

CENTRAL PACIFIC FINANCIAL CORP  
Form 10-Q  
May 07, 2013

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

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FORM 10-Q

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(Mark One)

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2013

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 001-31567

CENTRAL PACIFIC FINANCIAL CORP.

(Exact name of registrant as specified in its charter)

Hawaii  
(State or other jurisdiction of  
incorporation or organization)

99-0212597  
(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 ☒ 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 ☒ No ☐

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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 ☐ 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 ☒

The number of shares outstanding of registrant’s common stock, no par value, on May 1, 2013 was 41,938,294 shares.

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CENTRAL PACIFIC FINANCIAL CORP. AND SUBSIDIARIES

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PART I. FINANCIAL INFORMATION

Forward-Looking Statements

This document may contain forward-looking statements concerning projections of revenues, income/loss, earnings/loss 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,” “anticipates,” “forecasts,” “hopes,” “should,” “estimates” 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 be limited to: the effect of, and our failure to comply with all of the requirements of any regulatory orders or regulatory agreements we are or may become subject to; our ability to continue making progress on our recovery plan; oversupply of inventory and adverse conditions in the Hawaii and California real estate markets and weakness in the construction industry; adverse changes in the financial performance and/or condition of our borrowers and, as a result, increased loan delinquency rates, deterioration in asset quality and losses in our loan portfolio; the impact of local, national, and international economies and events (including natural disasters such as wildfires, tsunamis, storms 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 international economic conditions, including issues associated with the European debt crisis; deterioration or malaise in economic conditions, including destabilizing factors in the financial industry and 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 in general and in financial institutions in particular; changes in estimates of future reserve requirements based upon the periodic review thereof under relevant regulatory and accounting requirements; the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act, changes in capital standards, other regulatory reform, including but not limited to regulations promulgated by the Consumer Financial Protection Bureau, government-sponsored enterprise reform, and any related rules and regulations on our business operations and competitiveness; the costs and effects of legal and regulatory developments, including the resolution of legal proceedings or regulatory or other governmental inquiries and the results of regulatory examinations or reviews; the effects of and changes in trade, monetary and fiscal policies and laws, including the interest rate policies of the Board of Governors of the Federal Reserve System; inflation, interest rate, securities market and monetary fluctuations; negative trends in our market capitalization and adverse changes in the price of the Company’s common shares; political instability; acts of war or terrorism; changes in consumer spending, borrowings and savings habits; technological changes; changes in the competitive environment among financial holding companies and other financial service providers; the effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Public Company Accounting Oversight Board, the Financial Accounting Standards Board and other accounting standard setters; our ability to attract and retain skilled employees; changes in our organization, compensation and benefit plans; and our success at managing the risks involved in the foregoing items. 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 and, in particular, the discussion of “Risk Factors” set forth therein. The Company does not update any of its forward-looking statements except as required by law.

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

|                                                                                                 | March 31,<br>2013      | December 31,<br>2012 |
|-------------------------------------------------------------------------------------------------|------------------------|----------------------|
|                                                                                                 | (Dollars in thousands) |                      |
| <b>Assets</b>                                                                                   |                        |                      |
| Cash and due from banks                                                                         | \$ 46,877              | \$ 56,473            |
| Interest-bearing deposits in other banks                                                        | 167,632                | 120,902              |
| Investment securities:                                                                          |                        |                      |
| Available for sale, at fair value                                                               | 1,537,065              | 1,536,745            |
| Held to maturity (fair value of \$159,483 at March 31, 2013 and \$162,528 at December 31, 2012) | 159,363                | 161,848              |
| Total investment securities                                                                     | 1,696,428              | 1,698,593            |
| Loans held for sale                                                                             | 17,293                 | 38,283               |
| Loans and leases                                                                                | 2,274,598              | 2,203,944            |
| Less allowance for loan and lease losses                                                        | 86,806                 | 96,413               |
| Net loans and leases                                                                            | 2,187,792              | 2,107,531            |
| Premises and equipment, net                                                                     | 48,578                 | 48,759               |
| Accrued interest receivable                                                                     | 14,148                 | 13,896               |
| Investment in unconsolidated subsidiaries                                                       | 10,078                 | 10,975               |
| Other real estate                                                                               | 10,068                 | 10,686               |
| Other intangible assets                                                                         | 36,175                 | 37,499               |
| Bank-owned life insurance                                                                       | 147,975                | 147,411              |
| Federal Home Loan Bank stock                                                                    | 47,494                 | 47,928               |
| Other assets                                                                                    | 150,539                | 31,432               |
| Total assets                                                                                    | \$ 4,581,077           | \$ 4,370,368         |
| <b>Liabilities and Equity</b>                                                                   |                        |                      |
| Deposits:                                                                                       |                        |                      |
| Noninterest-bearing demand                                                                      | \$ 857,427             | \$ 843,292           |
| Interest-bearing demand                                                                         | 692,537                | 672,838              |
| Savings and money market                                                                        | 1,168,989              | 1,186,011            |
| Time                                                                                            | 1,045,738              | 978,631              |
| Total deposits                                                                                  | 3,764,691              | 3,680,772            |
| Long-term debt                                                                                  | 108,276                | 108,281              |
| Other liabilities                                                                               | 48,058                 | 66,536               |
| Total liabilities                                                                               | 3,921,025              | 3,855,589            |
| <b>Equity:</b>                                                                                  |                        |                      |
| Preferred stock, no par value, authorized 1,100,000 shares, issued and outstanding              |                        |                      |
| none at March 31, 2013 and December 31, 2012, respectively                                      | -                      | -                    |

|                                                                                                                                                                                   |  |  |  |            |           |              |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--|--|--|------------|-----------|--------------|
| Common stock, no par value, authorized<br>185,000,000 shares, issued and outstanding<br>41,938,294 and 41,867,046 shares at March 31,<br>2013 and December 31, 2012, respectively |  |  |  | 784,519    |           | 784,512      |
| Surplus                                                                                                                                                                           |  |  |  | 71,735     |           | 70,567       |
| Accumulated deficit                                                                                                                                                               |  |  |  | (212,118 ) |           | (349,427 )   |
| Accumulated other comprehensive income (loss)                                                                                                                                     |  |  |  | 5,965      |           | (830 )       |
| Total shareholders' equity                                                                                                                                                        |  |  |  | 650,101    |           | 504,822      |
| Non-controlling interest                                                                                                                                                          |  |  |  | 9,951      |           | 9,957        |
| Total equity                                                                                                                                                                      |  |  |  | 660,052    |           | 514,779      |
| Total liabilities and equity                                                                                                                                                      |  |  |  | \$         | 4,581,077 | \$ 4,370,368 |

See accompanying notes to consolidated financial statements.

CENTRAL PACIFIC FINANCIAL CORP. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

Three Months Ended March 31,

(Amounts in thousands, except per share data)

2013

2012

|                                                               |           |           |
|---------------------------------------------------------------|-----------|-----------|
| <b>Interest income:</b>                                       |           |           |
| Interest and fees on loans and leases                         | \$ 24,443 | \$ 25,008 |
| Interest and dividends on investment securities:              |           |           |
| Taxable interest                                              | 7,031     | 7,614     |
| Tax-exempt interest                                           | 1,027     | 197       |
| Dividends                                                     | 5         | 3         |
| Interest on deposits in other banks                           | 89        | 81        |
| Total interest income                                         | 32,595    | 32,903    |
| <b>Interest expense:</b>                                      |           |           |
| Interest on deposits:                                         |           |           |
| Demand                                                        | 81        | 86        |
| Savings and money market                                      | 217       | 299       |
| Time                                                          | 759       | 1,073     |
| Interest on long-term debt                                    | 869       | 943       |
| Total interest expense                                        | 1,926     | 2,401     |
| Net interest income                                           | 30,669    | 30,502    |
| Provision (credit) for loan and lease losses                  | (6,561 )  | (4,990 )  |
| Net interest income after provision for loan and lease losses | 37,230    | 35,492    |
| <b>Other operating income:</b>                                |           |           |
| Service charges on deposit accounts                           | 1,591     | 2,316     |
| Other service charges and fees                                | 4,330     | 4,421     |
| Income from fiduciary activities                              | 697       | 626       |
| Equity in earnings of unconsolidated subsidiaries             | 28        | 46        |
| Fees on foreign exchange                                      | 71        | 90        |
| Loan placement fees                                           | 149       | 240       |
| Net gain on sales of residential loans                        | 4,128     | 2,977     |
| Income from bank-owned life insurance                         | 564       | 591       |
| Other                                                         | 914       | 1,925     |
| Total other operating income                                  | 12,472    | 13,232    |
| <b>Other operating expense:</b>                               |           |           |
| Salaries and employee benefits                                | 18,535    | 16,626    |
| Net occupancy                                                 | 3,227     | 3,266     |
| Equipment                                                     | 958       | 957       |
| Amortization of other intangible assets                       | 2,248     | 1,761     |
| Communication expense                                         | 950       | 854       |
| Legal and professional services                               | 2,310     | 4,057     |
| Computer software expense                                     | 933       | 935       |

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|                               |            |           |
|-------------------------------|------------|-----------|
| Advertising expense           | 812        | 869       |
| Foreclosed asset expense      | (258 )     | (107 )    |
| Write down of assets          | -          | 1,759     |
| Other                         | 2,480      | 4,269     |
| Total other operating expense | 32,195     | 35,246    |
| Income before income taxes    | 17,507     | 13,478    |
| Income tax benefit            | (119,802 ) | -         |
| Net income                    | \$ 137,309 | \$ 13,478 |
| Per common share data:        |            |           |
| Basic earnings per share      | \$ 3.28    | \$ 0.32   |
| Diluted earnings per share    | 3.25       | 0.32      |
| Shares used in computation:   |            |           |
| Basic shares                  | 41,816     | 41,631    |
| Diluted shares                | 42,297     | 41,839    |

See accompanying notes to consolidated financial statements.



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

|                                                        | Three Months Ended<br>March 31, |           |
|--------------------------------------------------------|---------------------------------|-----------|
|                                                        | 2013                            | 2012      |
|                                                        | (Dollars in thousands)          |           |
| Net income                                             | \$ 137,309                      | \$ 13,478 |
| Other comprehensive income (loss), net of tax          |                                 |           |
| Net change in unrealized gain on investment securities | (4,823 )                        | (3,480 )  |
| Net change in unrealized loss on derivatives           | 10,993                          | (572 )    |
| Defined benefit plans                                  | 625                             | 589       |
| Other comprehensive income (loss), net of tax          | 6,795                           | (3,463 )  |
| Comprehensive income                                   | \$ 144,104                      | \$ 10,015 |

See accompanying notes to consolidated financial statements.

CENTRAL PACIFIC FINANCIAL CORP. & SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY  
(Unaudited)

|                                                                         | Preferred | Common     |           | Accumulated  | Accumulated Other Comprehensive Income | Non-Controlling | Total      |
|-------------------------------------------------------------------------|-----------|------------|-----------|--------------|----------------------------------------|-----------------|------------|
|                                                                         | Stock     | Stock      | Surplus   | Deficit      | (Loss)                                 | Interests       |            |
| (Dollars in thousands, except per share data)                           |           |            |           |              |                                        |                 |            |
| Balance at December 31, 2012                                            | \$ -      | \$ 784,512 | \$ 70,567 | \$ (349,427) | \$ (830 )                              | \$ 9,957        | \$ 514,779 |
| Net income                                                              | -         | -          | -         | 137,309      | -                                      | -               | 137,309    |
| Other comprehensive income                                              | -         | -          | -         | -            | 6,795                                  | -               | 6,795      |
| 83 shares of common stock sold by directors' deferred compensation plan | -         | 7          | -         | -            | -                                      | -               | 7          |
| Share-based compensation                                                | -         | -          | 1,168     | -            | -                                      | -               | 1,168      |
| Non-controlling interests                                               | -         | -          | -         | -            | -                                      | (6 )            | (6 )       |
| Balance at March 31, 2013                                               | \$ -      | \$ 784,519 | \$ 71,735 | \$ (212,118) | \$ 5,965                               | \$ 9,951        | \$ 660,052 |
| Balance at December 31, 2011                                            | \$ -      | \$ 784,539 | \$ 66,585 | \$ (396,848) | \$ 2,164                               | \$ 9,980        | \$ 466,420 |
| Net income                                                              | -         | -          | -         | 13,478       | -                                      | -               | 13,478     |
| Other comprehensive loss                                                | -         | -          | -         | -            | (3,463 )                               | -               | (3,463 )   |
| 48 shares of common stock sold by directors' deferred compensation plan | -         | 35         | -         | -            | -                                      | -               | 35         |
| Share-based compensation                                                | -         | -          | 976       | -            | -                                      | -               | 976        |
| Non-controlling interests                                               | -         | -          | -         | -            | -                                      | (6 )            | (6 )       |
| Balance at March 31, 2012                                               | \$ -      | \$ 784,574 | \$ 67,561 | \$ (383,370) | \$ (1,299 )                            | \$ 9,974        | \$ 477,440 |

See accompanying notes to consolidated financial statements.

