commercial mortgage loans. Compared with 2008, average commercial mortgage loans increased $113.6 million, or 2.83%, to $4.13 billion, average residential mortgages and equity lines increased $90.5 million, or 12.3%, to $829.4 million. Offsetting the above increases, average commercial loans decreased $98.1 million, or 6.3%, to $1.46 billion and average construction loans decreased $50.7 million, or 5.8%, to $819.7 million. Average securities were $3.24 billion, a significant increase of $724.8 million, or 28.9%, due primarily to net increases of mortgage-backed securities of $773.2 million in 2009.

Average interest bearing deposits were $6.61 billion in 2009, an increase of $752.2 million, or 12.8%, from $5.86 billion in 2008 primarily due to increases of $553.4 million, or 12.2%, in time deposits and increases of $153.7 million, or 20.9%, in money market deposits. Average FHLB advances and other borrowings decreased $180.6 million to $997.3 million in 2009 from $1.18 billion in 2008.

Taxable-equivalent interest income decreased $62.1 million, or 10.5%, to $529.2 million in 2009, primarily due to decline in rates on loans and securities purchased under agreements to resell, which was partially offset by increases in volume and by a change in the mix of interest-earning assets as discussed below:

Increase in volume: Average interest-earning assets increased $766.0 million, or 7.6%, to $10.8 billion in 2009, compared with the average interest-earning assets of $10.0 billion in 2008. The increase in volume added $26.6 million to interest income and was primarily attributable to the growth in investment securities.

Decline in rate: The taxable-equivalent yield on interest-earning assets decreased 99 basis points to 4.90% in 2009 from 5.89% in 2008. In 2009, the yield earned on average loans decreased 74 basis points to 5.53% in 2009 from 6.27% in 2008. The yield earned on average taxable securities decreased 86 basis points to 3.85% in 2009 from 4.71% in 2008. The decline in rates among interest earning assets caused interest income to decrease by $88.7 million.

Change in the mix of interest-earnings assets: Average gross loans, which generally have a higher yield than other types of investments, comprised 67.2% of total average interest-earning assets in 2009 and decreased from 71.9% in 2008. Average securities comprised 29.9% of total average interest-bearing assets in 2009 and increased from 25.0% in 2008.

Interest expense decreased by $48.8 million to $246.0 million in 2009 compared with $294.8 million in 2008 primarily due to decreased cost from time deposits offset by increased cost from securities sold under agreement to repurchase. The overall decrease in interest expense was primarily due to a net decrease in rate offset by a net increase in volume as discussed below:

Increase in volume: Average interest-bearing liabilities increased $548.3 billion in 2009, due primarily to the growth of time deposits of $553.4 million and money market deposits of $153.7 million, offset by decreases in FHLB advances and other borrowings of $180.6 million.

Decline in rate: As a result of the declining interest rate environment during 2008, the average cost of interest bearing liabilities decreased 72 basis points to 2.63% in 2009 from 3.35% in 2008.

Change in the mix of interest-bearing liabilities: Average interest bearing deposits of $6.61 billion increased to 70.7% of total interest-bearing liabilities in 2009 compared to 66.6% in 2008. Offsetting the increases, average FHLB advances and other borrowing of $997.3 million decreased to 10.7% of total interest-bearing liabilities in 2009 compared to 13.4% in 2008.

Our taxable-equivalent net interest margin, defined as taxable-equivalent net interest income to average interest-earning assets, decreased 33 basis points to 2.62% in 2009 from 2.95% in 2008. The decrease in net interest margin from the prior year primarily resulted from increases in non-accrual loans and the increase in the borrowing rate on our long term repurchase agreements as discussed above and the increase in the average rate paid on other borrowed funds as lower cost short term borrowings matured. The majority of our variable rate loans contain interest rate floors, which help limit the impact of the recent decreases in the prime interest rate.

Net interest income declined $14.4 million, or 4.6%, from $309.5 million in 2007 to $295.1 million in 2008. Taxable-equivalent net interest income, using a statutory Federal income tax rate of 35%, totaled $296.4 million in 2008, compared with $310.9 million in 2007. Interest income on tax-exempt securities was $2.9 million, or $4.2 million on a tax-equivalent basis in 2008 compared to $2.7 million, or $4.0 million on a tax-equivalent basis in 2007. The decrease in net interest income was due to the decline in the net interest margin which was partially offset by growth in loans and investment securities compared to the prior year.

Average loans for 2008 were $7.21 billion, which is $1.04 billion, or 16.9%, higher than 2007 due primarily to the growth in commercial mortgage loans. Compared with 2007, average commercial mortgage loans increased $537.4 million, or 15.4%, to $4.02 billion, average commercial loans increased $257.9 million, or 19.8%, to $1.56 billion, average residential mortgages and equity lines increased $127.7 million, or 20.9%, to $738.9 million and average construction loans increased $125.2 million, or 16.8%, to $870.4 million. Average securities were $2.51 billion, a significant increase of $647.8 million, or 34.8%, due primarily to net increases of mortgage-backed securities of $752.4 million in 2008.

Average deposits were $6.63 billion in 2008, an increase of $719.5 million, or 12.2%, from $5.91 billion in 2007 primarily due to increases of $678.5 million, or 17.6%, in time deposits. Average securities sold under agreement to repurchase increased $612.6 million to $1.55 billion in 2008 from $941.4 million in 2007. Average FHLB advances and other borrowings increased $167.3 million to $1.18 billion in 2008 from $1.01 billion in 2007.

Taxable-equivalent interest income decreased $25.4 million, or 4.1%, to $591.2 million in 2008, primarily due to a decline in rates on loans and investment securities which was partially offset by increases in volume and by a change in the mix of interest-earning assets as discussed below:

Increase in volume: Average interest-earning assets increased $1.58 billion, or 18.6%, to $10.0 billion in 2008, compared with the average interest-earning assets of $8.46 billion in 2007. The increase in volume added $98.4 million to interest income and was primarily attributable to the growth in loans and investment securities.

Decline in rate: The taxable-equivalent yield on interest-earning assets decreased 139 basis points from 7.28% in 2007 to 5.89% in 2008. In 2008, the yield earned on average loans decreased 152 basis points to 6.27% from 7.79% in 2007. The yield earned on average taxable securities decreased 88 basis points from 5.59% in 2007 to 4.71% in 2008. The decline in rates among interest earning assets caused interest income to decrease by $123.8 million.

Change in the mix of interest-earnings assets: Average gross loans, which generally have a higher yield than other types of investments, comprised 71.9% of total average interest-earning assets in 2008 and decreased from 72.9% in 2007. Average securities comprised 25.0% of total average interest-bearing assets in 2008 and increased from 22.0% in 2007.

Interest expense decreased by $10.9 million to $294.8 million in 2008 compared with $305.7 million in 2007 primarily due to decreased cost from time deposits offset by increased cost from securities sold under agreement to repurchase. The overall decrease in interest expense was primarily due to a net decrease in rate offset by a net increase in volume as discussed below:

Increase in volume: Average interest-bearing liabilities increased $1.54 billion in 2008, due primarily to the growth of time deposits of $678.5 million, securities sold under agreement to repurchase of $612.6 million, and FHLB advances and other borrowings of $167.3 million.

Decline in rate: As a result of the declining interest rate environment during 2008, the average cost of interest bearing liabilities decreased 86 basis points from 4.21% in 2007 to 3.35% in 2008.

Change in the mix of interest-bearing liabilities: Average interest bearing deposits of $5.86 billion decreased to 66.6% of total interest-bearing liabilities in 2008 compared to 70.6% in 2007, due primarily to increases in securities under agreement to repurchase. In addition, average FHLB advances and other borrowing of $1.18 billion decreased to 13.4% of total interest-bearing liabilities in 2008 compared to 13.9% in 2007. Offsetting these decreases, average securities under agreement to repurchase of $1.55 billion increased to 17.7% of total interest-bearing liabilities in 2008 compared to 13.0% in 2007.

Table of Contents

Our taxable-equivalent net interest margin, defined as taxable-equivalent net interest income to average interest-earning assets, decreased 72 basis points to 2.95% in 2008 from 3.67% in 2007 primarily resulting from the lag in the downward repricing of certificates of deposit following the decreases in the prime rate, the increase in the borrowing rate on our long term repurchase agreements and smaller decreases in rates paid on core deposits and other borrowed funds compared to the decreases in the prime rate. The majority of our variable rate loans contain interest rate floors, which help limit the impact of the recent decreases in the prime interest rate.

