CENTRAL PACIFIC FINANCIAL CORP
Form 10-Q
May 07, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington D.C. 20549

FORM 10-Q

(Mark One)

T QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2010

or

£ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ________ to ________

Commission file number 0-10777

CENTRAL PACIFIC FINANCIAL CORP.
(Exact name of registrant as specified in its charter)

Hawaii	99-0212597
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

220 South King Street, Honolulu, Hawaii 96813
(Address of principal executive offices) (Zip Code)

(808) 544-0500
(Registrant's telephone number, including area code)

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 T 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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes T No £

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

Large accelerated filer £	Accelerated filer T	Non-accelerated filer £	Smaller reporting company £

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

The number of shares outstanding of registrant’s common stock, no par value, on May 3, 2010 was 30,370,421 shares.

CENTRAL PACIFIC FINANCIAL CORP. AND SUBSIDIARIES

Table of Contents

PART I. FINANCIAL INFORMATION

Forward-Looking Statements

This document may contain forward-looking statements concerning projections of revenues, income, earnings per share, capital expenditures, dividends, capital structure, or other financial items, concerning plans and objectives of management for future operations, concerning future economic performance, or concerning any of the assumptions underlying or relating to any of the foregoing. Forward-looking statements can be identified by the fact that they do not relate strictly to historical or current facts, and may include the words “believes”, “plans”, “intends”, “expects”, “anticipate “forecasts” or words of similar meaning. While we believe that our forward-looking statements and the assumptions underlying them are reasonably based, such statements and assumptions are by their nature subject to risks and uncertainties, and thus could later prove to be inaccurate or incorrect. Accordingly, actual results could materially differ from projections for a variety of reasons, to include, but not limited to: the impact of local, national, and international economies and events (including natural disasters such as wildfires, tsunamis and earthquakes) on the Company’s business and operations and on tourism, the military, and other major industries operating within the Hawaii market and any other markets in which the Company does business; the impact of legislation affecting the banking industry; the impact of regulatory action on the Company and Central Pacific Bank; the impact of competitive products, services, pricing, and other competitive forces; movements in interest rates; loan delinquency rates and changes in asset quality; adverse conditions in the public debt market, the stock market or other capital markets, including any adverse changes in the price of the Company's stock; and a general deterioration or malaise in economic conditions, including the continued destabilizing factors in the financial industry and continued deterioration of the real estate market, as well as the impact of declining levels of consumer and business confidence in the state of the economy and in financial institutions in general and in particular our bank. For further information on factors that could cause actual results to materially differ from projections, please see the Company’s publicly available Securities and Exchange Commission filings, including the Company’s Form 10-K for the last fiscal year. The Company does not update any of its forward-looking statements.

CENTRAL PACIFIC FINANCIAL CORP. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Unaudited)

	March 31, 2010	December 31, 2009
	(Dollars in thousands)	
Assets		
Cash and due from banks	$ 207,015	$ 87,897
Interest-bearing deposits in other banks	658,337	400,470
Investment securities:		
Trading, at fair value	49,491	-
Available for sale, at fair value	395,073	919,655
Held to maturity (fair value of $4,355 at March 31, 2010 and $4,804 at December 31, 2009)	4,234	4,704
Total investment securities	448,798	924,359
Loans held for sale	57,659	83,830
Loans and leases	2,844,189	3,041,980
Less allowance for loan and lease losses	211,646	205,279
Net loans and leases	2,632,543	2,836,701
Premises and equipment, net	73,349	75,189
Accrued interest receivable	12,063	14,588
Investment in unconsolidated subsidiaries	16,450	17,395
Other real estate	31,571	26,954
Goodwill	-	102,689
Other intangible assets	45,610	45,390
Bank-owned life insurance	140,841	139,811
Federal Home Loan Bank stock	48,797	48,797
Income tax receivable	38,977	39,839
Other assets	22,167	25,613
Total assets	$ 4,434,177	$ 4,869,522
Liabilities and Equity		
Deposits:		
Noninterest-bearing demand	$ 611,840	$ 638,328
Interest-bearing demand	630,942	588,396
Savings and money market	1,090,159	1,195,815
Time	1,002,097	1,146,377
Total deposits	3,335,038	3,568,916
Short-term borrowings	202,074	242,429
Long-term debt	657,537	657,874
Other liabilities	57,403	54,314
Total liabilities	4,252,052	4,523,533
Equity:		