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

|                                                                                   | Three Months Ended March 31, |            |
|-----------------------------------------------------------------------------------|------------------------------|------------|
|                                                                                   | 2013                         | 2012       |
|                                                                                   | (Dollars in thousands)       |            |
| Cash flows from operating activities:                                             |                              |            |
| Net income                                                                        | \$ 137,309                   | \$ 13,478  |
| Adjustments to reconcile net income to net cash provided by operating activities: |                              |            |
| Provision (credit) for loan and lease losses                                      | (6,561 )                     | (4,990 )   |
| Depreciation and amortization                                                     | 1,518                        | 1,544      |
| Write down of assets                                                              | -                            | 1,759      |
| Write down of other real estate, net of gain on sale                              | (584 )                       | (33 )      |
| Amortization of other intangible assets                                           | 2,248                        | 1,761      |
| Net amortization of investment securities                                         | 3,962                        | 3,530      |
| Share-based compensation                                                          | 1,168                        | 976        |
| Net gain on sales of residential loans                                            | (4,128 )                     | (2,977 )   |
| Proceeds from sales of loans held for sale                                        | 212,432                      | 189,500    |
| Originations of loans held for sale                                               | (187,314 )                   | (158,372 ) |
| Equity in earnings of unconsolidated subsidiaries                                 | (28 )                        | (46 )      |
| Increase in cash surrender value of bank-owned life insurance                     | (564 )                       | (2,009 )   |
| Release of DTA valuation allowance                                                | (119,802 )                   | -          |
| Net change in other assets and liabilities                                        | (6,918 )                     | (17,316 )  |
| Net cash provided by operating activities                                         | 32,738                       | 26,805     |
| Cash flows from investing activities:                                             |                              |            |
| Proceeds from maturities of and calls on investment securities available for sale | 155,045                      | 72,665     |
| Purchases of investment securities available for sale                             | (164,052 )                   | (232,633 ) |
| Proceeds from maturities of and calls on investment securities held to maturity   | 2,388                        | 226        |
| Net loan originations                                                             | (74,798 )                    | (21,703 )  |
| Proceeds from sales of loans originated for investment                            | 460                          | -          |
| Proceeds from sale of other real estate                                           | 1,842                        | 9,533      |
| Proceeds from bank-owned life insurance                                           | -                            | 1,423      |
| Purchases of premises and equipment                                               | (1,337 )                     | (519 )     |
| Distributions from unconsolidated subsidiaries                                    | 550                          | 428        |
| Contributions to unconsolidated subsidiaries                                      | (50 )                        | -          |
| Proceeds from redemption of FHLB stock                                            | 434                          | -          |
| Net cash used in investing activities                                             | (79,518 )                    | (170,580 ) |
| Cash flows from financing activities:                                             |                              |            |
| Net increase in deposits                                                          | 83,919                       | 64,275     |
| Repayments of long-term debt                                                      | (5 )                         | (50,004 )  |
| Net decrease in short-term borrowings                                             | -                            | (34 )      |
| Net cash provided by financing activities                                         | 83,914                       | 14,237     |

|                                                      |            |            |
|------------------------------------------------------|------------|------------|
| Net increase (decrease) in cash and cash equivalents | 37,134     | (129,538 ) |
| Cash and cash equivalents at beginning of period     | 177,375    | 257,072    |
| Cash and cash equivalents at end of period           | \$ 214,509 | \$ 127,534 |

Supplemental disclosure of cash flow information:

Cash paid during the period for:

|              |           |          |
|--------------|-----------|----------|
| Interest     | \$ 14,048 | \$ 1,787 |
| Income taxes | 5         | -        |

Supplemental disclosure of noncash investing and financing activities:

|                                                                          |         |          |
|--------------------------------------------------------------------------|---------|----------|
| Net change in common stock held by directors' deferred compensation plan | \$ (7 ) | \$ (35 ) |
| Net reclassification of loans to other real estate                       | 640     | 544      |
| Net transfer of loans to loans held for sale                             | -       | 290      |

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, 2012. 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.

Certain prior period amounts in the consolidated financial statements and the notes thereto have been reclassified to conform to the current period presentation. Such reclassifications had no effect on net income or shareholders’ equity for any periods presented.

2. REGULATORY MATTERS

The Company entered into a Written Agreement (the “Written Agreement”) with the Federal Reserve Bank of San Francisco (the “FRBSF”) and the Hawaii Division of Financial Institutions (the “DFI”) dated July 2, 2010, which superseded in its entirety the Memorandum of Understanding that the Company entered into on April 1, 2009 with the FRBSF and DFI. Among other matters, the Written Agreement provided that unless we receive the consent of the FRBSF and DFI, we cannot: (i) pay dividends; (ii) receive dividends or payments representing a reduction in capital from Central Pacific Bank (“the bank” or “our bank”); (iii) directly or through any non-bank subsidiaries make any payments on subordinated debentures or trust preferred securities; (iv) directly or through any non-bank subsidiaries incur, increase or guarantee any debt; or (v) purchase or redeem any shares of our stock. The Written Agreement also required that our Board of Directors fully utilize the Company’s financial and managerial resources to ensure that the bank complies with any other supervisory action taken by the bank’s regulators. We were also required to submit to the FRBSF an acceptable capital plan and cash flow projection. On February 12, 2013, the Written Agreement was terminated.

On October 9, 2012, the bank entered into a separate Memorandum of Understanding (the “Compliance MOU”) with the Federal Deposit Insurance Corporation (the “FDIC”) to improve the bank’s compliance management system (“CMS”). Under the Compliance MOU, we are required to, among other things, (i) improve the Board of Directors’ oversight of the bank’s CMS; (ii) ensure the establishment and implementation of the bank’s CMS is commensurate with the complexity of the bank’s operations; (iii) perform a full review of all compliance policy and procedures, then revise and adopt policy and procedures to ensure compliance with all consumer protection regulations; (iv) enhance the bank’s training program relating to consumer protection and fair lending regulations; (v) develop and implement an effective internal monitoring program to ensure compliance with all applicable laws and regulations; (vi) strengthen the compliance audit function to ensure that the compliance audits are appropriately and comprehensively scoped; (vii) develop and implement internal controls for the bank’s third-party payment processing activity; (viii) strengthen the Board of Directors and senior management’s oversight of third-party relationships and (ix) enhance the bank’s overdraft payment program. The bank believes it has already taken substantial steps to comply with the Compliance MOU. In addition to the steps taken to comply with the Compliance MOU, the bank received an “Outstanding” rating in a recently completed Community Reinvestment performance evaluation that measures how financial institutions

support their communities in the areas of lending, investment and service.

We cannot assure you whether or when the Company and the bank will be in full compliance with the Compliance MOU or whether or when the Compliance MOU will be terminated. Even if terminated, we may still be subject to other agreements with regulators which restrict our activities or may also continue to impose capital ratios or other requirements on our business. The requirements and restrictions of the Compliance MOU are judicially enforceable and the Company or the bank's failure to comply with such requirements and restrictions may subject the Company and the bank to additional regulatory restrictions including: the imposition of additional regulatory requirements or orders; limitations on our activities; the imposition of civil monetary penalties; and further directives which affect our business, including, in the most severe circumstances, termination of the bank's deposit insurance or appointment of a conservator or receiver for the bank.

### 3. RECENT ACCOUNTING PRONOUNCEMENTS

In December 2011, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2011-11, “Disclosures about Offsetting Assets and Liabilities.” ASU 2011-11 expands the disclosure requirements for financial instruments and derivatives that may be offset in accordance with enforceable master netting agreements or similar arrangements. The disclosures are required regardless of whether the instruments have been offset (or netted) in the balance sheet. Under ASU 2011-11, companies must describe the nature of offsetting arrangements and provide quantitative information about those agreements, including the gross and net amounts of financial instruments that are recognized in the balance sheet. ASU 2011-11 is effective for the Company’s reporting period beginning on January 1, 2013, with retrospective application required. We adopted this ASU effective January 1, 2013 and the adoption of this guidance did not have a material impact on our consolidated financial statements.

In July 2012, the FASB issued ASU 2012-02, “Testing Indefinite-Lived Intangible Assets for Impairment.” The provisions of ASU 2012-02 permit an entity to first assess qualitative factors to determine whether it is more likely than not that an indefinite-lived intangible asset is impaired as a basis for determining whether it is necessary to perform a quantitative impairment test, as is currently required by GAAP. ASU 2012-02 is effective for annual and interim impairment tests performed for the Company’s reporting period beginning on January 1, 2013. We adopted this ASU effective January 1, 2013. As the Company does not have any indefinite-lived assets, the adoption of this guidance did not have a material impact on our consolidated financial statements.

In February 2013, the FASB issued ASU 2013-02, “Amendments to Topic 220, Other Comprehensive Income.” The amendments in ASU 2013-02 supersede and replace the presentation requirements for reclassifications out of accumulated other comprehensive income in ASUs 2011-05 (issued in June 2011) and 2011-12 (issued in December 2011) for all public and private organizations. The amendments would require an entity to provide additional information about reclassifications out of accumulated other comprehensive income. ASU 2013-02 is effective for the Company’s reporting period beginning on January 1, 2013. We adopted this ASU effective January 1, 2013. As the Company provided these required disclosures in the notes to the consolidated financial statements, the adoption of this guidance had no impact on the Company's consolidated balance sheets and statements of income. See Note 13 for the disclosures required by ASU 2013-02.

## 4. INVESTMENT SECURITIES

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

|                                                               | Amortized<br>cost   | Gross<br>unrealized<br>gains<br>(Dollars in thousands) | Gross<br>unrealized<br>losses | Estimated<br>fair value |
|---------------------------------------------------------------|---------------------|--------------------------------------------------------|-------------------------------|-------------------------|
| <b>March 31, 2013</b>                                         |                     |                                                        |                               |                         |
| <b>Available for Sale</b>                                     |                     |                                                        |                               |                         |
| U.S. Government sponsored entities debt securities            | \$ 207,755          | \$ 2,343                                               | \$ -                          | \$ 210,098              |
| States and political subdivisions debt securities             | 193,648             | 2,022                                                  | (2,044 )                      | 193,626                 |
| U.S. Government sponsored entities mortgage-backed securities | 981,911             | 15,876                                                 | (2,781 )                      | 995,006                 |
| Corporate securities                                          | 125,117             | 2,479                                                  | (61 )                         | 127,535                 |
| Non-agency collateralized mortgage obligations                | 9,965               | 19                                                     | -                             | 9,984                   |
| Other                                                         | 751                 | 65                                                     | -                             | 816                     |
| <b>Total</b>                                                  | <b>\$ 1,519,147</b> | <b>\$ 22,804</b>                                       | <b>\$ (4,886 )</b>            | <b>\$ 1,537,065</b>     |
| <b>Held to Maturity</b>                                       |                     |                                                        |                               |                         |
| U.S. Government sponsored entities mortgage-backed securities | \$ 159,363          | \$ 452                                                 | \$ (332 )                     | \$ 159,483              |
| <b>December 31, 2012</b>                                      |                     |                                                        |                               |                         |
| <b>Available for Sale</b>                                     |                     |                                                        |                               |                         |
| U.S. Government sponsored entities debt securities            | \$ 278,198          | \$ 2,741                                               | \$ -                          | \$ 280,939              |
| States and political subdivisions debt securities             | 184,274             | 2,831                                                  | (1,194 )                      | 185,911                 |
| U.S. Government sponsored entities mortgage-backed securities | 925,018             | 17,548                                                 | (1,523 )                      | 941,043                 |
| Corporate securities                                          | 125,649             | 2,360                                                  | (63 )                         | 127,946                 |
| Other                                                         | 866                 | 40                                                     | -                             | 906                     |
| <b>Total</b>                                                  | <b>\$ 1,514,005</b> | <b>\$ 25,520</b>                                       | <b>\$ (2,780 )</b>            | <b>\$ 1,536,745</b>     |
| <b>Held to Maturity</b>                                       |                     |                                                        |                               |                         |
| U.S. Government sponsored entities mortgage-backed securities | \$ 161,848          | \$ 695                                                 | \$ (15 )                      | \$ 162,528              |

The amortized cost and estimated fair value of investment securities at March 31, 2013 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, 2013         |                         |
|-------------------------|------------------------|-------------------------|
|                         | Amortized<br>Cost      | Estimated<br>Fair Value |
|                         | (Dollars in thousands) |                         |
| Available for Sale      |                        |                         |
| Due in one year or less | \$ 110,289             | \$ 110,667              |



|                                           |              |              |
|-------------------------------------------|--------------|--------------|
| Due after one year through<br>five years  | 176,722      | 181,273      |
| Due after five years through<br>ten years | 96,482       | 96,745       |
| Due after ten years                       | 143,027      | 142,574      |
| Mortgage-backed securities                | 991,876      | 1,004,990    |
| Other                                     | 751          | 816          |
| Total                                     | \$ 1,519,147 | \$ 1,537,065 |
| Held to Maturity                          |              |              |
| Mortgage-backed securities                | \$ 159,363   | \$ 159,483   |

We did not sell any available for sale securities during the first quarter of 2013 and 2012.

Investment securities of \$863.9 million and \$905.5 million at March 31, 2013 and December 31, 2012, respectively, were pledged to secure public funds on deposit, securities sold under agreements to repurchase and other long-term and short-term borrowings. None of these securities were pledged to a secured party that has the right to sell or repledge the collateral as of the same periods.