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

	2009 Average Balance	Interest Income/ Expense (4)	Average Yield/ Rate (1)(2)	2008 Average Balance	Interest Income/ Expense (4)	Average Yield/ Rate (1)(2)	2007 Average Balance	Interest Income/ Expense (4)	A
	(Dollars in thousands)								
rning									
al	$ 1,464,696	$ 69,648	4.76%	$ 1,562,775	$ 86,056	5.51%	$ 1,304,862	$ 104,262	
l	829,418	43,742	5.27	738,923	42,124	5.70	611,200	38,043	
al	4,133,061	251,343	6.08	4,019,448	269,232	6.70	3,482,083	268,467	
n	819,746	36,339	4.43	870,410	53,748	6.18	745,164	68,639	
s and	19,333	759	3.93	23,133	1,056	4.56	27,196	1,358	
leases	7,266,254	401,831	5.53	7,214,689	452,216	6.27	6,170,505	480,769	
	3,216,516	123,939	3.85	2,460,181	115,890	4.71	1,800,930	100,663	
pt 3)	18,996	1,212	6.38	50,520	4,155	8.22	61,932	4,031	
k	71,798	149	0.21	66,025	3,301	5.00	50,293	2,348	
nds urities under to	58,482	1,351	2.31	234,896	15,017	6.39	318,778	24,309	
aring	174,939	673	0.38	14,631	656	4.48	62,101	4,489	
rnings	$ 10,806,985	$ 529,155	4.90	$ 10,040,942	$ 591,235	5.89	$ 8,464,539	$ 616,609	
st sets									
ue s	111,736			85,928			89,109		
g	803,789			700,737			635,976		

st ets		915,525			786,665			725,085	
wance sses		(168,530)			(81,066)			(66,192)	
oan		(9,173)			(10,411)			(11,761)	
ts	$	11,544,807			$ 10,736,130			$ 9,111,671	
aring									
aring		295,770	1,059	0.36	255,185	1,544	0.61	232,114	2,823
rket		890,427	13,233	1.49	736,739	13,581	1.84	699,606	21,531
		338,781	799	0.24	334,222	1,188	0.36	344,066	3,258
sits		5,084,309	118,465	2.33	4,530,923	161,397	3.56	3,852,468	181,891
aring		6,609,287	133,556	2.02	5,857,069	177,710	3.03	5,128,254	209,503
nds		8,392	23	0.27	40,128	903	2.25	32,190	1,612
sold ement ase		1,562,447							

Business Combinations and Dispositions

See Notes 4 and 5 to the Consolidated Financial Statements for a discussion of Gallagher s 2009 business combinations and its 2009 and 2008 dispositions, respectively.

Results of Operations

In the discussion that follows regarding Gallagher s results of operations, Gallagher provides organic growth percentages with respect to its commission and fee revenues. This information may be considered a non-GAAP financial measure because it is derived from Gallagher s consolidated financial information but is not required to be presented in financial statements that are prepared in conformity with GAAP. Rules and regulations of the Securities and Exchange Commission (SEC) require supplemental explanations and reconciliations of all non-GAAP financial measures. When Gallagher refers to organic growth percentages with respect to its commission and fee revenues in its discussion of results of operations, Gallagher excludes the first twelve months of net commission and fee revenues generated from the acquisitions and the net commission and fee revenues related to operations disposed of in each year presented. These commissions and fees are excluded from organic revenues in order to determine the revenue growth that is associated with the operations that were part of Gallagher in both the current and prior year. In addition, organic growth excludes contingent commission revenues and foreign currency translation. These revenue items are excluded from organic revenues in order to determine a comparable measurement of revenue growth that is associated with the revenue sources that will be continuing in 2009 and beyond. Management has historically utilized organic revenue growth as an important indicator when assessing and evaluating the performance of its Brokerage and Risk Management Segments. Management also believes that the use of this measure allows financial statement users to measure, analyze and compare the growth from its Brokerage and Risk Management Segments in a meaningful and consistent manner. A reconciliation of organic revenue growth percentages to the reported revenue growth percentages for the Brokerage and Risk Management Segments is presented in the paragraphs immediately following each table in which such percentages are presented.

In the discussion that follows regarding Gallagher s results of operations, Gallagher provides the following ratios with respect to its operating results: pretax profit margin, compensation expense ratio and operating expense ratio. Pretax profit margin represents pretax earnings from continuing operations divided by total revenues. The compensation expense ratio is derived by dividing compensation expense by total revenues. The operating expense ratio is derived by dividing operating expense by total revenues.

Brokerage

The Brokerage Segment accounted for 74% of Gallagher s revenue during the six-month period ended June 30, 2009. Gallagher s Brokerage Segment is primarily comprised of retail and wholesale brokerage operations. Gallagher s retail brokerage operations negotiate and place P/C, employer-provided health and welfare insurance and retirement solutions, principally for middle-market commercial, industrial, public entity, religious and not-for-profit entities. Many of Gallagher s retail brokerage customers choose to

- 35 -

Table of Contents

place their insurance with insurance underwriters, while others choose to use alternative vehicles such as self-insurance pools, risk retention groups or captive insurance companies. In addition, Gallagher s wholesale brokerage operations assist Gallagher brokers and other unaffiliated brokers and agents in the placement of specialized, unique and hard to place insurance programs.

The primary source of Gallagher s compensation for its retail brokerage services is commissions paid by insurance companies, which are usually based upon a percentage of the premium paid by insureds and brokerage and advisory fees paid directly by its clients. For wholesale brokerage services, Gallagher generally receives a share of the commission paid to the retail broker from the insurer. Commission rates are dependent on a number of factors, including the type of insurance, the particular insurance company underwriting the policy and whether Gallagher acts as retail or wholesale broker. Advisory fees are dependent on the extent and value of services provided. Under certain circumstances, Gallagher may also receive contingent commissions, which are based on the estimated profit the underwriting insurance company earns and/or the overall volume of business placed by Gallagher in a given period of time.

Financial information relating to Gallagher s Brokerage Segment is as follows (in millions, except percentages and workforce data):

	Three-month period ended June 30, 2009	2008	Percent Change	Six-month period ended June 30, 2009	2008	Percent Change
Commissions	$ 267.6	$ 246.0	9%	$ 500.8	$ 452.3	11%
ees	67.8	58.4	16%	116.9	103.8	13%
nvestment ncome and ther	4.7	7.8	(40%)	11.9	14.1	(16%)
otal evenues	340.1	312.2	9%	629.6	570.2	10%
ompensation	199.5	175.8	13%	381.8	342.9	11%
perating	51.1	56.0	(9%)	102.2	114.7	(11%)
epreciation	4.7	4.7		9.4	8.6	9%
mortization	13.9	10.1	38%	26.1	18.9	38%
hange in stimated cquisition arnout ayables	1.4		NMF	1.4		NMF
otal xpenses	270.6	246.6	10%	520.9	485.1	7%
arnings from ontinuing perations efore income axes	69.5	65.6	6%	108.7	85.1	28%

rovision for ncome taxes	28.0	26.4	6%	43.1	34.0	27%
arnings from ontinuing perations	$ 41.5	$ 39.2	6%	$ 65.6	$ 51.1	28%
rowth - evenues	9%	6%		10%	8%	
rganic rowth decline) in ommissions nd fees	(1%)	0%		(1%)	1%	
ompensation xpense ratio	59%	56%		61%	60%	
perating xpense ratio	15%	18%		16%	20%	
retax profit nargin	20%	21%		17%	15%	
ffective tax ate	40%	40%		40%	40%	
Vorkforce at nd of period ncludes cquisitions)				6,076	5,440	
dentifiable ssets at June 0				$ 2,734.0	$ 2,663.3	

The aggregate increase in commissions and fees for the three-month period ended June 30, 2009 compared to the same period in 2008 was primarily due to revenues associated with acquisitions that were made in the last twelve months ($41.6 million), partially offset by negative organic growth from existing operations. New business production in commission and fees was $26.1 million in 2009, which was offset by renewal rate decreases and lost business of $38.0 million. Commissions increased 9% and fees increased 16% in the three-month period ended June 30, 2009 compared to the same period in 2008. Organic commission and fee revenues for the three-month period ended June 30, 2009 declined 1.2% compared to the same period in 2008. The aggregate increase in

Table of Contents

commissions and fees for the six-month period ended June 30, 2009 compared to the same period in 2008 was primarily due to revenues associated with acquisitions that were made in the last twelve months ($79.6 million), partially offset by negative organic revenue growth from existing operations. New business production in commission and fees was $65.5 million in 2009, which was offset by renewal rate decreases and lost business of $90.2 million. Commissions increased 11% and fees increased 13% in the six-month period ended June 30, 2009 compared to the same period in 2008. Organic commission and fee revenue for the six-month period ended June 30, 2009 declined 1.3% compared to the same period in 2008.