Preferred stock, no par value, authorized 1,000,000 shares; issued and outstanding 135,000 shares at March 31, 2010 and December 31, 2009		129,344			128,975	
Common stock, no par value, authorized 185,000,000 shares, issued and outstanding 30,370,421 shares at March 31, 2010 and 30,328,764 shares at December 31, 2009		406,580			405,355	
Surplus		63,359			63,075	
Accumulated deficit		(420,224	)		(257,931	)
Accumulated other comprehensive loss		(6,954	)		(3,511	)
Total shareholders' equity		172,105			335,963	
Non-controlling interest		10,020			10,026	
Total equity		182,125			345,989	
Total liabilities and equity	$	4,434,177		$	4,869,522	

See accompanying notes to consolidated financial statements.

CENTRAL PACIFIC FINANCIAL CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

(Amounts in thousands, except per share data)	Three Months Ended March 30, 2010	2009
Interest income:		
Interest and fees on loans and leases	$ 37,312	$ 56,505
Interest and dividends on investment securities:		
Taxable interest	8,101	8,729
Tax-exempt interest	515	1,171
Dividends	3	3
Interest on deposits in other banks	330	-
Total interest income	46,261	66,408
Interest expense:		
Interest on deposits:		
Demand	258	321
Savings and money market	1,649	2,863
Time	3,981	9,894
Interest on short-term borrowings	189	238
Interest on long-term debt	5,115	6,619
Total interest expense	11,192	19,935
Net interest income	35,069	46,473
Provision for loan and lease losses	58,837	26,750
Net interest income (loss) after provision for loan and lease losses	(23,768)	19,723
Other operating income:		
Service charges on deposit accounts	3,207	3,537
Other service charges and fees	3,485	3,320
Income from fiduciary activities	811	970
Equity in earnings of unconsolidated subsidiaries	29	274
Fees on foreign exchange	156	116
Investment securities gains (losses)	831	(150)
Loan placement fees	85	248
Net gain on sales of residential loans	1,945	4,009
Income from bank-owned life insurance	1,184	1,070
Other	1,031	2,290
Total other operating income	12,764	15,684
Other operating expense:		
Salaries and employee benefits	14,836	16,260

Net occupancy		3,297		3,279
Equipment		1,477		1,512
Amortization of other intangible assets		1,408		1,421
Communication expense		1,212		1,139
Legal and professional services		5,650		2,716
Computer software expense		903		912
Advertising expense		839		755
Goodwill impairment		102,689		-
Foreclosed asset expense		5,532		135
Write down of assets		774		435
Other		10,598		9,134
Total other operating expense		149,215		37,698
Loss before income taxes		(160,219)		(2,291)
Income tax benefit		-		(4,920)
Net income (loss)		(160,219)		2,629
Preferred stock dividends and accretion		2,074		1,867
Net income (loss) available to common shareholders	$	(162,293)	$	762
Per common share data:				
Basic and diluted earnings (loss) per share	$	(5.36)	$	0.03
Shares used in computation:				
Basic shares		30,270		28,681
Diluted shares		30,270		28,692

See accompanying notes to consolidated financial statements.