Provided below is a summary of the 168 and 118 investment securities which were in an unrealized loss position at March 31, 2013 and December 31, 2012, respectively.

| Description of Securities                                     | Less than 12 months |                   | 12 months or longer |                   | Total      |                   |
|---------------------------------------------------------------|---------------------|-------------------|---------------------|-------------------|------------|-------------------|
|                                                               | Fair Value          | Unrealized Losses | Fair Value          | Unrealized Losses | Fair Value | Unrealized Losses |
| (Dollars in thousands)                                        |                     |                   |                     |                   |            |                   |
| At March 31, 2013:                                            |                     |                   |                     |                   |            |                   |
| States and political subdivisions debt securities             | \$ 106,117          | \$ (2,044 )       | \$ -                | \$ -              | \$ 106,117 | \$ (2,044 )       |
| U.S. Government sponsored entities mortgage-backed securities | 212,650             | (3,113 )          | -                   | -                 | 212,650    | (3,113 )          |
| Corporate securities                                          | 23,516              | (61 )             | -                   | -                 | 23,516     | (61 )             |
| Total temporarily impaired securities                         | \$ 342,283          | \$ (5,218 )       | \$ -                | \$ -              | \$ 342,283 | \$ (5,218 )       |
| At December 31, 2012:                                         |                     |                   |                     |                   |            |                   |
| States and political subdivisions debt securities             | \$ 73,128           | \$ (1,194 )       | \$ -                | \$ -              | \$ 73,128  | \$ (1,194 )       |
| U.S. Government sponsored entities mortgage-backed securities | 206,981             | (1,538 )          | -                   | -                 | 206,981    | (1,538 )          |
| Corporate securities                                          | 23,205              | (63 )             | -                   | -                 | 23,205     | (63 )             |
| Total temporarily impaired securities                         | \$ 303,314          | \$ (2,795 )       | \$ -                | \$ -              | \$ 303,314 | \$ (2,795 )       |

#### Other-than-temporary impairment (“OTTI”)

Unrealized losses for all investment securities are reviewed to determine whether the losses are deemed “other-than-temporary.” 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 and leases, excluding loans held for sale, consisted of the following:

|                                        | March 31,<br>2013      | December 31,<br>2012 |
|----------------------------------------|------------------------|----------------------|
|                                        | (Dollars in thousands) |                      |
| Commercial, financial and agricultural | \$ 316,999             | \$ 246,278           |
| Real estate:                           |                        |                      |
| Construction                           | 88,082                 | 96,240               |
| Mortgage - residential                 | 1,073,994              | 1,035,273            |
| Mortgage - commercial                  | 637,574                | 673,506              |
| Consumer                               | 150,144                | 143,387              |
| Leases                                 | 8,936                  | 10,504               |
|                                        | 2,275,729              | 2,205,188            |
| Unearned income                        | (1,131 )               | (1,244 )             |
| Total loans and leases                 | \$ 2,274,598           | \$ 2,203,944         |

During the three months ended March 31, 2013, we transferred two loans with a carrying value of \$0.6 million to other real estate. We did not transfer any portfolio loans to the held-for-sale category and no portfolio loans were sold or purchased during the three months ended March 31, 2013.

During the three months ended March 31, 2012, we transferred one loan, which was non-performing, with a carrying value of \$0.3 million, to the held-for-sale category. In addition, we transferred two loans with a carrying value of \$0.5 million to other real estate. No portfolio loans were sold or purchased during the three months ended March 31, 2012.

## Impaired Loans

The following table presents by class, the balance in the allowance for loan and lease losses and the recorded investment in loans and leases based on the Company's impairment measurement method as of March 31, 2013 and December 31, 2012:

|                                             | Commercial,<br>financial<br>&<br>agricultural | Construction | Real estate<br>Mortgage -<br>residential | Mortgage<br>-<br>commercial | Consumer   | Leases   | Total        |
|---------------------------------------------|-----------------------------------------------|--------------|------------------------------------------|-----------------------------|------------|----------|--------------|
|                                             | (Dollars in thousands)                        |              |                                          |                             |            |          |              |
| March 31, 2013                              |                                               |              |                                          |                             |            |          |              |
| Allowance for loan<br>and lease losses:     |                                               |              |                                          |                             |            |          |              |
| Ending balance<br>attributable to loans:    |                                               |              |                                          |                             |            |          |              |
| Individually<br>evaluated for<br>impairment | \$ 510                                        | \$ 1,582     | \$ -                                     | \$ 1,720                    | \$ -       | \$ 3     | \$ 3,815     |
| Collectively<br>evaluated for<br>impairment | 8,131                                         | 2,364        | 29,991                                   | 33,569                      | 2,864      | 72       | 76,991       |
|                                             | 8,641                                         | 3,946        | 29,991                                   | 35,289                      | 2,864      | 75       | 80,806       |
| Unallocated                                 |                                               |              |                                          |                             |            |          | 6,000        |
| Total ending<br>balance                     | \$ 8,641                                      | \$ 3,946     | \$ 29,991                                | \$ 35,289                   | \$ 2,864   | \$ 75    | \$ 86,806    |
| Loans and leases:                           |                                               |              |                                          |                             |            |          |              |
| Individually<br>evaluated for<br>impairment | \$ 5,043                                      | \$ 39,013    | \$ 40,225                                | \$ 23,664                   | \$ -       | \$ 59    | \$ 108,004   |
| Collectively<br>evaluated for<br>impairment | 311,956                                       | 49,069       | 1,033,769                                | 613,910                     | 150,144    | 8,877    | 2,167,725    |
|                                             | 316,999                                       | 88,082       | 1,073,994                                | 637,574                     | 150,144    | 8,936    | 2,275,729    |
| Unearned income                             | (131 )                                        | (31 )        | 407                                      | (1,185 )                    | (191 )     | -        | (1,131 )     |
| Total ending<br>balance                     | \$ 316,868                                    | \$ 88,051    | \$ 1,074,401                             | \$ 636,389                  | \$ 149,953 | \$ 8,936 | \$ 2,274,598 |
| December 31, 2012                           |                                               |              |                                          |                             |            |          |              |
| Allowance for loan<br>and lease losses:     |                                               |              |                                          |                             |            |          |              |
| Ending balance<br>attributable to loans:    |                                               |              |                                          |                             |            |          |              |
| Individually<br>evaluated for<br>impairment | \$ 882                                        | \$ 1,582     | \$ 272                                   | \$ 270                      | \$ -       | \$ 5     | \$ 3,011     |
| Collectively<br>evaluated for<br>impairment | 4,105                                         | 2,928        | 29,638                                   | 48,230                      | 2,421      | 80       | 87,402       |

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|                   |            |           |              |            |            |           |              |
|-------------------|------------|-----------|--------------|------------|------------|-----------|--------------|
|                   | 4,987      | 4,510     | 29,910       | 48,500     | 2,421      | 85        | 90,413       |
| Unallocated       |            |           |              |            |            |           | 6,000        |
| Total ending      |            |           |              |            |            |           |              |
| balance           | \$ 4,987   | \$ 4,510  | \$ 29,910    | \$ 48,500  | \$ 2,421   | \$ 85     | \$ 96,413    |
| Loans and leases: |            |           |              |            |            |           |              |
| Individually      |            |           |              |            |            |           |              |
| evaluated for     |            |           |              |            |            |           |              |
| impairment        | \$ 3,957   | \$ 48,264 | \$ 42,865    | \$ 15,911  | \$ -       | \$ 95     | \$ 111,092   |
| Collectively      |            |           |              |            |            |           |              |
| evaluated for     |            |           |              |            |            |           |              |
| impairment        | 242,321    | 47,976    | 992,408      | 657,595    | 143,387    | 10,409    | 2,094,096    |
|                   | 246,278    | 96,240    | 1,035,273    | 673,506    | 143,387    | 10,504    | 2,205,188    |
| Unearned income   | (60 )      | (46 )     | 124          | (1,258 )   | (4 )       | -         | (1,244 )     |
| Total ending      |            |           |              |            |            |           |              |
| balance           | \$ 246,218 | \$ 96,194 | \$ 1,035,397 | \$ 672,248 | \$ 143,383 | \$ 10,504 | \$ 2,203,944 |

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The following table presents by class, impaired loans as of March 31, 2013 and December 31, 2012:

|                                                         | Unpaid Principal<br>Balance | Recorded<br>Investment<br>(Dollars in thousands) | Allowance<br>Allocated |
|---------------------------------------------------------|-----------------------------|--------------------------------------------------|------------------------|
| <b>March 31, 2013</b>                                   |                             |                                                  |                        |
| Impaired loans with no related allowance recorded:      |                             |                                                  |                        |
| Commercial, financial & agricultural                    | \$ 2,677                    | \$ 1,978                                         | \$ -                   |
| Real estate:                                            |                             |                                                  |                        |
| Construction                                            | 39,337                      | 27,413                                           | -                      |
| Mortgage - residential                                  | 46,618                      | 40,225                                           | -                      |
| Mortgage - commercial                                   | 13,236                      | 12,604                                           | -                      |
| Total impaired loans with no related allowance recorded | 101,868                     | 82,220                                           | -                      |
| Impaired loans with an allowance recorded:              |                             |                                                  |                        |
| Commercial, financial & agricultural                    | 4,537                       | 3,065                                            | 510                    |
| Real estate:                                            |                             |                                                  |                        |
| Construction                                            | 13,678                      | 11,600                                           | 1,582                  |
| Mortgage - commercial                                   | 15,750                      | 11,060                                           | 1,720                  |
| Leases                                                  | 59                          | 59                                               | 3                      |
| Total impaired loans with an allowance recorded         | 34,024                      | 25,784                                           | 3,815                  |
| Total                                                   | \$ 135,892                  | \$ 108,004                                       | \$ 3,815               |
| <b>December 31, 2012</b>                                |                             |                                                  |                        |
| Impaired loans with no related allowance recorded:      |                             |                                                  |                        |
| Commercial, financial & agricultural                    | \$ 1,225                    | \$ 526                                           | \$ -                   |
| Real estate:                                            |                             |                                                  |                        |
| Construction                                            | 52,352                      | 36,664                                           | -                      |
| Mortgage - residential                                  | 47,364                      | 41,894                                           | -                      |
| Mortgage - commercial                                   | 13,616                      | 13,211                                           | -                      |
| Total impaired loans with no related allowance recorded | 114,557                     | 92,295                                           | -                      |
| Impaired loans with an allowance recorded:              |                             |                                                  |                        |
| Commercial, financial & agricultural                    | 4,807                       | 3,431                                            | 882                    |
| Real estate:                                            |                             |                                                  |                        |
| Construction                                            | 13,678                      | 11,600                                           | 1,582                  |
| Mortgage - residential                                  | 1,935                       | 971                                              | 272                    |
| Mortgage - commercial                                   | 3,939                       | 2,700                                            | 270                    |
| Leases                                                  | 95                          | 95                                               | 5                      |
| Total impaired loans with an allowance recorded         | 24,454                      | 18,797                                           | 3,011                  |
| Total                                                   | \$ 139,011                  | \$ 111,092                                       | \$ 3,011               |

The following table presents by class, the average recorded investment and interest income recognized on impaired loans as of March 31, 2013 and 2012:

Three Months Ended March 31,

|                                         | 2013                              |                                                            | 2012                              |                                  |
|-----------------------------------------|-----------------------------------|------------------------------------------------------------|-----------------------------------|----------------------------------|
|                                         | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized<br>(Dollars in thousands) | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized |
| Commercial, financial &<br>agricultural | \$ 4,091                          | \$ 6                                                       | \$ 2,086                          | \$ 3                             |
| Real estate:                            |                                   |                                                            |                                   |                                  |
| Construction                            | 43,643                            | 176                                                        | 76,184                            | 645                              |
| Mortgage - residential                  | 41,795                            | 131                                                        | 49,904                            | 57                               |
| Mortgage - commercial                   | 17,730                            | 90                                                         | 18,402                            | 22                               |
| Leases                                  | 82                                | -                                                          | -                                 | -                                |
| Total                                   | \$ 107,341                        | \$ 403                                                     | \$ 146,576                        | \$ 727                           |



## Aging Analysis of Accruing and Non-Accruing Loans and Leases

For all loan types, the Company determines delinquency status by considering the number of days full payments required by the contractual terms of the loan are past due. The following table presents by class, the aging of the recorded investment in past due loans and leases as of March 31, 2013 and December 31, 2012:

|                                            | Accruing<br>Loans<br>30-59<br>Days Past<br>Due | Accruing<br>Loans<br>60-89<br>Days Past<br>Due | Accruing<br>Loans<br>Greater<br>Than 90<br>Days<br>Past Due | Nonaccrual<br>Loans | Total Past<br>Due and<br>Nonaccrual | Loans and<br>Leases Not<br>Past Due | Total        |
|--------------------------------------------|------------------------------------------------|------------------------------------------------|-------------------------------------------------------------|---------------------|-------------------------------------|-------------------------------------|--------------|
| (Dollars in thousands)                     |                                                |                                                |                                                             |                     |                                     |                                     |              |
| March 31, 2013                             |                                                |                                                |                                                             |                     |                                     |                                     |              |
| Commercial,<br>financial<br>& agricultural | \$ 159                                         | \$ 136                                         | \$ -                                                        | \$ 4,605            | \$ 4,900                            | \$ 311,968                          | \$ 316,868   |
| Real estate:                               |                                                |                                                |                                                             |                     |                                     |                                     |              |
| Construction                               | -                                              | -                                              | -                                                           | 18,272              | 18,272                              | 69,779                              | 88,051       |
| Mortgage -<br>residential                  | 7,710                                          | 415                                            | -                                                           | 24,842              | 32,967                              | 1,041,434                           | 1,074,401    |
| Mortgage -<br>commercial                   | -                                              | -                                              | -                                                           | 17,462              | 17,462                              | 618,927                             | 636,389      |
| Consumer                                   | 327                                            | 96                                             | -                                                           | -                   | 423                                 | 149,530                             | 149,953      |
| Leases                                     | -                                              | -                                              | -                                                           | 59                  | 59                                  | 8,877                               | 8,936        |
| Total                                      | \$ 8,196                                       | \$ 647                                         | \$ -                                                        | \$ 65,240           | \$ 74,083                           | \$ 2,200,515                        | \$ 2,274,598 |
| December 31, 2012                          |                                                |                                                |                                                             |                     |                                     |                                     |              |
| Commercial,<br>financial<br>& agricultural | \$ 123                                         | \$ 139                                         | \$ -                                                        | \$ 3,510            | \$ 3,772                            | \$ 242,446                          | \$ 246,218   |
| Real estate:                               |                                                |                                                |                                                             |                     |                                     |                                     |              |
| Construction                               | 124                                            | -                                              | -                                                           | 38,742              | 38,866                              | 57,328                              | 96,194       |
| Mortgage -<br>residential                  | 8,330                                          | 590                                            | 387                                                         | 27,499              | 36,806                              | 998,591                             | 1,035,397    |
| Mortgage -<br>commercial                   | 219                                            | -                                              | -                                                           | 9,487               | 9,706                               | 662,542                             | 672,248      |
| Consumer                                   | 249                                            | 169                                            | 116                                                         | -                   | 534                                 | 142,849                             | 143,383      |
| Leases                                     | -                                              | -                                              | -                                                           | 94                  | 94                                  | 10,410                              | 10,504       |
| Total                                      | \$ 9,045                                       | \$ 898                                         | \$ 503                                                      | \$ 79,332           | \$ 89,778                           | \$ 2,114,166                        | \$ 2,203,944 |