Items excluded from organic revenue growth computations yet impacting revenue comparisons for the three-month periods ended June 30, 2009 and 2008 include the following (in millions):

	2009 Organic Revenue		2008 Organic Revenue	
	2009	2008	2008	2007
Total revenues as reported	$ 340.1	$ 312.2	$ 312.2	$ 294.6
Adjustments to revenues:				
Gains realized from books of business sales	(3.3)	(3.5)	(3.5)	(0.9)
Investment income	(1.4)	(4.3)	(4.3)	(6.1)
Retail contingent commissions related to acquisitions	(4.4)	(3.3)	(3.3)	(2.2)
MGA/MGU performance income	(1.9)	(1.7)	(1.7)	(0.9)
Revenues from acquisitions in the last twelve months	(41.6)		(23.0)	
Revenues related to divestitures in the last twelve months		(3.3)		(7.4)
Levelized foreign currency translation		(5.0)		0.3
Total revenue adjustments	(52.6)	(21.1)	(35.8)	(17.2)
Organic revenues	$ 287.5	$ 291.1	$ 276.4	$ 277.4
Organic revenue growth	-1.2%		-0.4%	

Items excluded from organic revenue growth computations yet impacting revenue comparisons for the six-month periods ended June 30, 2009 and 2008 include the following (in millions):

	2009 Organic Revenue		2008 Organic Revenue	
	2009	2008	2008	2007
	$ 629.6	$ 570.2	$ 570.2	$ 527.4

Total revenues as reported				
Adjustments to revenues:				
Gains realized from books of business sales	(9.4)	(5.2)	(5.2)	(2.1)
Investment income	(2.5)	(8.9)	(8.9)	(11.0)
Retail contingent commissions related to acquisitions	(11.7)	(7.3)	(7.3)	(3.0)
MGA/MGU performance income	(11.5)	(9.2)	(9.2)	(5.5)
Revenues from acquisitions in the last twelve months	(79.6)		(42.2)	
Revenues related to divestitures in the last twelve months		(9.4)		(12.2)
Levelized foreign currency translation		(8.4)		0.8
Total revenue adjustments	(114.7)	(48.4)	(72.8)	(33.0)
Organic revenues	$ 514.9	$ 521.8	$ 497.4	$ 494.4
Organic revenue growth	-1.3%		0.6%	

Investment income and other primarily represents interest income earned on cash and restricted funds and one-time gains related to sales of small books of business. The decrease in investment income and other in the three-month and six-month periods ended June 30, 2009 compared to the same period in 2008 was primarily due to a decrease in interest income earned on cash and restricted funds due to lower market yield and safer investment vehicles (i.e., non-interest bearing accounts). In fourth quarter 2008, Gallagher

Table of Contents

decided to move substantially all of its invested funds from interest bearing to non-interest bearing Federal government guaranteed accounts. One-time gains related to sales of books of business for the three-month period ended June 30, 2009 were $3.3 million compared to $3.5 million for the same period in 2008. One-time gains related to sales of books of business for the six-month period ended June 30, 2009 were $9.4 million compared to $5.2 million for the same period in 2008.

The increase in compensation expense for the three-month period ended June 30, 2009 compared to the same period in 2008 was primarily due to an increase in the average number of employees, salary increases, one-time compensation payments and increases in incentive compensation linked to Gallagher s overall operating results ($19.1 million in the aggregate) and an increase in employee benefits expense ($5.6 million), partially offset by decreases in temporary-help expense ($0.6 million) and stock compensation expense ($0.4 million). The increase in compensation expense for the six-month period ended June 30, 2009 compared to the same period in 2008 was primarily due to an increase in the average number of employees, salary increases, one-time compensation payments and increases in incentive compensation linked to Gallagher s overall operating results ($32.4 million in the aggregate) and an increase in employee benefits expense ($9.4 million), partially offset by decreases in stock compensation ($1.7 million) and temporary-help expense ($1.2 million). The increase in employee headcount in 2009 relates to the addition of employees associated with the acquisitions that were made in the last twelve months.

The decrease in operating expenses for the three-month period ended June 30, 2009 was due primarily to decreases in travel and entertainment ($2.3 million), foreign currency translation ($1.6 million), professional fees ($1.4 million), sales development ($1.2 million) and business insurance ($0.5 million), partially offset by an increase in net rent and utilities ($0.6 million). Also, partially offsetting the decrease in operating expenses in the three-month period ended June 30, 2009 were increased expenses associated with the acquisitions completed in the last twelve months. The decrease in operating expenses for the six-month period ended June 30, 2009 was due primarily to decreases in travel and entertainment ($5.1 million), sales development ($3.5 million), professional fees ($3.3 million) and business insurance ($0.7 million), partially offset by an increase in net rent and utilities ($0.6 million). Also, partially offsetting the decrease in operating expenses in the six-month period ended June 30, 2009 were increased expenses associated with the acquisitions completed in the last twelve months.

Depreciation expense remained unchanged in the three-month period ended June 30, 2009 compared to the same period in 2008. The increase in depreciation expense in the six-month period ended June 30, 2009 compared to the same period in 2008 was due primarily to the acquisitions completed in the last twelve months.

The increases in amortization expense in both the three-month and six-month periods ended June 30, 2009 compared to the same periods in 2008 were due primarily to amortization expense of intangible assets associated with acquisitions completed in the last twelve months. Expiration lists and non-compete agreements are amortized using the straight-line method over their estimated useful lives (five to fifteen years for expiration lists and five years for non-compete agreements).

The change in estimated acquisition earnout payable expense as reported in both the three-month and six-month periods ended June 30, 2009 compared to the same periods in 2008 was due to the adoption of SFAS 141(R), which was effective January 1, 2009 for acquisitions completed in 2009. During the three-month and six-month periods ended June 30, 2009, Gallagher recognized $1.4 million of expense in its Consolidated Statement of Earnings related to accretion of the discount related to its 2009 recorded earnout obligations.

The Brokerage Segment s effective tax rates for the three-month periods ended June 30, 2009 and 2008 were 40.3% and 40.2%, respectively. The Brokerage Segment s effective tax rates for the six-month periods ended June 30, 2009 and 2008 were 39.7% and 40.0%, respectively. See the Results of Operations for the Financial Services and Corporate Segment for a discussion on the overall effective income tax rate in 2009 compared to 2008.

Table of Contents

Risk Management

The Risk Management Segment accounted for 26% of Gallagher s revenue from continuing operations during the six-month period ended June 30, 2009. The Risk Management Segment provides contract claim settlement and administration services for enterprises that choose to self-insure some or all of their P/C coverages and for insurance companies that choose to outsource some or all of their P/C claims departments. In addition, Gallagher generates revenues from integrated disability management programs, information services, risk control consulting (loss control) services and appraisal services, either individually or in combination with arising claims. This Segment s revenues for risk management services are in the form of fees that are generally negotiated in advance on a per-claim or per-service basis, depending upon the type and estimated volume of the services to be performed.

Financial information relating to Gallagher s Risk Management Segment is as follows (in millions, except percentages and workforce data):

	Three-month period ended June 30, 2009	Three-month period ended June 30, 2008	Percent Change	Six-month period ended June 30, 2009	Six-month period ended June 30, 2008	Percent Change
Fees	$ 113.0	$ 114.1	(1%)	$ 224.8	$ 229.2	(2%)
Investment income and other	0.3	1.1	(73%)	0.7	2.2	(68%)
Total revenues	113.3	115.2	(2%)	225.5	231.4	(3%)
Compensation	69.9	70.4	(1%)	138.0	140.5	(2%)
Operating	27.0	29.2	(8%)	53.6	58.4	(8%)
Depreciation	2.8	3.2	(13%)	5.8	6.2	(6%)
Amortization	0.2	0.2		0.4	0.3	33%
Total expenses	99.9	103.0	(3%)	197.8	205.4	(4%)
Earnings from continuing operations before income taxes	13.4	12.2	10%	27.7	26.0	7%
Provision for income taxes	5.5	4.8	15%	11.1	10.1	10%
Earnings from continuing operations	$ 7.9	$ 7.4	7%	$ 16.6	$ 15.9	4%
Growth - revenues	(2%)	7%		(3%)	8%	

Organic growth in fees	2%	5%	2%	6%
Compensation expense ratio	62%	61%	61%	61%
Operating expense ratio	24%	25%	24%	25%
Pretax profit margin	12%	11%	12%	11%
Effective tax rate	41%	39%	40%	39%
Workforce at end of period (includes acquisitions)			3,862	3,892
Identifiable assets at June 30			$ 393.5	$ 367.8

The decrease in fees for the three-month period ended June 30, 2009 compared to the same period in 2008 was due primarily to lost business and the impact of decreased claim counts of $11.2 million, which were partially offset by new business of $10.1 million. Organic fee revenues for the three-month period ended June 30, 2009 increased 2.2% compared to 2008. The decrease in fees for the six-month period ended June 30, 2009 compared to the same period in 2008 was due primarily to lost business and the impact of decreased claim counts of $22.5 million, which were partially offset by new business of $18.1 million. Organic fee revenue for the six-month period ended June 30, 2009 increased 1.8% compared to 2008. Historically, the Risk Management Segment has made few acquisitions, and these acquisitions have not been material to this Segment s operations.