CENTRAL PACIFIC FINANCIAL CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Three Months Ended March 31, 2010	2009
	(Dollars in thousands)	
Cash flows from operating activities:		
Net income (loss)	$ (160,219)	$ 2,629
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Provision for loan and lease losses	58,837	26,750
Depreciation and amortization	2,062	2,090
Gain on sale of premises and equipment	-	(3,612)
Goodwill impairment	102,689	-
Write down of assets	774	435
Foreclosed asset expense	5,532	135
Amortization of other intangible assets	1,408	1,421
Net amortization of investment securities	812	674
Share-based compensation	284	(437)
Net loss (gain) on investment securities	(831)	150
Deferred income tax expense	2,439	3,412
Net gain on sales of residential loans	(1,945)	(4,009)
Ineffective portion of derivatives	-	184
Proceeds from sales of loans held for sale	262,534	542,074
Originations of loans held for sale	(216,694)	(561,013)
Equity in earnings of unconsolidated subsidiaries	(29)	(274)
Increase in cash surrender value of bank-owned life insurance	(1,030)	(1,066)
Decrease (increase) in income tax receivable	862	(5,328)
Net change in other assets and liabilities	3,441	(7,105)
Net cash provided by (used in) operating activities	60,926	(2,890)
Cash flows from investing activities:		
Proceeds from maturities of and calls on investment securities available for sale	131,753	59,080
Proceeds from sales of investment securities available for sale	439,436	2,135
Purchases of investment securities available for sale	(98,068)	(245,902)
Proceeds from maturities of and calls on investment securities held to maturity	461	1,162
Net loan principal repayments	71,082	66,693
Proceeds from sales of loans originated for investment	37,950	98,444
Proceeds from sale of other real estate	7,664	201
Proceeds from sale of premises and equipment	-	7,207
Purchases of premises and equipment	(222)	(2,454)

Distributions from unconsolidated subsidiaries		710		553
Contributions to unconsolidated subsidiaries		(227)		-
Net cash provided by (used in) investing activities		590,539		(12,881)
Cash flows from financing activities:				
Net increase (decrease) in deposits		(233,878)		91,007
Proceeds from long-term debt		50,000		-
Repayments of long-term debt		(50,284)		(25,268)
Net decrease in short-term borrowings		(40,355)		(195,976)
Cash dividends paid on preferred stock		-		(675)
Net proceeds from issuance of common stock and stock option exercises		-		50
Net proceeds from issuance of preferred stock and warrants		-		134,221
Other, net		37		36
Net cash provided by (used in) financing activities		(274,480)		3,395
Net increase (decrease) in cash and cash equivalents		376,985		(12,376)
Cash and cash equivalents at beginning of period		488,367		107,745
Cash and cash equivalents at end of period	$	865,352	$	95,369
Supplemental disclosure of cash flow information:				
Cash paid during the period for:				
Interest	$	11,276	$	20,681
Income taxes		-		1,531
Cash received during the period for:				
Income taxes		1,068		192
Supplemental disclosure of noncash investing and financing activities:				
Net change in common stock held by directors' deferred compensation plan	$	6	$	23
Net reclassification of loans to other real estate		17,364		5,539
Net transfer of loans to loans held for sale		17,724		-
Securitization of residential mortgage loans into available for sale mortgage backed securities		-		15,823
Dividends accrued on preferred stock		1,742		863
Accretion of preferred stock discount		332		329

See accompanying notes to consolidated financial statements.

CENTRAL PACIFIC FINANCIAL CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements of Central Pacific Financial Corp. and Subsidiaries (herein referred to as the "Company," "we," "us" or "our") have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. These interim condensed consolidated financial statements and notes should be read in conjunction with the Company's consolidated financial statements and notes thereto filed on Form 10-K for the fiscal year ended December 31, 2009. In the opinion of management, all adjustments necessary for a fair presentation have been made and include all normal recurring adjustments. Interim results of operations are not necessarily indicative of results to be expected for the year.

There were no material subsequent events that have occurred which would require recognition or disclosure in these consolidated financial statements.

2. GOING CONCERN AND REGULATORY MATTERS

We continue to operate in a difficult environment, and have been significantly impacted by the unprecedented credit and economic market turmoil, as well as the recessionary economy. Deterioration in the Hawaii and California commercial real estate markets and related declines in property values in those markets has had a negative impact on our operating results since the latter half of 2007.