## Modifications

Troubled debt restructurings (“TDRs”) included in nonperforming assets at March 31, 2013 consisted of 57 Hawaii residential mortgage loans with a combined principal balance of \$17.7 million, a U.S. Mainland commercial mortgage loan with a principal balance of \$2.2 million, six Hawaii construction and development loans with a combined principal balance of \$1.8 million and two Hawaii commercial loans with a combined principal balance of \$1.5 million. Concessions made to the original contractual terms of these loans consisted primarily of the deferral of interest and/or principal payments due to deterioration in the borrowers’ financial condition. The principal balances on these TDRs

had matured and/or were in default at the time of restructure and we have no commitments to lend additional funds to any of these borrowers. There were \$42.8 million of TDRs still accruing interest at March 31, 2013, none of which were more than 90 days delinquent. At December 31, 2012, there were \$31.8 million of TDRs still accruing interest, none of which were more than 90 days delinquent.

The majority of loans modified in a TDR are typically on nonaccrual status. Thus, these loans have already been identified as impaired and have already been evaluated under the Company's allowance for loan and lease losses (the "Allowance") methodology. As a result, the loans modified in a TDR did not have a material affect to our provision for loan and lease losses expense (the "Provision") and the Allowance during the three months ended March 31, 2013.

The following table presents by class, information related to loans modified in a TDR during the three months ended March 31, 2013 and 2012:

|                                      | Number<br>of<br>Contracts | Recorded<br>Investment (as<br>of period end)<br>(Dollars in thousands) | Increase<br>in the<br>Allowance |
|--------------------------------------|---------------------------|------------------------------------------------------------------------|---------------------------------|
| Three months ended March 31, 2013    |                           |                                                                        |                                 |
| Commercial, financial & agricultural | 1                         | \$ 1,500                                                               | \$ -                            |
| Three months ended March 31, 2012    |                           |                                                                        |                                 |
| Real estate:                         |                           |                                                                        |                                 |
| Mortgage - residential               | 6                         | \$ 3,209                                                               | \$ -                            |
| Mortgage - commercial                | 2                         | 6,775                                                                  | -                               |
| Total                                | 8                         | \$ 9,984                                                               | \$ -                            |

The following table presents by class, loans modified as a TDR within the previous twelve months that subsequently defaulted during the three months ended March 31, 2013 and 2012:

|                                      | Three Months Ended March 31, |                                                                        | 2012                      |                                              |
|--------------------------------------|------------------------------|------------------------------------------------------------------------|---------------------------|----------------------------------------------|
|                                      | Number<br>of<br>Contracts    | Recorded<br>Investment (as<br>of period end)<br>(Dollars in thousands) | Number<br>of<br>Contracts | Recorded<br>Investment (as<br>of period end) |
| Commercial, financial & agricultural | 1                            | \$ 1,500                                                               | -                         | \$ -                                         |
| Real estate:                         |                              |                                                                        |                           |                                              |
| Construction                         | 5                            | 5,437                                                                  | 2                         | 13,831                                       |
| Mortgage - residential               | 1                            | 354                                                                    | 11                        | 4,381                                        |
| Mortgage - commercial                | 1                            | 3,146                                                                  | 1                         | 3,158                                        |
| Total                                | 8                            | \$ 10,437                                                              | 14                        | \$ 21,370                                    |

## Credit Quality Indicators

The Company categorizes loans and leases into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Company analyzes loans and leases individually by classifying the loans and leases as to credit risk. This analysis includes loans and leases with an outstanding balance greater than \$0.5 million or \$1.0 million, depending on loan type, and non-homogeneous loans and leases, such as commercial and commercial real estate loans. This analysis is performed on a quarterly basis. The Company uses the following definitions for risk ratings:

**Special Mention.** Loans and leases classified as special mention, while still adequately protected by the borrower's capital adequacy and payment capability, exhibit distinct weakening trends and/or elevated levels of exposure to external conditions. If left unchecked or uncorrected, these potential weaknesses may result in deteriorated prospects of repayment. These exposures require management's close attention so as to avoid becoming undue or unwarranted credit exposures.

Substandard. Loans and leases classified as substandard are inadequately protected by the borrower's current financial condition and payment capability or of the collateral pledged, if any. Loans and leases so classified have a well-defined weakness or weaknesses that jeopardize the orderly repayment of debt. They are characterized by the distinct possibility that the bank will sustain some loss if the deficiencies are not corrected.

Doubtful. Loans and leases classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or orderly repayment in full, on the basis of current existing facts, conditions and values, highly questionable and improbable. Possibility of loss is extremely high, but because of certain important and reasonably specific factors that may work to the advantage and strengthening of the exposure, its classification as an estimate loss is deferred until its more exact status may be determined.

Loss. Loans and leases classified as loss are considered to be non-collectible and of such little value that their continuance as bankable assets is not warranted. This does not mean the loan has absolutely no recovery value, but rather it is neither practical nor desirable to defer writing off the loan, even though partial recovery may be obtained in the future. Losses are taken in the period in which they surface as uncollectible.

Loans and leases not meeting the criteria above that are analyzed individually as part of the process described above are considered to be pass rated loans and leases. Loans and leases listed as not rated are either less than \$0.5 million or are included in groups of homogeneous loan pools. The following table presents by class and credit indicator, the recorded investment in the Company's loans and leases as of March 31, 2013 and December 31, 2012:

|                                            | Pass       | Special<br>Mention | Substandard | Doubtful | Loss | Not Rated    | Less:<br>Unearned<br>Income | Total        |
|--------------------------------------------|------------|--------------------|-------------|----------|------|--------------|-----------------------------|--------------|
| (Dollars in thousands)                     |            |                    |             |          |      |              |                             |              |
| March 31, 2013                             |            |                    |             |          |      |              |                             |              |
| Commercial,<br>financial<br>& agricultural | \$ 268,961 | \$ 2,543           | \$ 7,243    | \$ -     | \$ - | \$ 38,252    | \$ 131                      | \$ 316,868   |
| Real estate:                               |            |                    |             |          |      |              |                             |              |
| Construction                               | 44,996     | 5,673              | 34,736      | -        | -    | 2,677        | 31                          | 88,051       |
| Mortgage -<br>residential                  | 95,881     | 718                | 27,449      | -        | -    | 949,946      | (407 )                      | 1,074,401    |
| Mortgage -<br>commercial                   | 555,691    | 35,798             | 34,469      | -        | -    | 11,616       | 1,185                       | 636,389      |
| Consumer                                   | 10,226     | 150                | 22          | -        | -    | 139,746      | 191                         | 149,953      |
| Leases                                     | 8,461      | 183                | 292         | -        | -    | -            | -                           | 8,936        |
| Total                                      | \$ 984,216 | \$ 45,065          | \$ 104,211  | \$ -     | \$ - | \$ 1,142,237 | \$ 1,131                    | \$ 2,274,598 |
| December 31, 2012                          |            |                    |             |          |      |              |                             |              |
| Commercial,<br>financial<br>& agricultural | \$ 192,298 | \$ 6,609           | \$ 7,607    | \$ -     | \$ - | \$ 39,764    | \$ 60                       | \$ 246,218   |
| Real estate:                               |            |                    |             |          |      |              |                             |              |
| Construction                               | 39,623     | 9,635              | 43,986      | -        | -    | 2,996        | 46                          | 96,194       |
| Mortgage -<br>residential                  | 83,535     | 1,109              | 30,896      | -        | -    | 919,733      | (124 )                      | 1,035,397    |
| Mortgage -<br>commercial                   | 563,813    | 65,114             | 30,754      | -        | -    | 13,825       | 1,258                       | 672,248      |
| Consumer                                   | 10,161     | -                  | 129         | -        | -    | 133,097      | 4                           | 143,383      |
| Leases                                     | 9,860      | 274                | 370         | -        | -    | -            | -                           | 10,504       |
| Total                                      | \$ 899,290 | \$ 82,741          | \$ 113,742  | \$ -     | \$ - | \$ 1,109,415 | \$ 1,244                    | \$ 2,203,944 |

In accordance with applicable Interagency Guidance issued by our primary bank regulators, we define subprime borrowers as typically having weakened credit histories that include payment delinquencies and possibly more severe problems such as charge-offs, judgments, and bankruptcies. They may also display reduced repayment capacity as measured by credit scores, debt-to-income ratios, or other criteria that may encompass borrowers with incomplete credit histories. Subprime loans are loans to borrowers displaying one or more of these characteristics at the time of origination or purchase. Such loans have a higher risk of default than loans to prime borrowers. At March 31, 2013 and December 31, 2012, we did not have any loans that we considered to be subprime.

## 6. ALLOWANCE FOR LOAN AND LEASE LOSSES

The following table presents by class, the activity in the Allowance for the periods indicated:

|                                              | Commercial,<br>financial<br>&<br>agricultural | Construction | Real estate<br>Mortgage<br>-<br>residential | Mortgage<br>-<br>commercial | Consumer | Leases | Unallocated | Total      |
|----------------------------------------------|-----------------------------------------------|--------------|---------------------------------------------|-----------------------------|----------|--------|-------------|------------|
| (Dollars in thousands)                       |                                               |              |                                             |                             |          |        |             |            |
| Three Months Ended March 31, 2013            |                                               |              |                                             |                             |          |        |             |            |
| Beginning balance                            | \$ 4,987                                      | \$ 4,510     | \$ 29,910                                   | \$ 48,500                   | \$ 2,421 | \$ 85  | \$ 6,000    | \$ 96,413  |
| Provision (credit) for loan and lease losses | 3,406                                         | (971 )       | 264                                         | (9,791 )                    | 542      | (11 )  | -           | (6,561 )   |
|                                              | 8,393                                         | 3,539        | 30,174                                      | 38,709                      | 2,963    | 74     | 6,000       | 89,852     |
| Charge-offs                                  | (244 )                                        | (78 )        | (414 )                                      | (3,674 )                    | (315 )   | -      | -           | (4,725 )   |
| Recoveries                                   | 492                                           | 485          | 231                                         | 254                         | 216      | 1      | -           | 1,679      |
| Net charge-offs                              | 248                                           | 407          | (183 )                                      | (3,420 )                    | (99 )    | 1      | -           | (3,046 )   |
| Ending balance                               | \$ 8,641                                      | \$ 3,946     | \$ 29,991                                   | \$ 35,289                   | \$ 2,864 | \$ 75  | \$ 6,000    | \$ 86,806  |
| Three Months Ended March 31, 2012            |                                               |              |                                             |                             |          |        |             |            |
| Beginning balance                            | \$ 6,110                                      | \$ 28,630    | \$ 32,736                                   | \$ 47,729                   | \$ 2,335 | \$ 553 | \$ 4,000    | \$ 122,093 |
| Provision (credit) for loan and lease losses | 603                                           | (6,049 )     | 792                                         | (1,820 )                    | (170 )   | (346 ) | 2,000       | (4,990 )   |
|                                              | 6,713                                         | 22,581       | 33,528                                      | 45,909                      | 2,165    | 207    | 6,000       | 117,103    |
| Charge-offs                                  | (1,682 )                                      | (1,626 )     | (200 )                                      | -                           | (426 )   | (28 )  | -           | (3,962 )   |
| Recoveries                                   | 270                                           | 425          | 117                                         | 2                           | 366      | 1      | -           | 1,181      |
| Net charge-offs                              | (1,412 )                                      | (1,201 )     | (83 )                                       | 2                           | (60 )    | (27 )  | -           | (2,781 )   |
| Ending balance                               | \$ 5,301                                      | \$ 21,380    | \$ 33,445                                   | \$ 45,911                   | \$ 2,105 | \$ 180 | \$ 6,000    | \$ 114,322 |

In accordance with GAAP, loans held for sale and other real estate assets are not included in our assessment of the Allowance.