Table of Contents

Items excluded from organic revenue growth computations yet impacting revenue comparisons for the three-month periods ended June 30, 2009 and 2008 include the following (in millions):

	2009 Organic Revenue 2009	2008	2008 Organic Revenue 2008	2007
Total revenues as reported	$ 113.3	$ 115.2	$ 115.2	$ 107.8
Adjustments to revenues:				
Investment income	(0.3)	(1.1)	(1.1)	(0.8)
Levelized foreign currency translation		(3.5)		1.5
Total revenue adjustments	(0.3)	(4.6)	(1.1)	0.7
Organic revenues	$ 113.0	$ 110.6	$ 114.1	$ 108.5
Organic revenue growth	2.2%		5.2%	

Items excluded from organic revenue growth computations yet impacting revenue comparisons for the six-month periods ended June 30, 2009 and 2008 include the following (in millions):

	2009 Organic Revenue 2009	2008	2008 Organic Revenue 2008	2007
Total revenues as reported	$ 225.5	$ 231.4	$ 231.4	$ 214.6
Adjustments to revenues:				
Investment income	(0.7)	(2.2)	(2.2)	(1.7)
Levelized foreign currency translation		(8.3)		3.3
Total revenue adjustments	(0.7)	(10.5)	(2.2)	1.6
Organic revenues	$ 224.8	$ 220.9	$ 229.2	$ 216.2
Organic revenue growth	1.8%		6.0%	

Investment income and other primarily represents interest income earned on Gallagher s cash and cash equivalents. The decreases in investment income in both the three-month and six-month periods ended June 30, 2009 compared to the same periods in 2008 are due to lower market yield and safer investment vehicles (i.e., non-interest bearing accounts). In fourth quarter 2008, Gallagher decided to move substantially all of its invested funds from interest bearing to non-interest bearing Federal government guaranteed accounts.

The decrease in compensation expense for the three-month period ended June 30, 2009 compared to the same period in 2008 was primarily due to the impact of foreign currency translation ($2.2

million) and decreased temporary-help costs ($0.8 million), partially offset by increases in salaries ($1.4 million) and employee benefits ($1.1 million). The decrease in compensation expense for the six-month period ended June 30, 2009 compared to the same period in 2008 was primarily due to the impact of foreign currency translation ($5.1 million), decreased headcount and decreased temporary-help costs ($1.8 million), partially offset by increases in salaries ($2.5 million) and employee benefits ($1.9 million).

The decrease in operating expenses for the three-month period ended June 30, 2009 compared to the same period in 2008 was primarily due to decreases in employee direct expense ($1.2 million), office expense ($1.2 million), travel and entertainment expense ($0.6 million), and net rent and utilities ($0.6 million), partially offset by an increase in business insurance ($1.7 million) and foreign currency translation ($0.6 million). The decrease in operating expenses for the six-month period ended June 30, 2009 compared to the same period in 2008 was primarily due to decreases in employee direct expense ($2.4 million), office expense ($1.6 million), travel and entertainment expense ($1.2 million) and bad debt expense ($0.6 million), partially offset by an increase in business insurance ($1.3 million) and foreign currency translation ($0.9 million).

Table of Contents

Depreciation expense remained relatively unchanged in both the three-month and six-month periods ended June 30, 2009 compared to the same periods in 2008 and reflects the net impact of purchases of furniture, equipment and leasehold improvements related to office expansions and moves and expenditures related to upgrading computer systems, less disposals.

Amortization expense was unchanged in both the three-month and six-month periods ended June 30, 2009 compared to the same periods in 2008. Historically, the Risk Management Segment has made few acquisitions, and no acquisitions were made by this Segment for the six-month period ended June 30, 2009.

The Risk Management Segment s effective tax rates for the three-month periods ended June 30, 2009 and 2008 were 41.0% and 39.3%, respectively. The Risk Management Segment s effective tax rates for the six-month periods ended June 30, 2009 and 2008 were 40.1% and 38.8%, respectively. See the Results of Operations for the Financial Services and Corporate Segment for a discussion on changes in the overall effective income tax rate in 2009 compared to 2008.

Financial Services and Corporate

The Financial Services and Corporate Segment manages Gallagher s interests in tax-advantaged and clean energy investments, venture capital funds and its equity ownership position in an alternative investment fund manager. This segment also holds all of Gallagher s corporate debt. Operations of the Financial Services and Corporate Segment are located in Itasca, Illinois. The Financial Services and Corporate Segment also includes interest on Gallagher s $400.0 million Note Purchase Agreement and borrowings made under Gallagher s unsecured multicurrency credit agreement. See Note 3 to the Consolidated Financial Statements for a summary of Gallagher s investments as of June 30, 2009 and December 31, 2008 and a discussion of the nature of the investments held. See Note 6 to the Consolidated Financial Statements for a summary of Gallagher s debt as of June 30, 2009 and December 31, 2008.

Financial information relating to Gallagher s Financial Services and Corporate Segment is as follows (in millions):

	Three-month period ended June 30,		Six-month period ended June 30,	
	2009	2008	2009	2008
Investment income (loss):				
Asset Alliance Corporation	$	$ (0.2)	$	$ (0.2)
Alternative energy		2.0	0.4	3.8
Real estate and venture capital	0.1	(0.1)	0.1	(0.3)
Total investment income	0.1	1.7	0.5	3.3
Investment gains (losses)	0.1	(0.2)	(0.9)	(0.2)
Total revenues	0.2	1.5	(0.4)	3.1

Investment expenses:				
Alternative energy	0.6	(0.5)	1.1	(1.8)
Compensation, professional fees and other	1.4	3.2	3.0	6.0
Total investment expenses	2.0	2.7	4.1	4.2
Interest	7.0	7.3	14.3	13.8
Total expenses	9.0	10.0	18.4	18.0
Loss from continuing operations before income taxes	(8.8)	(8.5)	(18.8)	(14.9)
Benefit for income taxes	(3.2)	(3.6)	(8.7)	(5.9)
Loss from continuing operations	$ (5.6)	$ (4.9)	$ (10.1)	$ (9.0)
Identifiable assets at June 30			$ 525.0	$ 478.4

Table of Contents

Investment income from Asset Alliance Corporation (AAC) is primarily derived from Gallagher s investments in common stock and preferred stock of AAC. Gallagher accounts for the common stock portion of its investment using equity method accounting and recognizes dividend income on its preferred stock investment as such income is earned.

Investment income from alternative energy investments in 2008 represents adjustments made, based on the actual factor published by the IRS in April 2008, to the estimated installment sale gains recorded in 2007. In 2009, the amount represents revenues generated by Chem-Mod for test burns at coal-fired power plants.

Income from real estate and venture capital investments primarily represents Gallagher s portion of the income and losses of these entities that are accounted for using equity method accounting.

Investment gains in the three-month period ended June 30, 2009 primarily represents a gain on the sale of one of Gallagher s low income housing properties. The loss for the six-months ended June 30, 2009 primarily represents the impairment loss which was the result of the estimated sales value for Gallagher s remaining interest in AAC.

Investment expenses include the operating expenses of the alternative energy investments. The 2008 credits represent adjustments made, based on the actual phase-out factor published by the IRS in April 2008, to the estimated amounts recorded in 2007. The 2009 amounts primarily represent the operating expenses related to Chem-Mod operations including test burns at coal-fired power plants and professional fees related to clean energy initiatives.

The decreases in investment expenses related to compensation, professional fees and other expenses in the three-month and six-month periods ended June 30, 2009 compared to the same periods in 2008 were primarily due to reductions in salaries, benefits and incentive compensation.

The decrease in interest expense in the three-month period ended June 30, 2009 compared to the same period in 2008 was primarily due to interest rate reductions on the outstanding borrowings, substantially offset by increased borrowing made under Gallagher s Credit Agreement. The increase in interest expense in the six-month period ended June 30, 2009 compared to the same period in 2008 was primarily due to increased borrowings substantially offset by interest rate reductions on the outstanding borrowings under Gallagher s Credit Agreement.