Going Concern

The consolidated financial statements have been prepared assuming that the Company will continue as a going concern, which contemplates the realization of assets and the discharge of liabilities in the normal course of business. We are under a Consent Order (the "Consent Order") that, among other things, required us to increase and maintain our leverage and total risk-based capital ratios to at least 10% and 12%, respectively, by March 31, 2010. We were unable to meet these capital ratio requirements as of March 31, 2010. Our inability to meet the capital ratio requirements under the Consent Order, as well as further declines in our capital ratios, exposes us to additional restrictions and regulatory actions, including potential regulatory take-over. Our inability to meet existing regulatory requirements and the uncertainty as to our ability to meet future regulatory requirements raises substantial doubt about our ability to continue as a going concern. The ability of the Company to continue as a going concern is dependent upon many factors, including regulatory action and the ability of management to achieve its recovery plan, which is discussed below. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Regulatory Action

In December 2009, the members of the Board of Directors of Central Pacific Bank agreed to the Consent Order with the Federal Deposit Insurance Corporation (the "FDIC") and the Hawaii Division of Financial Institutions (the "DFI"), which requires the bank to improve its capital position, asset quality, liquidity and management oversight, among other matters. In addition to the capital ratio requirements described above, the bank must also maintain an adequate allowance for loan and lease losses at all times, reduce doubtful and substandard assets to less than 75% of Tier 1 capital plus reserves, and systematically reduce commercial real estate loans, particularly land development and construction loans. The bank must also obtain approval from the FDIC and DFI before paying cash dividends or making other payments from the bank to Central Pacific Financial Corp.

To date, the bank has fulfilled many of the requirements of the Consent Order. However, as of the date of this filing, we were not in compliance with the leverage and total risk-based capital ratio requirements and our doubtful and substandard assets exceeded 75% of Tier 1 capital plus reserves. Consistent with our recovery plan, which is described more fully below, we will continue to pursue further opportunities to reduce our classified assets by aggressively managing our loan portfolio to minimize further credit losses and maximize recoveries. In addition, we continue to explore all options for raising additional capital concurrent with the execution of our recovery plan. Despite these actions, we do not anticipate being in compliance with these requirements in the near-term.

In addition to the Consent Order, Central Pacific Financial Corp. continues to be subject to the memorandum of understanding ("MOU") effective April 1, 2009 with the Federal Reserve Bank of San Francisco (the "FRBSF") and the DFI. The issues required to be addressed by management overlap, to a large extent, with those contained in the Consent Order and include, among other matters, to review and establish more comprehensive policies and methodologies relating to the adequacy of the allowance for loan and lease losses, to re-evaluate, develop and implement strategic and other plans and to increase and maintain the bank's leverage capital ratio at or above 9%. The MOU also includes our agreement to obtain the approval of the FRBSF and the DFI for Central Pacific Financial Corp. to increase, renew, incur or guarantee indebtedness, pay dividends and make payments on our trust preferred securities. To date, management has fulfilled many of the provisions of the MOU, however, we were not in compliance with the leverage capital ratio requirement of the MOU and have not reversed the Company's negative financial performance as of the date of this filing. As a result of the FRBSF's December 2009 examination of Central Pacific Financial Corp., we anticipate entering into a formal enforcement action with the FRBSF and DFI, and while we have not seen a draft of the formal enforcement action, we anticipate terms similar to the MOU and requiring compliance with the Consent Order.

Recovery Plan

As described above, we continue to pursue all available alternatives to improve our capital ratios, including raising capital and reducing assets. While we received interest from potential private equity investors in the first quarter of 2010, it is unlikely that we will be able to successfully complete an external capital raise on acceptable terms and conditions in the near-term. Accordingly, in March 2010, our Board determined that the implementation of our recovery plan, while continuing to seek new capital, was in the best interest of our stakeholders. The recovery plan was developed with the assistance of our outside advisors and is designed to improve our financial health and capital ratios by downsizing our bank and focusing on our core businesses and traditional markets in Hawaii.

Key elements of the recovery plan include, but are not limited to:

- Aggressively managing the bank's existing loan portfolios to minimize further credit losses and to maximize recoveries,
- Shrinking the bank's balance sheet, including the sale of pledged securities and reducing public deposits and repurchase positions,
- Reducing the bank's loan portfolio through paydowns, restructuring, and significantly reducing lending activity, and
- Significantly lowering operating costs to align with the restructured business model.