Our Provision was a credit of \$6.6 million in the three months ended March 31, 2013, compared to a credit of \$5.0 million in the three months ended March 31, 2012. The decrease in our Allowance is directly attributable to continued improvement in our credit risk profile as evidenced by declines in nonperforming assets and lower levels of net charge-offs.

In determining the amount of our Allowance, we rely on an analysis of our loan portfolio, our experience and our evaluation of general economic conditions, as well as regulatory requirements and input. If our assumptions prove to be incorrect, our current Allowance may not be sufficient to cover future loan losses and we may experience increases to our Provision.

## 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 was 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 available for sale securities and were therefore recorded at their fair value of \$5.3 million and \$6.3 million at March 31, 2013 and December 31, 2012, respectively. The fair values of these mortgage-backed securities were based on quoted prices of similar instruments in active markets. Unrealized gains of \$0.3 million and \$0.4 million on unsold mortgage-backed securities were recorded in accumulated other comprehensive income ("AOCI") at March 31, 2013 and December 31, 2012, respectively.



## 8. OTHER INTANGIBLE ASSETS

Other intangible assets include a core deposit premium and mortgage servicing rights. The following table presents changes in other intangible assets for the three months ended March 31, 2013:

|                              | Core<br>Deposit<br>Premium | Mortgage<br>Servicing<br>Rights<br>(Dollars in thousands) | Total     |
|------------------------------|----------------------------|-----------------------------------------------------------|-----------|
| Balance, beginning of period | \$ 15,378                  | \$ 22,121                                                 | \$ 37,499 |
| Additions                    | -                          | 924                                                       | 924       |
| Amortization                 | (669 )                     | (1,579 )                                                  | (2,248 )  |
| Balance, end of period       | \$ 14,709                  | \$ 21,466                                                 | \$ 36,175 |

Income generated as the result of new mortgage servicing rights is reported as gains on sales of loans and totaled \$0.9 million and \$1.2 million for the three months ended March 31, 2013 and 2012, respectively. Amortization of mortgage servicing rights was \$1.6 million and \$1.0 million for the three months ended March 31, 2013 and 2012, respectively.

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<br>March 31,<br>2013      2012<br>(Dollars in thousands) |   |           |   |
|----------------------------------------------|-----------------------------------------------------------------------------|---|-----------|---|
| Fair market value, beginning of period       | \$ 22,356                                                                   |   | \$ 23,149 |   |
| Fair market value, end of period             | 21,595                                                                      |   | 23,275    |   |
| Weighted average discount rate               | 8.0                                                                         | % | 8.5       | % |
| Weighted average prepayment speed assumption | 14.1                                                                        |   | 14.0      |   |

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

|                           | March 31, 2013             |                             |           | December 31, 2012          |                             |           |
|---------------------------|----------------------------|-----------------------------|-----------|----------------------------|-----------------------------|-----------|
|                           | Gross<br>Carrying<br>Value | Accumulated<br>Amortization | Net       | Gross<br>Carrying<br>Value | Accumulated<br>Amortization | Net       |
|                           | (Dollars in thousands)     |                             |           |                            |                             |           |
| Core deposit premium      | \$ 44,642                  | \$ (29,933 )                | \$ 14,709 | \$ 44,642                  | \$ (29,264 )                | \$ 15,378 |
| Mortgage servicing rights | 52,663                     | (31,197 )                   | 21,466    | 51,739                     | (29,618 )                   | 22,121    |
| Customer relationships    | -                          | -                           | -         | 1,400                      | (1,400 )                    | -         |
| Non-compete agreements    | -                          | -                           | -         | 300                        | (300 )                      | -         |
|                           | \$ 97,305                  | \$ (61,130 )                | \$ 36,175 | \$ 98,081                  | \$ (60,582 )                | \$ 37,499 |



Based on the core deposit premium and mortgage servicing rights held as of March 31, 2013, estimated amortization expense for the remainder of fiscal 2013, the next five succeeding fiscal years are as follows:

| Estimated Amortization Expense |                            |                                 |           |
|--------------------------------|----------------------------|---------------------------------|-----------|
|                                | Core<br>Deposit<br>Premium | Mortgage<br>Servicing<br>Rights | Total     |
|                                | (Dollars in thousands)     |                                 |           |
| 2013 (remainder)\$             | 2,006                      | \$ 4,315                        | \$ 6,321  |
| 2014                           | 2,674                      | 5,044                           | 7,718     |
| 2015                           | 2,674                      | 4,480                           | 7,154     |
| 2016                           | 2,674                      | 3,992                           | 6,666     |
| 2017                           | 2,674                      | 3,611                           | 6,285     |
| 2018                           | 2,007                      | 24                              | 2,031     |
|                                | \$ 14,709                  | \$ 21,466                       | \$ 36,175 |

We perform an impairment assessment of our other intangible assets whenever events or changes in circumstance indicate that the carrying value of those assets may not be recoverable. Our impairment assessments involve, among other valuation methods, the estimation of future cash flows and other methods of determining fair value. Estimating future cash flows and determining fair values is subject to judgment and often involves the use of significant estimates and assumptions. The variability of the factors we use to perform our impairment tests depend on a number of conditions, including the uncertainty about future events and cash flows. All such factors are interdependent and, therefore, do not change in isolation. Accordingly, our accounting estimates may materially change from period to period due to changing market factors.

## 9. DERIVATIVES

We utilize various designated and undesignated derivative financial instruments to reduce our exposure to movements in interest rates including interest rate swaps, interest rate lock commitments and forward sale commitments. We measure all derivatives at fair value on our consolidated balance sheet. In each reporting period, we record the derivative instruments in other assets or other liabilities depending on whether the derivatives are in an asset or liability position. For derivative instruments that are designated as hedging instruments, we record the effective portion of the changes in the fair value of the derivative in AOCI, net of tax, until earnings are affected by the variability of cash flows of the hedged transaction. We immediately recognize the portion of the gain or loss in the fair value of the derivative that represents hedge ineffectiveness in current period earnings. For derivative instruments that are not designated as hedging instruments, changes in the fair value of the derivative are included in current period earnings.

### Interest Rate Lock and Forward Sale Commitments

We enter into interest rate lock commitments on certain mortgage loans that are intended to be sold. To manage interest rate risk on interest rate lock commitments, we also enter into forward loan sale commitments. The interest rate lock and forward loan sale commitments are accounted for as undesignated derivatives and are recorded at their respective fair values in other assets or other liabilities, with changes in fair value recorded in current period earnings. These instruments serve to reduce our exposure to movements in interest rates. At March 31, 2013, we were a party to interest rate lock and forward sale commitments on \$64.6 million and \$21.2 million of mortgage loans, respectively.

The following table presents the location of all assets and liabilities associated with our derivative instruments within the consolidated balance sheet:

| Derivatives not<br>designated<br>as hedging<br>instruments | Asset Derivatives                         |                                    | Liability Derivatives                                           |                                    |                                       |
|------------------------------------------------------------|-------------------------------------------|------------------------------------|-----------------------------------------------------------------|------------------------------------|---------------------------------------|
|                                                            | Balance<br>Sheet<br>Location              | Fair Value at<br>March 31,<br>2013 | Fair Value at<br>December 31,<br>2012<br>(Dollars in thousands) | Fair Value at<br>March 31,<br>2013 | Fair Value at<br>December 31,<br>2012 |
| Interest rate<br>contracts                                 | Other assets<br>/<br>other<br>liabilities | \$ 358                             | \$ 303                                                          | \$ 236                             | \$ 551                                |

The following table presents the impact of derivative instruments and their location within the consolidated statements of income:

| Derivatives in Cash Flow<br>Hedging Relationship | Amount of Gain (Loss)<br>Reclassified from AOCI<br>into<br>Earnings (Effective<br>Portion)<br>(Dollars in thousands) |
|--------------------------------------------------|----------------------------------------------------------------------------------------------------------------------|
| Three Months Ended<br>March 31, 2013             |                                                                                                                      |
| Interest rate contracts                          | \$ (394 )                                                                                                            |
| Three Months Ended<br>March 31, 2012             |                                                                                                                      |
| Interest rate contracts                          | 572                                                                                                                  |

Amounts recognized in AOCI are net of income taxes. Amounts reclassified from AOCI into income are included in interest income in the consolidated statements of income. The ineffective portion has been recognized as other operating income in the consolidated statements of income.

| Derivatives not in Cash Flow<br>Hedging Relationship | Location of Gain<br>Recognized<br>in Earnings on Derivatives | Amount of Gain<br>Recognized in Earnings<br>on Derivatives<br>(Dollars in thousands) |
|------------------------------------------------------|--------------------------------------------------------------|--------------------------------------------------------------------------------------|
| Three Months Ended March 31,<br>2013                 |                                                              |                                                                                      |
| Interest rate contracts                              | Other operating income                                       | \$ 370                                                                               |
| Three Months Ended March 31,<br>2012                 |                                                              |                                                                                      |
| Interest rate contracts                              | Other operating income                                       | 153                                                                                  |

#### 10. SHORT-TERM BORROWINGS AND LONG-TERM DEBT

At March 31, 2013 and December 31, 2012, we had no short-term borrowings.

At March 31, 2013, our bank maintained a \$20.9 million line of credit with the Federal Reserve discount window, of which there were no advances outstanding. As of March 31, 2013, certain commercial and commercial real estate loans totaling \$34.8 million have been pledged as collateral on our line of credit with the Federal Reserve discount window. The Federal Reserve does not have the right to sell or repledge these loans.

The bank is a member of and maintained an \$862.4 million line of credit with the Federal Home Loan Bank of Seattle (the "FHLB") as of March 31, 2013. Long-term borrowings under this arrangement totaled \$27,000 at March 31, 2013, compared to \$32,000 at December 31, 2012. There were no short-term borrowings under this arrangement at March 31, 2013 and December 31, 2012. At March 31, 2013 the bank's pledged assets to the FHLB included investment securities with a fair value of \$97.7 million and certain real estate loans totaling \$1.2 billion.

On August 20, 2009, we began deferring regularly scheduled interest payments on our outstanding junior subordinated debentures relating to our trust preferred securities. The terms of the junior subordinated debentures and the trust

documents allow us to defer payments of interest for up to 20 consecutive quarterly periods without default or penalty. During the deferral period, the respective trusts suspended the declaration and payment of dividends on the trust preferred securities. Also during the deferral period, we may not, among other things and with limited exceptions, pay cash dividends on or repurchase our common stock or make any payment on outstanding debt obligations that rank equally with or junior to the junior subordinated debentures. During the deferral period, we continued to accrue, and reflect in our consolidated financial statements, the deferred interest payments on our junior subordinated debentures. In March 2013, the Company elected to pay all deferred interest on its subordinated debentures and related dividend payments on its trust preferred securities and resume quarterly payments for each outstanding trust. As a result, the deferred accrued interest in the amount of \$13.0 million was paid in full.

## 11. EQUITY

The warrant to purchase up to 79,288 shares of our common stock at a purchase price of \$10 per share currently held by the U.S. Treasury includes a “down-round” provision allowing for the future adjustment to the exercise price for any subsequent issuances of common stock by the Company. Subject to certain exceptions, if the Company subsequently issues common stock, or rights or shares convertible into common stock, at a per share price lower than the \$10 exercise price of the warrant, the exercise price of the warrant will be reduced to the per share common stock amount received in connection with the issuance and the number of shares of common stock subject to the warrant will be increased. This provision resulted in the warrant being carried as a derivative liability as compared to a common stock equivalent for balance sheet purposes as it possesses the characteristics of a freestanding derivative financial instrument as defined by Accounting Standards Codification (“ASC”) 815-10-15-83, Accounting for Derivatives and Hedging, and similar to the example illustrated in ASC 815-40-55-33 and -34. As a derivative liability, the warrant is carried at fair value, with subsequent remeasurements recorded through the current period's earnings. The initial value attributed to the warrant was \$1.7 million, with the fair value estimated using the Black-Scholes options pricing model, with the following assumptions: 67% volatility, a risk-free rate of 3.59%, a yield of 1.45% and an estimated life of 10 years. From February 18, 2011 through March 31, 2013, this instrument's estimated fair value decreased, which resulted in the recognition of \$1.0 million recorded in other noninterest income during the year ended December 31, 2011, and a \$0.1 million charge to other noninterest expense in 2012. From January 1, 2013 to March 31, 2013, this instrument's estimated fair value increased slightly, which resulted in the recognition of \$9,000 recorded in other noninterest expense during the first quarter of 2013.

We have generated considerable tax benefits, including net operating loss carry-forwards and federal and state tax credits. Our use of the tax benefits in the future would be significantly limited if we experience an “ownership change” for U.S. federal income tax purposes. In general, an “ownership change” will occur if there is a cumulative increase in the Company's ownership by “5-percent shareholders” (as defined under U.S. income tax laws) that exceeds 50 percentage points over a rolling three-year period.

On November 23, 2010, our board declared a dividend of preferred share purchase rights (“Rights”) in respect to our common stock which were issued pursuant to a Tax Benefits Preservation Plan, dated as of November 23, 2010 (the “Tax Benefits Preservation Plan”), between the Company and Wells Fargo Bank, National Association, as rights agent. Each Right represents the right to purchase, upon the terms and subject to the conditions in the Plan, 1/10,000th of a share of our Junior Participating Preferred Stock, Series C, no par value, for \$6.00, subject to adjustment. The Tax Benefits Preservation Plan is designed to reduce the likelihood that the Company will experience an ownership change by discouraging any person from becoming a beneficial owner of 4.99% or more of our common stock (a “Threshold Holder”).