Gallagher s consolidated effective tax rate for the three-month period ended June 30, 2009 was 40.6% compared to 39.8% for the same period in 2008. Gallagher s consolidated effective tax rate for the six-month period ended June 30, 2009 was 38.5% compared to 39.7% for the same period in 2008. The first and second quarter 2008 tax rates were lower than the statutory rates as the result of the resolution of certain matters related to prior years. The consolidated effective tax rates for the six-month periods ended June 30, 2009 and 2008 were lower than the statutory rates as the result of the resolution of certain matters related to prior years. Gallagher s consolidated effective tax rate in 2009 and future years will likely approximate 40.0% to 42.0%. Gallagher also anticipates reporting an effective tax rate of approximately 40.0% to 42.0% in both its Brokerage Segment and its Risk Management Segment for the foreseeable future.

Gallagher is an investor in two privately-owned clean energy ventures.

Chem-Mod, a multi-pollutant reduction venture, possesses rights, information and technology for the reduction of unwanted emissions created during the combustion of coal. Chem-Mod has developed and is the exclusive licensee of a new proprietary emissions technology it refers to as The Chem-Mod Solution, which uses a dual injection sorbent system to reduce mercury, sulfur dioxide and other toxic emissions at coal-fired power plants. Although Chem-Mod is in the early stages of commercializing the technology, the principal potential market for The Chem-Mod Solution is coal-fired power plants owned by utility companies. Effective August 2008, Gallagher has a 42% direct and indirect ownership interest in Chem-Mod and is required to consolidate its operations into Gallagher s Consolidated Financial Statements. Prior to August 2008, this investment was accounted for using equity method accounting. In addition, Gallagher, through a wholly-owned subsidiary, owns a 20% direct equity interest in Chem-Mod International LLC, the exclusive licensee of The Chem-Mod Solution on a global basis, excluding the U.S. and Canada. Chem-Mod continues to test and market its technology in an effort to secure more commercial licenses. While Gallagher currently believes that its Chem-Mod interests may prove to have substantial value, there can be no assurance given as to timing or amount, if any, with respect to any realization on this investment.

Table of Contents

Gallagher believes that The Chem-Mod Solution qualifies for refined coal tax credits under IRC Section 45. Management has the authorization to invest up to $15.0 million in capital expenditures to develop production plants that will have the ability to produce refined coal. In order to qualify for tax credits under IRC Section 45, these plants must be placed in service by December 31, 2009 and meet certain other requirements. Certain utilities have expressed an interest in using The Chem-Mod Solution and Gallagher has committed to capital expenditures of approximately $4.0 million in the third quarter of 2009 to build the first facility. If other utilities express interest in using The Chem-Mod Solution, Gallagher is prepared to make additional capital expenditures of $10.0 million to $12.0 million in the third and fourth quarters of 2009 to build additional facilities. The IRS is expected to issue guidance by September 1, 2009, which will further clarify the requirements of IRC Section 45. While Gallagher believes that the production plants will qualify for tax credits, there can be no assurance that Gallagher will be able to meet the requirements of IRC Section 45 or that Gallagher s investments will produce value.

C-Quest possesses rights, information and technology for the reduction of carbon dioxide emissions created by burning fossil fuels. Gallagher, through a wholly-owned subsidiary, currently owns a 5% direct equity interest in C-Quest and has an option to acquire an additional 22% direct interest in C-Quest. In addition, Gallagher, through a wholly-owned subsidiary, currently owns a 5% direct equity interest in C-Quest International, and has an option to acquire an additional 22% direct interest in C-Quest International, which possesses rights to use information and technology of C-Quest on a global basis, excluding the U.S. and Canada. Gallagher s options to acquire the additional 22% direct interest in C-Quest and C-Quest International are exercisable at any time on or prior to April 18, 2010 at an exercise price of $5.5 million for each option ($11.0 million total). While Gallagher currently believes that its C-Quest interests may prove to have substantial value, there can be no assurance given as to timing or amount, if any, with respect to any realization on this investment.

Financial Condition and Liquidity

Liquidity describes the ability of a company to generate sufficient cash flows to meet the cash requirements of its business operations. The insurance brokerage industry is not capital intensive. Historically, Gallagher s capital requirements have primarily included dividend payments on its common stock, repurchases of its common stock, funding of its investments, acquisitions of brokerage and risk management operations and capital expenditures.

Historically, Gallagher has depended on its ability to generate positive cash flow from operations to meet its cash requirements. However, to fund acquisitions made in the six-month periods ended June 30, 2009 and 2008, Gallagher relied to a large extent on proceeds from borrowings under its Credit Agreement and the issuance of Gallagher s common stock for the 2009 acquisitions. Management believes that Gallagher will have adequate resources to meet its liquidity needs in the foreseeable future.

Cash Flows From Operating Activities

Cash provided by operating activities was $77.6 million and $19.0 million for the six-month periods ended June 30, 2009 and 2008, respectively. The increase in cash provided by operating activities in 2009 compared to 2008 was primarily due to decreases in incentive compensation payments and income tax payments. Gallagher s cash flows from operating activities are primarily derived from its earnings from continuing operations, as adjusted for realized gains and losses and its noncash expenses, which include depreciation, amortization, deferred compensation, restricted stock and stock-based compensation expenses.

Gallagher anticipates that any contingent commission matters in 2009 will be funded by net cash flows from operating activities and the residual funds from the AVC. If net cash flows from operating activities do not provide the necessary cash flow to cover the contingent commission matters, then Gallagher may use borrowings under its Credit Agreement to meet its short-term cash flow needs.

When assessing the overall liquidity of Gallagher, the focus should be on earnings from continuing operations, adjusted for non-cash items, in the Consolidated Statement of Earnings and cash flows from operating activities in the Consolidated Statement of Cash Flows as indicators of trends in liquidity. From a balance sheet perspective, the focus should not be on premium and fees receivable, premiums payable or restricted cash for trends in liquidity. Because of the variability in the timing of premiums and fees receivable and premiums payable, net cash flows provided by operations will vary substantially from quarter-to-quarter and year-to-year related to these items. In order to consider these items in assessing trends in liquidity for Gallagher, they should be looked at in a combined manner, because changes in these balances are interrelated and are based on the timing of premium payments, both to and from Gallagher. In addition, funds legally restricted as to Gallagher s use relating to premiums and clients claim funds held as fiduciary funds are presented in Gallagher s Consolidated Balance Sheet as Restricted Cash and have not been included in determining Gallagher s overall liquidity.

- 43 -

Table of Contents

Gallagher s policy for funding its defined benefit pension plan is to contribute amounts at least sufficient to meet the minimum funding requirements under the IRC. There currently is no ERISA funding requirement for the plan in 2009. Contribution rates are determined by the plan s actuaries based on funding practices and requirements. Funding amounts may be influenced by future asset performance, the level of discount rates and other variables impacting the assets and/or liabilities of the plan. In addition, amounts funded in the future, to the extent not due under regulatory requirements, may be affected by alternative uses of Gallagher s cash flows, including dividends, acquisitions and common stock repurchases. During the six-month period ended June 30, 2009, Gallagher contributed $1.0 million to the plan. During the six-month period ended June 30, 2008, Gallagher did not make any contributions to the plan. While no minimum contribution is required to be made to the plan in 2009, Gallagher is considering making additional contributions to the plan in 2009 and may be required to make contributions to the plan in future periods.

Gallagher recognizes in its Consolidated Balance Sheet an asset for its defined benefit postretirement plans overfunded status or a liability for its plans underfunded status. Gallagher recognizes changes in the funded status of its defined benefit postretirement plans in comprehensive earnings in the year in which the changes occur. See Notes 15 and 16 to the Consolidated Financial Statements included in Gallagher s Annual Report on Form 10-K for the year ended December 31, 2008 for additional information required to be disclosed related to its defined benefit postretirement plans. GAAP requires that Gallagher recognize an accrued benefit plan liability for its underfunded defined benefit pension and unfunded retiree medical plans (the Plans). The offsetting adjustment to the amount of liabilities required to be recognized is recorded in Accumulated Other Comprehensive Loss, net of tax, in Gallagher s Consolidated Balance Sheet. Subsequent changes in the funded status will be recognized through the income statement and other comprehensive income in the year in which they occur as appropriate. The change in funded status of the Plans is impacted by numerous items, including actual results compared with prior estimates and assumptions and changes in assumptions to reflect information available at the respective measurement dates. In 2008, the funded status of Gallagher s Plans was significantly impacted by an increase in the discount rates used in the measurement of the pension liabilities at December 31, 2008, reflecting an increase in credit costs on high quality corporate debt obligations and negative asset returns. The change in funded status of the Plans resulted in a reduction in noncurrent assets of $14.8 million and an increase in noncurrent liabilities of $56.1 million, including a related adjustment to tax benefits of $28.7 million and a reduction of Gallagher s stockholders equity of $42.2 million in 2008. While the change in funded status of the Plans had no impact on Gallagher s cash flows from operations in 2009 or 2008, changes in the pension regulatory environment and investment losses in its pension plan have an effect on Gallagher s capital position and could require Gallagher to make significant contributions to its defined benefit pension plan and increase its pension expense in future periods.