To ensure the successful execution of the recovery plan and to monitor our capital raising efforts, our Board formed a Recovery Committee in March 2010 to oversee our progress against these initiatives.

To date, we executed the following as part of this plan:

- Sold investment securities totaling $439.4 million at a net gain of $0.8 million, which reduced our total investment securities as a percentage of total assets from 19.0% at December 31, 2009 to 10.1% at March 31, 2010.

- Reduced our credit risk exposure in the non-agency MBS and municipal securities portfolios by $52.7 million and $37.3 million, respectively. Our remaining exposure in the non-agency MBS and municipal securities portfolios as of March 31, 2010 were $18 thousand and $0.8 million, respectively.

- Reduced our total loan and lease portfolio to $2.8 billion at March 31, 2010 from $3.0 billion at December 31, 2009.

- Improved our liquidity position with cash and cash equivalents totaling $865.4 million at March 31, 2010, compared to $488.4 million at December 31, 2009.

- Continued to support home ownership in Hawaii by originating $234.2 million in residential mortgage loans. Substantially all of these loans were sold in the secondary market.

- Made progress with our previously announced plans to exit the Mainland market by closing two California loan production offices.

    - Initiated steps to reduce operating costs through personnel reductions and completed the previously announced consolidation of two retail branch locations in Honolulu within close proximity of each other.

While we did not achieve the leverage capital and Tier 1 risk-based capital mandates of 10% and 12%, respectively, by March 31, 2010, as required by the Consent Order, the actions described above are designed to reduce our capital needs over time by reducing our balance sheet and establishing a more streamlined and focused organization with a reduced infrastructure. However, there is no assurance that the recovery plan will be acceptable to our regulators, that we will be able to successfully implement this recovery plan or that the elements contemplated by the recovery plan are sufficient to ensure that we will continue operating as a going concern.

Liquidity

At March 31, 2010, the Company has cash and cash equivalents of $865.4 million. We also have access to a variety of other short-term and long-term funding sources, which include proceeds from maturities of our investment securities, as well as secondary funding sources such as the Federal Home Loan Bank, secured repurchase agreements and the Federal Reserve discount window, available to meet our liquidity needs. As further discussed in Notes 10 and 11, the Company’s liquidity position may be adversely affected by dividend limitations imposed on us and our access to these funding sources. Our ability to maintain adequate levels of liquidity is dependent on the successful execution of our recovery plan, and more specifically, our ability to further reduce our loan portfolio, improve our risk profile, increase our regulatory capital ratios, and comply with the provisions of the Consent Order.

3. RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In June 2009, the Financial Accounting Standards Board (“FASB”) issued certain guidance included in ASC 860-10 which required more information about transfers of financial assets and where companies have continuing exposure to the risks related to transferred financial assets. We adopted the guidance effective January 1, 2010 and the adoption had no material impact on our consolidated financial statements.

In June 2009, the FASB issued certain guidance, included in ASC 942-810, which changed how a company determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. We adopted the guidance effective January 1, 2010 and the adoption had no material impact on our consolidated financial statements.

In January 2010, the FASB issued Accounting Standards Update ("ASU") 2010-6, Fair Value Measurements and Disclosures (Topic 820), Improving Disclosures About Fair Value Measurements. This ASU required new disclosures regarding transfers and activity within the three levels of fair value hierarchy, as well as enhanced disclosures regarding the class of assets disclosed and the inputs and valuation techniques used to determine fair value. We adopted this statement effective January 1, 2010 and the adoption had no material impact on our consolidated financial statements.