To further protect our tax benefits, on January 26, 2011, our board approved an amendment to our restated articles of incorporation to restrict transfers of our stock if the effect of an attempted transfer would cause the transferee to become a Threshold Holder or to cause the beneficial ownership of a Threshold Holder to increase (the “Protective Charter Amendment”). At our annual meeting of shareholders on April 27, 2011, we proposed the amendment which shareholders approved. There is no guarantee, however, that the Tax Benefits Preservation Plan or the Protective Charter Amendment will prevent the Company from experiencing an ownership change.

As set forth above, our ability to pay dividends with respect to common stock was restricted until our obligations under our trust preferred securities were brought current which occurred in the quarter ended March 31, 2013. Additionally, our ability to pay dividends depends on our ability to obtain dividends from our bank. As a Hawaii state-chartered bank, Central Pacific Bank may only pay dividends to the extent it has retained earnings as defined under Hawaii banking law (“Statutory Retained Earnings”), which differs from GAAP retained earnings. As of March 31, 2013, the bank had Statutory Retained Earnings of \$160.9 million. In light of the Company's improved capital position and financial condition, our Board of Directors and management, in consultation with our regulators, are

currently evaluating a variety of alternatives to strategically manage the Company's capital levels, including the Company's prospects and ability to pay cash dividends to our stockholders. Any decision to pay dividends or otherwise take any action with respect to our capital position, including, but not limited to, repurchasing any of our securities, is subject to the discretion of our Board of Directors as well as any applicable regulatory and contractual limitations.



## 12. SHARE-BASED COMPENSATION

## Restricted Stock Awards and Units

The table below presents the activity of restricted stock awards and units for the three months ended March 31, 2013:

|                                 | Shares    | Weighted<br>Average<br>Grant Date<br>Fair Value |
|---------------------------------|-----------|-------------------------------------------------|
| Nonvested at January 1,<br>2013 | 1,098,806 | \$ 14.61                                        |
| Changes during the<br>period:   |           |                                                 |
| Granted                         | 103,558   | 15.49                                           |
| Vested                          | (650 )    | 13.84                                           |
| Forfeited                       | (26,570 ) | 14.63                                           |
| Nonvested at March 31,<br>2013  | 1,175,144 | 14.68                                           |

## 13. ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The following table presents the changes in AOCI for the three months ended March 31, 2013 and 2012, by component:

|                                                                  | Before Tax             | Tax Effect   | Net of Tax  |
|------------------------------------------------------------------|------------------------|--------------|-------------|
|                                                                  | (Dollars in thousands) |              |             |
| Three Months Ended March 31, 2013                                |                        |              |             |
| Net unrealized gain on investment securities:                    |                        |              |             |
| Net unrealized loss arising during the period                    | \$ (4,823 )            | \$ -         | \$ (4,823 ) |
| Change in net unrealized gain on investment securities           | (4,823 )               | -            | (4,823 )    |
|                                                                  |                        |              |             |
| Net unrealized loss on derivatives:                              |                        |              |             |
| Reclassification adjustment for gain/loss realized in net income | 394                    | (10,599 )    | 10,993      |
| Change in net unrealized loss on derivatives                     | 394                    | (10,599 )    | 10,993      |
|                                                                  |                        |              |             |
| Defined benefit plans:                                           |                        |              |             |
| Amortization of accumulated benefit plan losses                  | 616                    | -            | 616         |
| Amortization of unrecognized transition obligations              | 4                      | -            | 4           |
| Amortization of prior service cost                               | 5                      | -            | 5           |
| Change in defined benefit plans                                  | 625                    | -            | 625         |
|                                                                  |                        |              |             |
| Change in accumulated other comprehensive income                 | \$ (3,804 )            | \$ (10,599 ) | \$ 6,795    |
|                                                                  |                        |              |             |
| Three Months Ended March 31, 2012                                |                        |              |             |
| Net unrealized gain on investment securities:                    |                        |              |             |
| Net unrealized loss arising during the period                    | \$ (3,480 )            | \$ -         | \$ (3,480 ) |
| Change in net unrealized gain on investment securities           | (3,480 )               | -            | (3,480 )    |

|                                                                  |             |      |             |
|------------------------------------------------------------------|-------------|------|-------------|
| Net unrealized loss on derivatives:                              |             |      |             |
| Reclassification adjustment for gain/loss realized in net income | (572 )      | -    | (572 )      |
| Change in net unrealized loss on derivatives                     | (572 )      | -    | (572 )      |
| Defined benefit plans:                                           |             |      |             |
| Amortization of accumulated benefit plan losses                  | 580         | -    | 580         |
| Amortization of unrecognized transition obligations              | 4           | -    | 4           |
| Amortization of prior service cost                               | 5           | -    | 5           |
| Change in defined benefit plans                                  | 589         | -    | 589         |
| Change in accumulated other comprehensive income                 | \$ (3,463 ) | \$ - | \$ (3,463 ) |

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The following table presents the changes in each component of AOCI, net of tax, for the three months ended March 31, 2013:

|                                                            | Net<br>Unrealized<br>Gain on<br>Investment<br>Securities | Net<br>Unrealized<br>Loss on<br>Derivatives<br>(Dollars in thousands) | Defined<br>Benefit<br>Plans | Total     |
|------------------------------------------------------------|----------------------------------------------------------|-----------------------------------------------------------------------|-----------------------------|-----------|
| Balance at January 1, 2013                                 | \$ 22,740                                                | \$ (10,993 )                                                          | \$ (12,577 )                | \$ (830 ) |
| Other comprehensive income (loss) before reclassifications | (4,823 )                                                 | -                                                                     | -                           | (4,823 )  |
| Amounts reclassified from AOCI                             | -                                                        | 10,993                                                                | 625                         | 11,618    |
| Net current-period other comprehensive income (loss)       | (4,823 )                                                 | 10,993                                                                | 625                         | 6,795     |
| Balance at March 31, 2013                                  | \$ 17,917                                                | \$ -                                                                  | \$ (11,952 )                | \$ 5,965  |

The following table presents the amounts reclassified out of each component of AOCI for the three months ended March 31, 2013:

| Details about AOCI Components<br>(Dollars in thousands) | Amount<br>Reclassified<br>from AOCI | Affected Line<br>Item in<br>the Statement<br>Where<br>Net Income is<br>Presented |
|---------------------------------------------------------|-------------------------------------|----------------------------------------------------------------------------------|
| Unrealized loss on derivatives                          |                                     |                                                                                  |
|                                                         | \$ 394                              | Interest income                                                                  |
|                                                         | 10,599                              | Income tax benefit                                                               |
|                                                         | \$ 10,993                           | Net of tax                                                                       |
| Amortization of defined benefit plan items              |                                     |                                                                                  |
| Net actuarial losses                                    | \$ 616                              | (1)                                                                              |
| Transition obligations                                  | 4                                   | (1)                                                                              |
| Prior service cost                                      | 5                                   | (1)                                                                              |
|                                                         | 625                                 | Total before income tax                                                          |
|                                                         | -                                   | Income tax benefit                                                               |
|                                                         |                                     | Net of income tax                                                                |
|                                                         | \$ 625                              |                                                                                  |
| Total reclassifications for the period                  | \$ 11,618                           | Net of income tax                                                                |

(1) These accumulated other comprehensive income components are included in the computation of net periodic pension cost (see Note 14 for additional details).

#### 14. PENSION AND SUPPLEMENTAL EXECUTIVE RETIREMENT PLANS

Central Pacific Bank has a defined benefit retirement plan (the "Pension Plan") which covers certain eligible employees. The plan was curtailed effective December 31, 2002, and accordingly, plan benefits were fixed as of that date. The following table sets forth the components of net periodic benefit cost for the Pension Plan:

|                                      | Three Months Ended<br>March 31, |        |
|--------------------------------------|---------------------------------|--------|
|                                      | 2013                            | 2012   |
|                                      | (Dollars in thousands)          |        |
| Interest cost                        | \$ 348                          | \$ 398 |
| Expected return on assets            | (470 )                          | (447 ) |
| Amortization of<br>unrecognized loss | 599                             | 581    |
| Net periodic cost                    | \$ 477                          | \$ 532 |

Our bank also established Supplemental Executive Retirement Plans (“SERPs”), which provide certain officers of our bank with supplemental retirement benefits. The following table sets forth the components of net periodic benefit cost for the SERPs:

|                                                    | Three Months Ended<br>March 31, |        |
|----------------------------------------------------|---------------------------------|--------|
|                                                    | 2013                            | 2012   |
|                                                    | (Dollars in thousands)          |        |
| Service cost                                       | \$ -                            | \$ -   |
| Interest cost                                      | 103                             | 107    |
| Amortization of unrecognized transition obligation | 4                               | 4      |
| Amortization of prior service cost                 | 5                               | 5      |
| Amortization of unrecognized (gain) loss           | 18                              | (1 )   |
| Net periodic cost                                  | \$ 130                          | \$ 115 |

## 15. INCOME AND FRANCHISE TAXES

In assessing the realizability of deferred tax assets (“DTA”), management considers whether it is more likely than not that some portion or all of the DTA will not be realized. The ultimate realization of DTA is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the reversal of deferred tax liabilities (including the impact of available carryback and carryforward periods), projected future taxable income and tax-planning strategies in making this assessment.

In the first quarter of 2013, the Company reversed a significant portion of the valuation allowance that was established against our net DTA during the third quarter of 2009. The valuation allowance was established during 2009 due to uncertainty at the time regarding our ability to generate sufficient future taxable income to fully realize the benefit of our net DTA. The quarter ended March 31, 2013 marked our ninth consecutive quarter of profitability. Based on this earnings performance trend, improvements in our financial condition, asset quality and capital ratios, and the expectation of continued profitability, the Company determined that it was more likely than not that a significant portion of our net DTA would be realized.

The Company does not expect to recognize any income tax expense until the first quarter of 2014 as a portion of the remaining deferred tax asset valuation allowance is expected to offset income tax expense for the remainder of 2013. The net impact of reversing the valuation allowance and recording the provision for income tax expense was a net income tax benefit of \$119.8 million. The Company did not recognize any income tax expense in the comparable prior period. As of March 31, 2013, the remaining valuation allowance on our net DTA totaled \$14.3 million. Net of this valuation allowance, as of March 31, 2013, the Company’s net DTA totaled \$130.0 million, compared to a fully reserved net DTA of \$147.5 million as of December 31, 2012, and is included in other assets on our consolidated balance sheets.

## 16. EARNINGS PER SHARE

The following table presents the information used to compute basic and diluted earnings per common share for the periods indicated:

|                                       | Three Months Ended March<br>31, |      |
|---------------------------------------|---------------------------------|------|
|                                       | 2013                            | 2012 |
| (In thousands, except per share data) |                                 |      |

|                                                           |            |           |
|-----------------------------------------------------------|------------|-----------|
| Net income                                                | \$ 137,309 | \$ 13,478 |
| Weighted average shares outstanding - basic               | 41,816     | 41,631    |
| Dilutive effect of employee stock options and awards      | 447        | 127       |
| Dilutive effect of deferred salary restricted stock units | 5          | 60        |
| Dilutive effect of Treasury warrants                      | 29         | 21        |
| Weighted average shares outstanding - diluted             | 42,297     | 41,839    |
| Basic earnings per share                                  | \$ 3.28    | \$ 0.32   |
| Diluted earnings per share                                | \$ 3.25    | \$ 0.32   |

A total of 26,256 and 40,166 potentially dilutive securities have been excluded from the dilutive share calculation for the three months ended March 31, 2013 and 2012, respectively, as their effect was antidilutive.

## 17. FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

### Disclosures about Fair Value of Financial Instruments

Fair value estimates, methods and assumptions are set forth below for our financial instruments.

#### Short-Term Financial Instruments

The carrying values of short-term financial instruments are deemed to approximate fair values. Such instruments are considered readily convertible to cash and include cash and due from banks, interest-bearing deposits in other banks, accrued interest receivable, the majority of short-term borrowings and accrued interest payable.

#### Investment Securities

The fair value of investment securities is based on market price quotations received from securities dealers. Where quoted market prices are not available, fair values are based on quoted market prices of comparable securities.

#### Loans

Fair values of loans are estimated based on discounted cash flows of portfolios of loans with similar financial characteristics including the type of loan, interest terms and repayment history. Fair values are calculated by discounting scheduled cash flows through estimated maturities using estimated market discount rates. Estimated market discount rates are reflective of credit and interest rate risks inherent in the Company's various loan types and are derived from available market information, as well as specific borrower information. The fair value of loans are not based on the notion of exit price.

#### Loans Held for Sale

The fair value of loans classified as held for sale are generally based upon quoted prices for similar assets in active markets, acceptance of firm offer letters with agreed upon purchase prices, discounted cash flow models that take into account market observable assumptions, or independent appraisals of the underlying collateral securing the loans. We report the fair values of Hawaii and U.S. Mainland construction and commercial real estate loans net of applicable selling costs on our consolidated balance sheets.

#### Other Interest Earning Assets

The equity investment in common stock of the FHLB, which is redeemable for cash at par value, is reported at its par value.

#### Deposit Liabilities

The fair values of deposits with no stated maturity, such as noninterest-bearing demand deposits and interest-bearing demand and savings accounts, are equal to the amount payable on demand. The fair value of time deposits is estimated using discounted cash flow analyses. The discount rate is estimated using the rates currently offered for deposits of similar remaining maturities.