Cash Flows From Financing Activities

At June 30, 2009, Gallagher had $400.0 million of corporate related borrowings outstanding under its Note Purchase Agreement and a cash and cash equivalent balance of $226.1 million. See Note 6 to the Consolidated Financial Statements for a discussion of the terms of the Note Purchase Agreement. Gallagher also has a $450.0 million Credit Agreement it uses from time-to-time to borrow funds to supplement operating cash flows. There were $193.0 million of borrowings outstanding under the Credit Agreement at June 30, 2009. Due to outstanding letters of credit and borrowings, $242.9 million remained available for potential borrowings under the Credit Agreement at June 30, 2009. The Credit Agreement expires on October 4, 2010.

In the six-month period ended June 30, 2009, Gallagher borrowed and repaid $105.0 million and $44.0 million, respectively, under the Credit Agreement. Principal uses of the 2009 borrowings under the Credit Agreement were to fund acquisitions completed in 2009, earnout payments related to acquisitions completed prior to 2009 and general corporate purposes. In the six-month period ended June 30, 2008, Gallagher borrowed and repaid $134.0 million and $29.0 million, respectively, under the Credit Agreement. Principal uses of the 2008 borrowings under the Credit Agreement were to fund acquisitions and earnout payments related to acquisitions completed prior to 2008.

Table of Contents

The Note Purchase Agreement and the Credit Agreement contain various financial covenants that require Gallagher to maintain specified levels of net worth and financial leverage ratios. Gallagher was in compliance with these covenants at June 30, 2009.

Unprecedented disruptions in the current credit and financial markets, particularly in the U.S. and Europe, have had a significant material adverse impact on a number of financial institutions and have limited access to capital and credit for many companies. These disruptions could make it more difficult for Gallagher to obtain financing for its operations or investments or increase its cost of obtaining financing.

Although Gallagher is not currently experiencing any limitation of access to its revolving credit facility and is not aware of any issues currently impacting the ability or willingness of the lenders under its revolving credit facility to honor their commitments to extend credit, the U.S. and global credit crisis could adversely affect its ability to borrow on its revolving credit facility in the future.

Gallagher also has a significant amount of trade accounts receivable from some of the insurance companies with which it places insurance. If those insurance companies experience liquidity problems or other financial difficulties, Gallagher could encounter delays or defaults in payments owed to Gallagher, which could have a significant adverse impact on Gallagher s consolidated financial condition and result of operations.

See Part I, Item 1A, Risk Factors, included in Gallagher s Annual Report on Form 10-K for the year ended December 31, 2008 for additional information.

Dividends - Gallagher s dividend policy is determined by the Board of Directors. Dividends are declared on a quarterly basis by the Board of Directors after consideration of Gallagher s available cash from earnings, its anticipated cash needs and current conditions in the economy and financial markets.

In the six-month period ended June 30, 2009, Gallagher declared $64.8 million in cash dividends on its common stock, or $.32 per common share. On July 15, 2009, Gallagher paid a second quarter dividend of $.32 per common share to shareholders of record at June 30, 2009. If the dividend is maintained at $.32 per common share throughout 2009, this dividend level would result in an annualized net cash used by financing activities in 2009 of approximately $129.6 million (based on the number of outstanding shares as of June 30, 2009) or an increase in cash used of approximately $11.0 million compared to 2008.

Common Stock Repurchases - Gallagher has a common stock repurchase plan that has been approved by the Board of Directors. Gallagher did not repurchase shares under the plan during the six-month periods ended June 30, 2009 and 2008. Repurchased shares are generally held for reissuance in connection with Gallagher s equity compensation and stock option plans. Under the provisions of the repurchase plan, as of June 30, 2009, Gallagher was authorized to repurchase approximately 10.0 million additional shares. The plan authorizes the repurchase of Gallagher s common stock at such times and prices as Gallagher may deem advantageous, in transactions on the open market or in privately negotiated transactions. Gallagher is under no commitment or obligation to repurchase any particular amount of common stock, and the share repurchase plan can be suspended at any time at Gallagher s discretion. Funding for share repurchases may come from a variety of sources, including cash from operations, short-term or long-term borrowings under Gallagher s Credit Agreement or other sources. The common stock repurchases reported in the Consolidated Statement of Cash Flows for the six-month period ended June 30, 2009 represent 18,000 shares (at a cost of $0.3 million) that were repurchased by Gallagher from its employees to cover their income tax withholding obligations in connection with 2009 restricted stock distributions. Under these circumstances, Gallagher will withhold the proceeds from the repurchases and remit them to the taxing authorities on the employees behalf to cover their income tax withholding obligations. The common stock repurchases reported in the Consolidated Statement of Cash Flows for the six-month period ended June 30, 2008 represent 46,000 shares (at a cost of $1.1 million) that were repurchased by Gallagher to cover employee income tax withholding obligations in connection with 2008 restricted stock distributions.

Another source of liquidity to Gallagher is the issuance of its common stock pursuant to its stock option and employee stock purchase plans. Proceeds from issuance of common stock under these plans for the six-month periods ended June 30, 2009 and 2008 were $4.5 million and $12.9 million, respectively. Prior to 2009, Gallagher issued stock options under four stock option-based employee compensation plans. In May 2008, all of these plans expired. The options were primarily granted at the fair value of the underlying shares at the date of grant and generally became exercisable at the rate of 10% per year beginning the calendar year after the date of grant. On May 12, 2009, the stockholders of Gallagher approved the 2009 Long-Term Incentive Plan (LTIP).

Table of Contents

All officers, employees and non-employee directors of Gallagher and persons expected to become officers, employees or non-employee directors of Gallagher are eligible to receive awards under the LTIP. Awards include non-qualified and incentive stock options, stock-settled stock appreciation rights, restricted stock, restricted stock units and performance units any or all of which may be made contingent upon the achievement of performance criteria. As of the effective date of the plan, 3.0 million shares of Gallagher s common stock were available for awards granted under the LTIP. In addition, Gallagher has an employee stock purchase plan (ESPP) which allows Gallagher s employees to purchase its common stock at 95% of its fair market value. Prior to January 1, 2009, eligible employees were allowed to purchase its common stock at 85% of its fair market value. For all periods prior to January 1, 2009, Gallagher recognized compensation expense related to the common stock issued under ESPP. Effective January 1, 2009, Gallagher no longer recognizes any compensation expense related to the common stock issued under the ESPP. Proceeds from the issuance of its common stock related to these plans have contributed favorably to net cash provided by financing activities and Gallagher believes this favorable trend will continue in the foreseeable future, but at reduced levels from what occurred historically.

Cash Flows From Investing Activities

Capital Expenditures - Net capital expenditures were $13.5 million and $16.4 million for the six-month periods ended June 30, 2009 and 2008, respectively. In 2009, Gallagher expects total expenditures for capital improvements to be approximately $30.0 million, primarily related to office moves and expansions and updating computer systems and equipment.

Acquisitions - Cash paid for acquisitions, net of cash acquired, was $31.9 million and $131.7 million in the six-month periods ended June 30, 2009 and 2008, respectively. Gallagher completed nine acquisitions and twenty acquisitions in the six-month periods ended June 30, 2009 and 2008, respectively.

During the six-month period ended June 30, 2009, Gallagher issued 1.1 million shares of its common stock related to an acquisition made in December 2008 and recorded in the consolidated financial statements as of December 31, 2008. During the six-month period ended June 30, 2009, Gallagher issued 641,000 shares of its common stock, paid $3.9 million in cash and accrued $0.8 million in current liabilities related to earnout obligations for acquisitions made prior to 2009 and recorded additional goodwill of $11.2 million. During the six-month period ended June 30, 2008, Gallagher paid $5.5 million in cash related to earnout obligations for acquisitions made prior to 2008 and recorded additional goodwill of $3.3 million.

Gallagher s acquisition program has been an important part of it historical growth in revenues and earnings in its Brokerage Segment. While Gallagher intends to continue to seek to complete acquisitions, its ability to do so using cash may be inhibited in light of current conditions in the economy and financial markets, and there can be no assurance that Gallagher s level of acquisition activity and growth from acquisitions will be consistent with past levels.