4. INVESTMENT SECURITIES

A summary of available for sale and held to maturity investment securities are as follows:

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
		(Dollars in thousands)		
March 31, 2010				
Available for Sale				
U.S. Government sponsored entities debt securities	$212,418	$714	$(314)	$212,818
States and political subdivisions	14,018	6	-	14,024
U.S. Government sponsored entities mortgage-backed securities	162,903	4,459	(148)	167,214
Non-agency collateralized mortgage obligations	18	-	-	18
Other	982	17	-	999
Total	$390,339	$5,196	$(462)	$395,073
Held to Maturity				
States and political subdivisions	$500	$6	$-	$506
U.S. Government sponsored entities mortgage-backed securities	3,734	115	-	3,849
Total	$4,234	$121	$-	$4,355
December 31, 2009				
Available for Sale				
U.S. Government sponsored entities debt securities	$207,292	$1,010	$(659)	$207,643
States and political subdivisions	51,449	375	(339)	51,485
U.S. Government sponsored entities mortgage-backed securities	600,507	14,088	(1,507)	613,088
Non-agency collateralized mortgage obligations	52,691	-	(6,222)	46,469
Other	984	-	(14)	970
Total	$912,923	$15,473	$(8,741)	$919,655
Held to Maturity				
States and political subdivisions	$500	$2	$-	$502
U.S. Government sponsored entities mortgage-backed securities	4,204	98	-	4,302
Total	$4,704	$100	$-	$4,804

The amortized cost and estimated fair value of investment securities at March 31, 2010 by contractual maturity are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	March 31, 2010	
	Amortized Cost	Estimated Fair Value
	(Dollars in thousands)	
Available for Sale		
Due in one year or less	$ 22,656	$ 22,753

Due after one year through five years		150,112		150,559
Due after five years through ten years		47,520		47,382
Due after ten years		6,148		6,148
Mortage-backed securities		162,921		167,232
Other		982		999
Total	$	390,339	$	395,073
Held to Maturity				
Due after one year through five years	$	500	$	506
Mortage-backed securities		3,734		3,849
Total	$	4,234	$	4,355

Effective March 31, 2010, as part of our recovery plan, we completed the sale of certain available for sale securities during the quarter ended March 31, 2010 and received gross proceeds of $439.4 million. Gross realized gains and losses on sales of available for sale securities during the three months ended March 31, 2010 were $9.6 million and $8.8 million, respectively. Proceeds from sales of investment securities available for sale were $2.1 million for the three months ended March 31, 2009, resulting in gross realized losses of $0.2 million. There were no gross realized gains in the three months ended March 31, 2009. The basis on which the cost of all securities sold was determined using the specific identification method.

In addition to these sales, we also transferred certain securities formerly classified as available for sale to trading securities as we intend to sell these securities in the near-term as part of our recovery plan. The transfer of these securities to the trading category was accounted for at fair value and resulted in the immediate recognition of a net unrealized gain of $0.4 million.

Investment securities of $428.4 million at March 31, 2010 were pledged to secure public funds on deposit, securities sold under agreements to repurchase and other long-term and short-term borrowings.

Provided below is a summary of the 12 and 40 investment securities which were in an unrealized loss position at March 31, 2010 and December 31, 2009, respectively.

	Less than 12 months		12 months or longer		Total	
Description of Securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
			(Dollars in thousands)			
At March 31, 2010:						
U.S. Government sponsored entities debt securities	$ 77,259	$ (314)	$ -	$ -	$ 77,259	$ (314)
U.S. Government sponsored entities mortgage-backed securities	5,051	(147)	74	(1)	5,125	(148)
Total temporarily impaired securities	$ 82,310	$ (461)	$ 74	$ (1)	$ 82,384	$ (462)
At December 31, 2009:						
U.S. Government sponsored entities debt securities	$ 89,172	$ (659)	$ -	$ -	$ 89,172	$ (659)
States and political subdivisions	6,956	(197)	3,696	(142)	10,652	(339)
U.S. Government sponsored entities mortgage-backed securities	70,213	(1,504)	55	(3)	70,268	(1,507)
Non-agency collateralized mortgage obligations	7,624	(162)	38,845	(6,060)	46,469	(6,222)
Other	-	-	970	(14)	970	(14)
Total temporarily impaired securities	$ 173,965	$ (2,522)	$ 43,566	$ (6,219)	$ 217,531	$ (8,741)