#### Short-Term Borrowings and Long-Term Debt

The fair value for a portion of our short-term borrowings is estimated by discounting scheduled cash flows using rates currently offered for securities of similar remaining maturities. The fair value of our long-term debt is estimated by discounting scheduled cash flows over the contractual borrowing period at the estimated market rate for similar borrowing arrangements.



### Off-Balance Sheet Financial Instruments

The fair values of off-balance sheet financial instruments are estimated based on the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties, current settlement values or quoted market prices of comparable instruments.

For derivative financial instruments, the fair values are based upon current settlement values, if available. If there are no relevant comparables, fair values are based on pricing models using current assumptions for interest rate swaps and options.

### Limitations

Fair value estimates are made at a specific point in time based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time our entire holdings of a particular financial instrument. Because no market exists for a significant portion of our financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value estimates are based on existing on- and off-balance sheet financial instruments without attempting to estimate the value of future business and the value of assets and liabilities that are not considered financial instruments. For example, significant assets and liabilities that are not considered financial assets or liabilities include deferred tax assets, premises and equipment and intangible assets. In addition, the tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in many of the estimates.

|                                                               |                    |                         | Fair Value Measurement Using                                                  |                                                           |                                                    |
|---------------------------------------------------------------|--------------------|-------------------------|-------------------------------------------------------------------------------|-----------------------------------------------------------|----------------------------------------------------|
|                                                               |                    |                         | Quoted Prices<br>in Active<br>Markets for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|                                                               | Carrying<br>amount | Estimated<br>fair value | (Dollars in thousands)                                                        |                                                           |                                                    |
| March 31, 2013                                                |                    |                         |                                                                               |                                                           |                                                    |
| Financial assets                                              |                    |                         |                                                                               |                                                           |                                                    |
| Cash and due from banks                                       | \$ 46,877          | \$ 46,877               | \$ 46,877                                                                     | \$ -                                                      | \$ -                                               |
| Interest-bearing deposits in<br>other banks                   | 167,632            | 167,632                 | 167,632                                                                       | -                                                         | -                                                  |
| Investment securities                                         | 1,696,428          | 1,696,548               | 816                                                                           | 1,683,019                                                 | 12,713                                             |
| Loans held for sale                                           | 17,293             | 17,293                  | -                                                                             | -                                                         | 17,293                                             |
| Net loans and leases                                          | 2,187,792          | 2,106,972               | -                                                                             | 104,189                                                   | 2,002,783                                          |
| Accrued interest receivable                                   | 14,148             | 14,148                  | 14,148                                                                        | -                                                         | -                                                  |
|                                                               |                    |                         |                                                                               |                                                           |                                                    |
| Financial liabilities                                         |                    |                         |                                                                               |                                                           |                                                    |
| Deposits:                                                     |                    |                         |                                                                               |                                                           |                                                    |
| Noninterest-bearing deposits                                  | 857,427            | 857,427                 | 857,427                                                                       | -                                                         | -                                                  |
| Interest-bearing demand and<br>savings deposits               | 1,861,526          | 1,861,526               | 1,861,526                                                                     | -                                                         | -                                                  |
| Time deposits                                                 | 1,045,738          | 1,047,948               | -                                                                             | -                                                         | 1,047,948                                          |
| Long-term debt                                                | 108,276            | 45,029                  | -                                                                             | 45,029                                                    | -                                                  |
| Accrued interest payable<br>(included in other liabilities)   | 1,009              | 1,009                   | 1,009                                                                         | -                                                         | -                                                  |
|                                                               |                    |                         |                                                                               |                                                           |                                                    |
| Off-balance sheet financial<br>instruments                    |                    |                         |                                                                               |                                                           |                                                    |
| Commitments to extend credit                                  | 568,013            | 2,840                   | -                                                                             | 2,840                                                     | -                                                  |
| Standby letters of credit and<br>financial guarantees written | 18,663             | 140                     | -                                                                             | 140                                                       | -                                                  |
| Interest rate options                                         | 64,598             | 183                     | -                                                                             | 183                                                       | -                                                  |
| Forward interest rate contracts                               | 21,219             | (61 )                   | -                                                                             | (61 )                                                     | -                                                  |
|                                                               |                    |                         |                                                                               |                                                           |                                                    |
| December 31, 2012                                             |                    |                         |                                                                               |                                                           |                                                    |
| Financial assets                                              |                    |                         |                                                                               |                                                           |                                                    |
| Cash and due from banks                                       | \$ 56,473          | \$ 56,473               | \$ 56,473                                                                     | \$ -                                                      | \$ -                                               |
| Interest-bearing deposits in<br>other banks                   | 120,902            | 120,902                 | 120,902                                                                       | -                                                         | -                                                  |
| Investment securities                                         | 1,698,593          | 1,699,273               | 906                                                                           | 1,685,541                                                 | 12,826                                             |
| Loans held for sale                                           | 38,283             | 38,283                  | -                                                                             | -                                                         | 38,283                                             |
| Net loans and leases                                          | 2,107,531          | 2,083,514               | -                                                                             | 108,081                                                   | 1,975,433                                          |
| Accrued interest receivable                                   | 13,896             | 13,896                  | 13,896                                                                        | -                                                         | -                                                  |
|                                                               |                    |                         |                                                                               |                                                           |                                                    |
| Financial liabilities                                         |                    |                         |                                                                               |                                                           |                                                    |
| Deposits:                                                     |                    |                         |                                                                               |                                                           |                                                    |
| Noninterest-bearing deposits                                  | 843,292            | 843,292                 | 843,292                                                                       | -                                                         | -                                                  |
|                                                               | 1,858,849          | 1,858,849               | 1,858,849                                                                     | -                                                         | -                                                  |

Interest-bearing demand and  
savings deposits

|                                                             |         |         |        |        |         |
|-------------------------------------------------------------|---------|---------|--------|--------|---------|
| Time deposits                                               | 978,631 | 981,059 | -      | -      | 981,059 |
| Long-term debt                                              | 108,281 | 43,156  | -      | 43,156 | -       |
| Accrued interest payable<br>(included in other liabilities) | 13,131  | 13,131  | 13,131 | -      | -       |

Off-balance sheet financial  
instruments

|                                                               |         |        |   |        |   |
|---------------------------------------------------------------|---------|--------|---|--------|---|
| Commitments to extend credit                                  | 554,477 | 2,772  | - | 2,772  | - |
| Standby letters of credit and<br>financial guarantees written | 13,813  | 104    | - | 104    | - |
| Interest rate options                                         | 67,072  | 106    | - | 106    | - |
| Forward interest rate contracts                               | 49,222  | (353 ) | - | (353 ) | - |

## Fair Value Measurements

We group our financial assets and liabilities at fair value into three levels based on the markets in which the financial assets and liabilities are traded and the reliability of the assumptions used to determine fair value as follows:

- Level 1 – Valuation is based upon quoted prices (unadjusted) for identical assets or liabilities traded in active markets. A quoted price in an active market provides the most reliable evidence of fair value and shall be used to measure fair value whenever available.
- Level 2 – Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.
- Level 3 – Valuation is generated from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect our own estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of discounted cash flow models and similar techniques that requires the use of significant judgment or estimation.

We base our fair values on the price that we would expect to receive if an asset were sold or pay to transfer a liability in an orderly transaction between market participants at the measurement date. We also maximize the use of observable inputs and minimize the use of unobservable inputs when developing fair value measurements.

We use fair value measurements to record adjustments to certain financial assets and liabilities and to determine fair value disclosures. Available for sale securities and derivatives are recorded at fair value on a recurring basis. From time to time, we may be required to record other financial assets at fair value on a nonrecurring basis such as loans held for sale, impaired loans and mortgage servicing rights. These nonrecurring fair value adjustments typically involve application of the lower of cost or fair value accounting or write-downs of individual assets.

There were no transfers of financial assets and liabilities between Level 1 and Level 2 of the fair value hierarchy during the three months ended March 31, 2013.

The following table presents the balances of assets and liabilities measured at fair value on a recurring basis as of March 31, 2013 and December 31, 2012:

|                                                               |              | Fair Value at Reporting Date Using                                            |                                                           |                                                    |
|---------------------------------------------------------------|--------------|-------------------------------------------------------------------------------|-----------------------------------------------------------|----------------------------------------------------|
|                                                               |              | Quoted Prices<br>in Active<br>Markets for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|                                                               | Fair Value   | (Dollars in thousands)                                                        |                                                           |                                                    |
| March 31, 2013                                                |              |                                                                               |                                                           |                                                    |
| Available for sale securities:                                |              |                                                                               |                                                           |                                                    |
| U.S. Government sponsored entities debt securities            | \$ 210,098   | \$ -                                                                          | \$ 210,098                                                | \$ -                                               |
| States and political subdivisions debt securities             | 193,626      | -                                                                             | 180,913                                                   | 12,713                                             |
| U.S. Government sponsored entities mortgage-backed securities | 995,006      | -                                                                             | 995,006                                                   | -                                                  |
| Non-agency collateralized mortgage obligations                | 9,984        | -                                                                             | 9,984                                                     | -                                                  |
| Corporate securities                                          | 127,535      | -                                                                             | 127,535                                                   | -                                                  |
| Other                                                         | 816          | 816                                                                           | -                                                         | -                                                  |
| Derivatives:                                                  |              |                                                                               |                                                           |                                                    |
| Interest rate contracts                                       | 122          | -                                                                             | 122                                                       | -                                                  |
| Amended TARP Warrant                                          | (828 )       | -                                                                             | (828 )                                                    | -                                                  |
| Total                                                         | \$ 1,536,359 | \$ 816                                                                        | \$ 1,522,830                                              | \$ 12,713                                          |
|                                                               |              |                                                                               |                                                           |                                                    |
| December 31, 2012                                             |              |                                                                               |                                                           |                                                    |
| Available for sale securities:                                |              |                                                                               |                                                           |                                                    |
| U.S. Government sponsored entities debt securities            | \$ 280,939   | \$ -                                                                          | \$ 280,939                                                | \$ -                                               |
| States and political subdivisions debt securities             | 185,911      | -                                                                             | 173,085                                                   | 12,826                                             |
| U.S. Government sponsored entities mortgage-backed securities | 941,043      | -                                                                             | 941,043                                                   | -                                                  |
| Corporate securities                                          | 127,946      | -                                                                             | 127,946                                                   | -                                                  |
| Other                                                         | 906          | 906                                                                           | -                                                         | -                                                  |
| Derivatives:                                                  |              |                                                                               |                                                           |                                                    |
| Interest rate contracts                                       | (248 )       | -                                                                             | (248 )                                                    | -                                                  |
| Amended TARP warrant                                          | (819 )       | -                                                                             | (819 )                                                    | -                                                  |
| Total                                                         | \$ 1,535,678 | \$ 906                                                                        | \$ 1,521,946                                              | \$ 12,826                                          |

For the three months ended March 31, 2013 and 2012, the changes in Level 3 assets and liabilities measured at fair value on a recurring basis are summarized as follows:

Available for sale states  
and political subdivisions  
debt securities  
(Dollars in thousands)

|                                                            |    |        |
|------------------------------------------------------------|----|--------|
| Balance at December 31, 2012                               | \$ | 12,826 |
| Principal payments received                                |    | (100 ) |
| Unrealized net loss included in other comprehensive income |    | (86 )  |
| Purchases, sales, issuances and settlements, net           |    | 73     |
| Balance at March 31, 2013                                  | \$ | 12,713 |
| Balance at December 31, 2011                               | \$ | 12,994 |
| Principal payments received                                |    | (95 )  |
| Unrealized net gain included in other comprehensive income |    | 334    |
| Balance at March 31, 2012                                  | \$ | 13,233 |

Within the state and political subdivisions debt securities category, the Company holds five mortgage revenue bonds issued by the City & County of Honolulu with an aggregate fair value of \$12.7 million. The Company estimates the fair value of its mortgage revenue bonds by using a discounted cash flow model to calculate the present value of estimated future principal and interest payments.

The significant unobservable input used in the fair value measurement of the Company's mortgage revenue bonds is the weighted average discount rate. As of March 31, 2013, the weighted average discount rate utilized was 4.51%, which was derived by incorporating a credit spread over the FHLB Fixed-Rate Advance curve. Significant increases (decreases) in the weighted average discount rate could result in a significantly lower (higher) fair value measurement.

For assets measured at fair value on a nonrecurring basis that were recorded at fair value on our balance sheet at March 31, 2013 and December 31, 2012, the following table provides the level of valuation assumptions used to determine the respective fair values:

|                        |            | Fair Value Measurements Using                                                    |                                                           |                                                    |
|------------------------|------------|----------------------------------------------------------------------------------|-----------------------------------------------------------|----------------------------------------------------|
|                        | Fair Value | Quoted<br>Prices<br>in Active<br>Markets for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| (Dollars in thousands) |            |                                                                                  |                                                           |                                                    |
| March 31, 2013         |            |                                                                                  |                                                           |                                                    |
| Impaired loans (1)     | \$ 104,189 | \$ -                                                                             | \$ 104,189                                                | \$ -                                               |
| Other real estate (2)  | 10,068     | -                                                                                | 10,068                                                    | -                                                  |
| December 31, 2012      |            |                                                                                  |                                                           |                                                    |
| Impaired loans (1)     | \$ 108,081 | \$ -                                                                             | \$ 108,081                                                | \$ -                                               |
| Other real estate (2)  | 10,686     | -                                                                                | 10,686                                                    | -                                                  |

(1) Represents carrying value and related write-downs of loans for which adjustments are based on agreed upon purchase prices for the loans or the appraised value of the collateral.