For a further discussion of risks associated with Gallagher s acquisition activity, see Item 1A, Risk Factors, in Gallagher s Annual Report on Form 10-K for the year ended December 31, 2008.

Dispositions - During 2008, Gallagher signed definitive agreements to sell substantially all of its reinsurance brokerage business. Under the agreements, Gallagher received proceeds of $33.1 million and potential additional contingent proceeds of up to $14.6 million that are based on revenues relating to risks attaching on reinsurance agreements placed in the twelve-month period after the closing dates under the agreements, with the express intention that Gallagher be credited with eighteen months of revenues in respect of any risk attaching in such twelve-month period. These contingent proceeds can be adjusted for any changes (i.e., premium audits) made to the underlying revenues during the thirty-month periods subsequent to the anniversary dates of the agreements. In January 2009, Gallagher signed and closed a definitive agreement to sell all of the remaining run-off obligations of the U.S. reinsurance brokerage operations. Under the agreement, Gallagher transferred restricted cash of $10.7 million, receivables of $128.7 million and liabilities of $139.4 million to the buyer.

During the six-month periods ended June 30, 2009 and 2008, Gallagher sold several small books of business and recognized one-time gains of $9.4 million and $5.2 million, respectively, which approximated the cash proceeds received related to these transactions.

Table of Contents

Contractual Obligations and Commitments

In connection with its investing and operating activities, Gallagher has entered into certain contractual obligations and commitments. See Note 13 to the Consolidated Financial Statements for additional discussion of these obligations and commitments. In addition, see Note 17 to the Consolidated Financial Statements included in Gallagher s Annual Report on Form 10-K for the year ended December 31, 2008 for additional discussion of these obligations and commitments.

Off-Balance Sheet Arrangements

See Notes 3, 6 and 13 to the Consolidated Financial Statements for a discussion of Gallagher s off-balance sheet arrangements. In addition, see Notes 3, 8 and 17 to the Consolidated Financial Statements included in Gallagher s Annual Report on Form 10-K for the year ended December 31, 2008 for additional discussion of these off-balance sheet arrangements.

Information Concerning Forward-Looking Statements

This quarterly report contains forward-looking statements within the meaning of that term in the Private Securities Litigation Reform Act of 1995 (the Act) found at Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). Additional written or oral forward-looking statements may be made by Gallagher from time-to-time in filings with the Securities and Exchange Commission, press releases, its website or otherwise. Statements contained in this report that are not historical facts are forward-looking statements made pursuant to the safe harbor provisions of the Act and the Exchange Act.

Forward-looking statements may include, but are not limited to, discussions concerning revenues, expenses, earnings, cash flow, capital structure, financial losses, as well as market and industry conditions, premium rates, financial markets, interest rates, foreign exchange rates, contingencies and matters relating to Gallagher s operations and income taxes. In addition, when used in this report, the words anticipates, believes, should, estimates, expects, intends, plans and variations thereof and similar expressions are intended to identify forward-looking statements.

Forward-looking statements made by or on behalf of Gallagher are subject to risks and uncertainties, including but not limited to the following: Gallagher s commission revenues are highly dependent on premiums charged by insurers, which are subject to fluctuation; lower interest rates reduce Gallagher s income earned on invested funds; alternative insurance market continues to grow, which could unfavorably impact commission revenue and favorably impact fee revenue, though not necessarily to the same extent; Gallagher s revenues vary significantly from period-to-period as a result of the timing of policy inception dates and the net effect of new and lost business production; the insurance brokerage industry is subject to uncertainty due to investigations into its business practices by various governmental authorities and related private litigation; the general level of economic activity can have a substantial impact on Gallagher s renewal business; Gallagher s operating results, returns on investments and financial position may be adversely impacted by exposure to various market risks such as interest rates, equity pricing, foreign exchange rates and the competitive environment; disruptions in the credit and financial markets could limit access to capital and credit and make it more difficult for Gallagher to obtain financing for its operations or investments or increase its cost of obtaining financing; liquidity or capital problems at one or more of the lenders under Gallagher s revolving credit facility could reduce or eliminate the amount available for Gallagher to draw under such facility; changes in the pension regulatory environment and investment losses in its pension plan could require Gallagher to make significant contributions to its defined benefit pension plan and increase its pension expense in future periods; and Gallagher s effective income tax rate and obligations under tax indemnity agreements may be subject to increase as a result of changes in income tax laws, unfavorable interpretations of past, current or future tax laws or developments resulting in the loss or unavailability of historically claimed IRC Section 29-related Syn/Coal tax credits. Gallagher s ability to grow has been enhanced through acquisitions, which may or may not be available on acceptable terms in the future and which, if consummated, may or may not be advantageous to Gallagher. Accordingly, actual results may differ materially from those set forth in the forward-looking statements. For a further discussion of certain of the matters described above see Item 1A, Risk Factors in Gallagher s Annual Report on Form 10-K for the year ended December 31, 2008.

Table of Contents

Readers are cautioned not to place undue reliance on any forward-looking statements contained in this report, which speak only as of the date set forth on the signature page hereto. Gallagher undertakes no obligation to publicly release the result of any revisions to these forward-looking statements that may be made to reflect events or circumstances after such date or to reflect the occurrence of anticipated or unanticipated events.

Item 3. Quantitative and Qualitative Disclosure About Market Risk

Gallagher is exposed to various market risks in its day-to-day operations. Market risk is the potential loss arising from adverse changes in market rates and prices, such as interest and foreign currency exchange rates and equity prices. The following analyses present the hypothetical loss in fair value of the financial instruments held by Gallagher at June 30, 2009 that are sensitive to changes in interest rates and equity prices. The range of changes in interest rates used in the analyses reflects Gallagher s view of changes that are reasonably possible over a one-year period. This discussion of market risks related to Gallagher s Consolidated Balance Sheet includes estimates of future economic environments caused by changes in market risks. The effect of actual changes in these market risk factors may differ materially from Gallagher s estimates. In the ordinary course of business, Gallagher also faces risks that are either nonfinancial or unquantifiable, including credit risk and legal risk. These risks are not included in the following analyses.

Gallagher s invested assets are primarily held as cash and cash equivalents, which are subject to various market risk exposures such as interest rate risk. The fair value of Gallagher s cash and cash equivalents investment portfolio at June 30, 2009 approximated its carrying value due to its short-term duration. Market risk was estimated as the potential decrease in fair value resulting from a hypothetical one-percentage point increase in interest rates for the instruments contained in the cash and cash equivalents investment portfolio. The resulting fair values were not materially different from the carrying values at June 30, 2009.

Gallagher has other investments that have valuations that are indirectly influenced by equity markets and general economic conditions, which can change rapidly. In addition, some investments require direct and active financial and operational support from Gallagher. A future material adverse effect may result from changes in market conditions or if Gallagher elects to withdraw financial or operational support.

At June 30, 2009, Gallagher had $400.0 million of borrowings outstanding under its Note Purchase Agreement. The fair value of these borrowings at June 30, 2009 was $366.3 million due to their long-term duration and fixed interest rates. There is no active or observable market for Gallagher s private placement long-term debt. Therefore, the estimated fair value of this debt is based on discounted future cash flows using current interest rates available for debt with similar terms and remaining maturities. To estimate an all-in interest rate for discounting, a broker quote was obtained for notes with the same terms as Gallagher s. There is no rate adjustment for the risk profile changes, covenant issues or credit rating changes at Gallagher, therefore the broker quote is deemed to be the closest approximation of current market rates. Market risk was estimated as the potential increase in fair value resulting from a hypothetical one-percentage point decrease in Gallagher s weighted average borrowing rate at June 30, 2009 and the resulting fair values would be $23.6 million higher than their carrying value.

At June 30, 2009, Gallagher had $193.0 million of borrowings outstanding under its Credit Agreement. The fair value of these borrowings approximate their carrying value due to their short-term duration and variable interest rates. Market risk would be estimated as the potential increase in fair value resulting from a hypothetical one-percentage point decrease in Gallagher s weighted average short-term borrowing rate at June 30, 2009 and the resulting fair values would not be materially different from their carrying value.