Unrealized losses for all investment securities are reviewed to determine whether the losses are deemed “other-than-temporary impairment” (“OTTI”). Investment securities are evaluated for OTTI on at least a quarterly basis and more frequently when economic or market conditions warrant such an evaluation to determine whether a decline in their value below amortized cost is other-than-temporary. In conducting this assessment, we evaluate a number of factors including, but not limited to:

- The length of time and the extent to which fair value has been less than the amortized cost basis;
- Adverse conditions specifically related to the security, an industry, or a geographic area;
- The historical and implied volatility of the fair value of the security;
- The payment structure of the debt security and the likelihood of the issuer being able to make payments;
- Failure of the issuer to make scheduled interest or principal payments;
- Any rating changes by a rating agency; and
- Recoveries or additional decline in fair value subsequent to the balance sheet date.

The term “other-than-temporary” is not intended to indicate that the decline is permanent, but indicates that the prospects for a near-term recovery of value are not necessarily favorable, or that there is a general lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. Once a decline in value is determined to be other-than-temporary, the value of the security is reduced and a corresponding charge to earnings is recognized for anticipated credit losses.

The declines in market value were primarily attributable to changes in interest rates and disruptions in the credit and financial markets. Because we have no intent to sell securities in an unrealized loss position and it is not more likely than not that we will be required to sell such securities before recovery of its amortized cost basis, we do not consider these investments to be other-than-temporarily impaired.

5. LOANS AND LEASES

Loans, excluding loans held for sale, consisted of the following at the dates indicated:

	March 31, 2010	December 31, 2009
	(Dollars in thousands)	
Commercial, financial and agricultural	$ 253,349	$ 260,784
Real estate:		
Construction	752,001	813,333
Mortgage - residential	772,022	823,274
Mortgage - commercial	910,053	972,537
Consumer	123,488	136,090
Leases	38,853	41,803
	2,849,766	3,047,821
Unearned income	(5,577)	(5,841)
Total loans and leases	$ 2,844,189	$ 3,041,980

Impaired loans requiring an allowance for loan and lease losses at March 31, 2010 and December 31, 2009 amounted to $277.6 million and $293.2 million, respectively, and included all nonaccrual and restructured loans greater than $0.5 million. Impaired loans not requiring an allowance for loan and lease losses at March 31, 2010 and December 31, 2009 amounted to $132.8 million and $185.7 million, respectively.

6. ALLOWANCE FOR LOAN AND LEASE LOSSES

The following table presents the changes in the allowance for loan and lease losses (the "Allowance") for the periods indicated:

	Three Months Ended March 31, 2010	2009
	(Dollars in thousands)	
Balance, beginning of period	$ 205,279	$ 119,878
Provision for loan and lease losses	58,837	26,750
	264,116	146,628
Charge-offs	(59,968)	(24,815)
Recoveries	7,498	473
Net charge-offs	(52,470)	(24,342)
Balance, end of period	$ 211,646	$ 122,286

The increase in the Allowance in the first quarter of 2010 was primarily due to increased risk volatility and downward risk rating migration in our loan portfolios with direct exposure to the real estate markets in which we serve. In particular, we experienced adverse migration in portions of our mainland and Hawaii construction and commercial real estate portfolios and heightened delinquencies in our residential mortgage and consumer loan portfolios. The increase in our Allowance for the first quarter of 2010 was necessary in response to uncertain economic conditions present at the time and continued deterioration in the Hawaii and California real estate markets. In accordance with GAAP, loans held for sale and other real estate assets are not included in our assessment of the Allowance.

7. SECURITIZATIONS

In prior years, we securitized certain residential mortgage loans with a U.S. Government sponsored entity and continue to service the residential mortgage loans. The servicing assets were recorded at their respective fair values at the time of securitization. The fair value of the servicing assets were determined using a discounted cash flow model based on market value assumptions at the time of securitization and is amortized in proportion to and over the period of net servicing income.

All unsold mortgage-backed securities were categorized as trading or available for sale securities and were therefore recorded at their fair value of $14.1 million and $56.2 million at March 31, 2010 and December 31, 2009, respectively. The fair values of these mortgage-backed securities were based on quoted prices of similar instruments in active markets. Unrealized losses of $0.1 million and $0.5 million on unsold mortgage-backed securities were recorded in accumulated other comprehensive income (loss) at March 31, 2010 and December 31, 2009, respectively.

8. GOODWILL AND OTHER INTANGIBLE ASSETS

We review the carrying amount of goodwill for impairment on an annual basis. Additionally, we perform an impairment assessment of goodwill and other intangible assets whenever events or changes in circumstances indicate that the carrying value of goodwill and other intangible assets may not be recoverable. Significant negative industry or economic trends, disruptions to our business, unexpected significant changes or planned changes in use of the assets, divestitures and market capitalization declines may result in impairments to goodwill. Absent any impairment indicators, we perform our annual goodwill impairment test during the fourth quarter of each fiscal year.

Our impairment assessment of goodwill and other intangible assets involves the estimation of future cash flows and the fair value of reporting units to which goodwill is allocated. We reconcile the estimated fair values of our reporting units to our total market capitalization plus a control premium. Estimating future cash flows and determining fair values of the reporting units is judgmental and often involves the use of significant estimates and assumptions. These estimates and assumptions could have a significant impact on whether or not an impairment charge is recognized and also the magnitude of the impairment charge.

During the first quarter of 2010, we determined that an impairment test was required because of the uncertainty regarding our ability to continue as a going concern combined with the fact that our market capitalization remained depressed. As a result of our impairment test, we determined that the remaining goodwill associated with our Hawaii Market reporting unit was impaired and we recorded a non-cash impairment charge of $102.7 million during the quarter. As of March 31, 2010, we had no goodwill remaining on our consolidated balance sheet.

Other intangible assets include a core deposit premium, mortgage servicing rights, customer relationships and non-compete agreements. The following table presents changes in other intangible assets for the three months ended March 31, 2010:

	Core Deposit Premium	Mortgage Servicing Rights	Customer Relationships	Non-Compete Agreements	Total

	(Dollars in thousands)				
Balance, beginning of period	$ 23,401	$ 20,589	$ 1,190	$ 210	$ 45,390
Additions	-	1,628	-	-	1,628
Amortization	(668)	(690)	(35)	(15)	(1,408)
Balance, end of period	$ 22,733	$ 21,527	$ 1,155	$ 195	$ 45,610

Income generated as the result of new mortgage servicing rights is reported as gains on sales of loans and totaled $1.6 million for the three months ended March 31, 2010, compared to $4.8 million for the three months ended March 31, 2009. Amortization of mortgage servicing rights was $0.7 million for each of the three months ended March 31, 2010 and 2009.

The following table presents the fair market value and key assumptions used in determining the fair market value of our mortgage servicing rights:

	Three Months Ended March 31,	
	2010	2009
	(Dollars in thousands)	
Fair market value, beginning of period	$ 23,019	$ 12,107
Fair market value, end of period	22,897	17,122
Weighted average discount rate	8.5 %	8.6 %
Weighted average prepayment speed assumption	13.2	14.4

The gross carrying value and accumulated amortization related to our intangible assets are presented below:

	March 31, 2010			December 31, 2009		
	Gross Carrying Value	Accumulated Amortization	Net	Gross Carrying Value	Accumulated Amortization	Net
	(Dollars in thousands)					
Core deposit premium	$ 44,642	$ (21,909)	$ 22,733	$ 44,642	$ (21,241)	$ 23,401
Mortgage servicing rights	36,985	(15,458)	21,527	35,357	(14,768)	20,589
Customer relationships	1,400	(245)	1,155	1,400	(210)	1,190
Non-compete agreements	300	(105)	195	300	(90)	210
	$ 83,327	$ (37,717)	$ 45,610	$ 81,699	$ (36,309)	$ 45,390

Based on the core deposit premium, mortgage servicing rights, customer relationships and non-compete agreements held as of March 31, 2010, estimated amortization expense for the remainder of fiscal 2010, the next five succeeding fiscal years and all years thereafter are as follows:

Estimated Amortization Expense			
Core Deposit Premium	Mortgage Servicing Rights	Customer	Non-Compete