Gallagher is subject to foreign currency exchange rate risk primarily from its U.K. based subsidiaries that incur expenses denominated primarily in British pounds while receiving a substantial portion of their revenues in U.S. dollars. In addition, Gallagher is subject to foreign currency exchange rate risk from its Canadian and Australian operations due to transacting business in their local denominated currencies. Foreign currency gains (losses) related to this market risk are recorded in earnings from continuing operations before income taxes as they are incurred. Assuming a hypothetical adverse change of 10% in the average foreign currency exchange rate for 2009 (a weakening of the U.S. dollar), earnings from continuing operations before income taxes would decrease by approximately $4.0 million. Gallagher is also subject to foreign currency exchange rate risk associated with the translation of local currencies of its foreign subsidiaries into U.S. dollars. However, it is management s opinion that this foreign currency exchange risk is not material to Gallagher s consolidated operating results or financial position. Gallagher manages the balance sheets of its foreign

Table of Contents

subsidiaries, where practical, such that foreign liabilities are matched with equal foreign assets, thereby maintaining a balanced book which minimizes the effects of currency fluctuations. Historically, Gallagher has rarely entered into derivatives or other similar financial instruments for hedging, trading or speculative purposes. However, with respect to managing foreign currency exchange rate risk in the U.K., Gallagher has periodically purchased financial instruments when market opportunities arose to minimize its exposure to this risk. The impact of this hedging strategy was not material to Gallagher s Consolidated Financial Statements for the three-month and six-month periods ended June 30, 2009 and 2008.

Item 4. Controls and Procedures

As of June 30, 2009, Gallagher s management, including Gallagher s Chief Executive Officer (CEO) and Chief Financial Officer (CFO), have conducted an evaluation of the effectiveness of its disclosure controls and procedures pursuant to Rule 13a-15(b) of the Exchange Act. Based on that evaluation, the CEO and CFO concluded that Gallagher s disclosure controls and procedures were effective as of June 30, 2009.

There has been no change in Gallagher s internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) during the six-month period ended June 30, 2009 that has materially affected, or is reasonably likely to materially affect, Gallagher s internal control over financial reporting.

Part II Other Information

Item 1. Legal Proceedings

See Note 13 (Commitments, Contingencies and Off-Balance Sheet Arrangements) to the Consolidated Financial Statements.

Item 1A. Risk Factors

The following is a discussion of the material changes to the risk factors previously disclosed in Item 1A, Risk Factors, included in Gallagher s Annual Report on Form 10-K for the year ended December 31, 2008:

Gallagher is developing production plants that will have the ability to produce refined coal that may qualify for tax credits under IRC Section 45. These production plants may not be able to meet the requirements of IRC Section 45 and would therefore not produce tax credits to Gallagher or others.

IRC Section 45 provides a tax credit for the production and sale of refined coal. Gallagher owns 42% of Chem-Mod, LLC, which has developed technologies that reduce harmful emissions from coal-fired power plants. Although to date the IRS has issued little public guidance regarding the administration of the IRC Section 45 tax credit program and the restrictions on the availability of such credits, Gallagher believes that commercial facilities that produce clean-burning coal using the Chem-Mod technology qualify for tax credits under IRC Section 45. The IRS is expected to issue guidance by September 1, 2009, which will further clarify the requirements of IRC Section 45. Management has the authorization to invest up to $15.0 million in capital expenditures to develop production plants that will have the ability to produce refined coal. Certain utilities have expressed an interest in using The Chem-Mod Solution and Gallagher has committed to capital expenditures of approximately $4.0 million in the third quarter of 2009 to build the first facility. If other utilities express interest in using The Chem-Mod Solution, Gallagher is prepared to make additional capital expenditures of $10.0 million to $12.0 million in the third and fourth quarters of 2009 to build additional facilities.

There are significant uncertainties related to these investments, which must be favorably resolved in order for Gallagher to capitalize on these investments, including the release of favorable IRS guidance, the timely receipt by the utility of regulatory permits, completion of construction by December 31, 2009 and satisfaction of certain other emissions and pricing requirements. The IRS may challenge IRC Section 45 tax credits claimed by Gallagher based on any one of these or other conditions. In addition, Congress may modify or repeal IRC Section 45 so that these tax credits may not be available in the future. If Gallagher is not successful in claiming IRC Section 45 credits from these facilities, Gallagher may not be able to capitalize on its investments in Chem-Mod or the refined coal production facilities.

Table of Contents

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

Issuer Purchases of Equity Securities

(in thousands, except per share data)

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1)	Maximum Number of Shares that May Yet be Purchased Under the Plans or Programs
April 1 to April 30, 2009		$		10,000
May 1 to May 31, 2009				10,000
June 1 to June 30, 2009				10,000
Total		$		

(1) As set forth in its public filings, Gallagher has a common stock repurchase plan that was adopted by the Board of Directors on May 10, 1988 and has been periodically amended (the last amendment was on January 24, 2008) since that date to authorize additional shares for repurchase. Under the provisions of the repurchase plan, as of June 30, 2009, Gallagher continues to have the capacity to repurchase approximately 10.0 million shares. There is no expiration date for the repurchase plan and Gallagher is under no commitment or obligation to repurchase any particular amount of common stock under the plan. At its discretion, Gallagher may suspend the repurchase plan at any time.

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

At the Annual Meeting of Stockholders of Arthur J. Gallagher & Co. held on May 12, 2009, 91,731,497 shares of Gallagher s common stock, or 92.0% of the total common stock outstanding on the record date for the meeting, were represented.

The stockholders elected Mr. Frank E. English, Jr., Mr. J. Patrick Gallagher, Jr., Ms. Ilene S. Gordon and Mr. James R. Wimmer as Class I Directors with terms expiring in 2010. Of the shares voted with respect to the election of Mr. English, 89,489,922 were voted in favor and 2,241,575 were withheld. Of the shares voted with respect to the election of Mr. Gallagher, 89,486,757 were voted in favor and 2,244,740 were withheld. Of the shares voted with respect to the election of Ms. Gordon, 85,523,434 were voted in favor and 6,208,063 were withheld. Of the shares voted with respect to the election of Mr. Wimmer, 89,428,512 were voted in favor and 2,302,985 were withheld.

Continuing as Class II Directors with terms expiring in 2010 are Mr. William L. Bax, Mr. T. Kimball Brooker and Mr. David S. Johnson. Continuing as Class III Directors with terms expiring in 2011 are Mr. Elbert O. Hand, Ms. Kay W. McCurdy and Mr. Norman L. Rosenthal.

The stockholders also ratified the appointment of Ernst & Young LLP as Gallagher s independent registered public accounting firm for the fiscal year ending December 31, 2009. Of the shares voted with respect to the ratification of Ernst & Young LLP, 90,670,657 were voted in favor, 978,267 were voted against and 85,573 were withheld.

The stockholders also approved the Arthur J. Gallagher & Co. 2009 Long-Term Incentive Plan (LTIP). Of the shares voted with respect to the approval of the LTIP, 74,608,660 were voted in favor, 7,884,825 were voted against, 315,063 were withheld and 8,925,949 were broker non-votes.

Table of Contents

Item 6. Exhibits

10.1.1	Amendment to the Assurance of Voluntary Compliance between the Attorney General of the State of Illinois and Arthur J. Gallagher & Co., dated July 23, 2009.
10.15.1	First Amendment to the Arthur J. Gallagher & Co. Supplemental Savings and Thrift Plan (as amended and restated effective January 1, 2008).
10.46	2009 Long-Term Incentive Plan (incorporated by reference to Exhibit 4.4 of the Gallagher s Form S-8 Registration Statement No. 333-159150).
15.1	Letter of acknowledgement from Ernst & Young LLP concerning unaudited interim financial information.
31.1	Rule 13a-14(a) Certification of Chief Executive Officer.
31.2	Rule 13a-14(a) Certification of Chief Financial Officer.
32.1	Section 1350 Certification of Chief Executive Officer.
32.2	Section 1350 Certification of Chief Financial Officer.

Table of Contents

Signature

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

Arthur J. Gallagher & Co.

Date: July 30, 2009

/s/ Douglas K. Howell
Douglas K. Howell

Vice President and Chief Financial Officer

(principal financial officer and duly authorized officer)

Table of Contents

Arthur J. Gallagher & Co.

Quarterly Report on Form 10-Q

For The Quarterly Period Ended June 30, 2009

Exhibit Index

10.1.1	Amendment to the Assurance of Voluntary Compliance between the Attorney General of the State of Illinois and Arthur J. Gallagher & Co., dated July 23, 2009.
10.15.1	First Amendment to the Arthur J. Gallagher & Co. Supplemental Savings and Thrift Plan (as amended and restated effective January 1, 2008).
15.1	Letter of acknowledgement from Ernst & Young LLP concerning unaudited interim financial information.
31.1	Rule 13a-14(a) Certification of Chief Executive Officer.
31.2	Rule 13a-14(a) Certification of Chief Financial Officer.
32.1	Section 1350 Certification of Chief Executive Officer.
32.2	Section 1350 Certification of Chief Financial Officer.