(2) Represents other real estate that is carried at the lower of carrying value or fair value less costs to sell.

Fair value is generally based upon independent market prices or appraised values of the collateral.

## 18. SEGMENT INFORMATION

We have the following three reportable segments: Banking Operations, Treasury and All Others. These segments are consistent with our internal functional reporting lines and are managed separately because each unit has different target markets, technological requirements, marketing strategies and specialized skills.

The Banking Operations segment includes construction and real estate development lending, commercial lending, residential mortgage lending and servicing, indirect auto lending, trust services, retail brokerage services and our retail branch offices, which provide a full range of deposit and loan products, as well as various other banking services. The Treasury segment is responsible for managing the Company's investment securities portfolio and wholesale funding activities. The All Others segment consists of all activities not captured by the Banking Operations or Treasury

segments described above and includes activities such as electronic banking, data processing and management of bank owned properties.

The accounting policies of the segments are consistent with the Company's accounting policies that are described in Note 1 to the consolidated financial statements in the Annual Report on Form 10-K for the year ended December 31, 2012 filed with the SEC. The majority of the Company's net income is derived from net interest income. Accordingly, management focuses primarily on net interest income, rather than gross interest income and expense amounts, in evaluating segment profitability.

Intersegment net interest income (expense) was allocated to each segment based upon a funds transfer pricing process that assigns costs of funds to assets and earnings credits to liabilities based on market interest rates that reflect interest rate sensitivity and maturity characteristics. All administrative and overhead expenses are allocated to the segments at cost. Cash, investment securities, loans and leases and their related balances are allocated to the segment responsible for acquisition and maintenance of those assets. Segment assets also include all premises and equipment used directly in segment operations.



Segment profits (losses) and assets are provided in the following table for the periods indicated.

|                                                  | Banking<br>Operations | Treasury<br>(Dollars in thousands) | All Others  | Total        |
|--------------------------------------------------|-----------------------|------------------------------------|-------------|--------------|
| Three months ended March 31, 2013:               |                       |                                    |             |              |
| Net interest income                              | \$ 24,046             | \$ 6,623                           | \$ -        | \$ 30,669    |
| Intersegment net interest income (expense)       | 3,541                 | (6,311 )                           | 2,770       | -            |
| Credit for loan and lease losses                 | 6,561                 | -                                  | -           | 6,561        |
| Other operating income                           | 11,537                | 872                                | 63          | 12,472       |
| Other operating expense                          | (18,445 )             | (489 )                             | (13,261 )   | (32,195 )    |
| Administrative and overhead expense allocation   | (13,174 )             | (214 )                             | 13,388      | -            |
| Income taxes                                     | 120,712               | 127                                | (1,037 )    | 119,802      |
| Net income (loss)                                | \$ 134,778            | \$ 608                             | \$ 1,923    | \$ 137,309   |
| Three months ended March 31, 2012:               |                       |                                    |             |              |
| Net interest income                              | \$ 23,237             | \$ 7,265                           | \$ -        | \$ 30,502    |
| Intersegment net interest income (expense)       | 12,416                | (5,857 )                           | (6,559 )    | -            |
| Credit for loan and lease losses                 | 4,990                 | -                                  | -           | 4,990        |
| Other operating income                           | 12,336                | 1,086                              | (190 )      | 13,232       |
| Other operating expense                          | (21,844 )             | (398 )                             | (13,004 )   | (35,246 )    |
| Administrative and overhead expense allocation   | (12,754 )             | (196 )                             | 12,950      | -            |
| Net income (loss)                                | \$ 18,381             | \$ 1,900                           | \$ (6,803 ) | \$ 13,478    |
| At March 31, 2013:                               |                       |                                    |             |              |
| Investment securities                            | \$ -                  | \$ 1,696,428                       | \$ -        | \$ 1,696,428 |
| Loans and leases (including loans held for sale) | 2,291,891             | -                                  | -           | 2,291,891    |
| Other                                            | 111,977               | 408,918                            | 71,863      | 592,758      |
| Total assets                                     | \$ 2,403,868          | \$ 2,105,346                       | \$ 71,863   | \$ 4,581,077 |
| At December 31, 2012:                            |                       |                                    |             |              |
| Investment securities                            | \$ -                  | \$ 1,698,593                       | \$ -        | \$ 1,698,593 |
| Loans and leases (including loans held for sale) | 2,242,227             | -                                  | -           | 2,242,227    |
| Other                                            | (7,267 )              | 363,815                            | 73,000      | 429,548      |
| Total assets                                     | \$ 2,234,960          | \$ 2,062,408                       | \$ 73,000   | \$ 4,370,368 |

## 19. LEGAL PROCEEDINGS

We are involved in legal actions arising in the ordinary course of business. Management, after consultation with our legal counsel, believes the ultimate disposition of those matters will not have a material adverse effect on our consolidated financial statements.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

### Overview

Central Pacific Financial Corp. ("CPF") is a Hawaii corporation and a bank holding company. Our principal business is to serve as a holding company for our bank subsidiary, Central Pacific Bank. We refer to Central Pacific Bank herein as "our bank" or "the bank," and when we say "the Company," "we," "us" or "our," we mean the holding company on a consolidated basis with the bank and our other consolidated subsidiaries.

Central Pacific Bank is a full-service community bank with 35 branches and 114 ATMs located throughout the state of Hawaii. The bank offers a broad range of products and services including accepting time and demand deposits and originating loans, including commercial loans, construction loans, commercial and residential mortgage loans, and consumer loans.

As previously disclosed, we adopted and implemented a recovery plan in March 2010 to improve our financial health by completing a significant recapitalization, reducing our credit risk exposure and returning to profitability by focusing on our core businesses and traditional markets in Hawaii.

We have continued to accomplish a number of key milestones in our recovery plan, including:

- We maintained a strong capital position with tier 1 risk-based capital, total risk-based capital, and leverage capital ratios as of March 31, 2013 to 22.85%, 24.12%, and 14.86%, respectively, from 22.83%, 24.13%, and 14.03%, respectively, as of March 31, 2012. Our capital ratios continue to exceed the levels required for a "well-capitalized" regulatory designation.
- We reported nine consecutive profitable quarters with net income totaling \$137.3 million in the first quarter of 2013 and \$47.4 million and \$36.6 million for the years ended December 31, 2012 and 2011, respectively.
- Recorded an income tax benefit of \$119.8 million in the first quarter of 2013 resulting from the reversal of a significant portion of a valuation allowance that was established against the Company's net deferred tax assets in the third quarter of 2009.
- We reduced our nonperforming assets by \$130.3 million to \$75.3 million at March 31, 2013 from \$205.6 million at March 31, 2012.
- We significantly reduced our construction and development loan portfolio as of March 31, 2013 to \$88.1 million, or 3.9% of our total loan portfolio. At March 31, 2012, this portfolio totaled \$147.6 million, or 7.1% of our total loan portfolio.
- We maintained an allowance for loan and lease losses as a percentage of total loans and leases of 3.82% at March 31, 2013, compared to 5.49% at March 31, 2012. In addition, we maintained an allowance for loan and lease losses as a percentage of nonperforming assets of 115.27% at March 31, 2013, compared to 55.61% at March 31, 2012.

In addition, on February 12, 2013, the Written Agreement (the "Written Agreement") that we entered into with the Federal Reserve Bank of San Francisco ("FRBSF") and the Hawaii Division of Financial Institutions (the "DFI") in July 2010 was terminated.

We intend to continue to execute on our recovery plan and focus on, among other things, improving our asset quality, increasing profitability from our banking operations, enhancing our cross-selling of products and services to our customers, improving our efficiency ratio and operating efficiencies and effectively competing in the Hawaii market.

#### Basis of Presentation

Management's discussion and analysis of financial condition and results of operations should be read in conjunction with the accompanying consolidated financial statements under "Part I, Item 1. Financial Statements (Unaudited)." The following discussion should also be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2012 filed with the U.S. Securities and Exchange Commission (the "SEC") on February 28, 2013.

## Critical Accounting Policies

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America (“GAAP”) requires that management make certain judgments and use certain estimates and assumptions that affect amounts reported and disclosures made. Accounting estimates are deemed critical when a different estimate could have reasonably been used or where changes in the estimate are reasonably likely to occur from period to period and would materially impact our consolidated financial statements as of or for the periods presented. Management has discussed the development and selection of the critical accounting estimates noted below with the Audit Committee of the Board of Directors, and the Audit Committee has reviewed the accompanying disclosures.

### Allowance for Loan and Lease Losses

The allowance for loan and lease losses (the “Allowance”) is management’s estimate of credit losses inherent in our loan and lease portfolio at the balance sheet date. We maintain our Allowance at an amount we expect to be sufficient to absorb probable losses inherent in our loan and lease portfolio based on a projection of probable net loan charge-offs.

For loans classified as impaired, an estimated impairment loss is calculated. To estimate loan charge-offs on other loans, we evaluate the level and trend of nonperforming and potential problem loans and historical loss experience. We also consider other relevant economic conditions and borrower-specific risk characteristics, including current repayment patterns of our borrowers, the fair value of collateral securing specific loans, changes in our lending and underwriting standards and general economic factors, nationally and in the markets we serve, including the real estate market generally and the residential and commercial construction markets in particular. Estimated loss rates are determined by loan category and risk profile, and an overall required Allowance is calculated, which includes amounts for imprecision and uncertainty. Based on our estimate of the level of Allowance required, a corresponding charge or credit to the provision for loan and lease losses (the “Provision”) is recorded to maintain the Allowance at an appropriate level.

Our policy is to charge a loan off in the period in which the loan is deemed to be uncollectible. We consider a loan to be uncollectible when it is probable that a loss has been incurred and the Company can make a reasonable estimate of the loss. In these instances, the likelihood of and/or timeframe for recovery of the amount due is uncertain, weak, or protracted.

Our process for determining the reserve for unfunded commitments is consistent with our process for determining the Allowance and is adjusted for estimated loan funding probabilities. Reserves for unfunded commitments are recorded separately through a valuation allowance included in other liabilities. Credit losses for off-balance sheet credit exposures are deducted from the allowance for credit losses on off-balance sheet credit exposures in the period in which the liability is settled. The allowance for credit losses on off-balance sheet credit losses is established by a charge to other operating expense.

In the first quarter of 2013, we recorded a credit to the Provision of \$6.6 million. We had an Allowance as a percentage of total loans and leases of 3.82% at March 31, 2013, compared to 4.37% at December 31, 2012. Although other factors of our overall risk profile have improved in recent quarters and general economic trends and market conditions have shown signs of stabilization to some degree, as further described in the “Material Trends” section below, concerns over the global and U.S. economies still remain. Accordingly, it is possible that the real estate markets for which we have exposure to could begin to deteriorate. If this occurs, it would result in an increase in loan delinquencies, an increase in loan charge-offs or a need for additional increases in our Allowance. Even if economic conditions improve or stay the same, it is possible that we may experience material credit losses and in turn, increases to our Allowance and Provision, due to the elevated risk still inherent in our existing loan portfolio resulting from our high concentration of commercial real estate and construction loans.

Since we cannot predict with certainty the amount of loan and lease charge-offs that will be incurred and because the eventual level of loan and lease charge-offs are impacted by numerous conditions beyond our control, we use our historical loss experience adjusted for current conditions to determine the Allowance and Provision. In addition, various regulatory agencies, as an integral part of their examination processes, periodically review our Allowance. The determination of the Allowance requires us to make estimates of losses that are highly uncertain and involves a high degree of judgment. Accordingly, actual results could differ from those estimates. Changes in the estimate of the Allowance and related Provision could materially affect our operating results.

## Loans Held for Sale

Loans held for sale consists of the following two types: (1) Hawaii residential mortgage loans that are originated with the intent to sell them in the secondary market and (2) Hawaii and U.S. Mainland construction and commercial real estate loans that were originated with the intent to be held in our portfolio but were subsequently transferred to the held for sale category. Hawaii residential mortgage loans classified as held for sale are carried at the lower of cost or fair value on an aggregate basis while the Hawaii and U.S. Mainland construction and commercial real estate loans are recorded at the lower of cost or fair value on an individual basis.

When a construction or commercial real estate loan is transferred to the held for sale category, the loan is recorded at the lower of cost or fair value. Any reduction in the loan's value is reflected as a write-down of the recorded investment resulting in a new cost basis, with a corresponding reduction in the Allowance. In subsequent periods, if the fair value of a loan classified as held for sale is less than its cost basis, a valuation adjustment is recognized in our consolidated statement of income in other operating expense and the carrying value of the loan is adjusted accordingly. The valuation adjustment may be recovered in the event that the fair value increases, which is also recognized in our consolidated statement of income in other operating expense.

The fair value of loans classified as held for sale are generally based upon quoted prices for similar assets in active markets, acceptance of firm offer letters with agreed upon purchase prices, discounted cash flow models that take into account market observable assumptions, or independent appraisals of the underlying collateral securing the loans. We report the fair values of Hawaii and U.S. Mainland construction and commercial real estate loans net of applicable selling costs on our consolidated balance sheets.

## Reserve for Residential Mortgage Loan Repurchase Losses

We sell residential mortgage loans on a "whole-loan" basis to government-sponsored entities ("GSEs" or "Agencies") Fannie Mae and Freddie Mac and also to non-agency investors. These loan sales occur under industry standard contractual provisions that include various representations and warranties, which typically cover ownership of the loan, compliance with loan criteria set forth in the applicable agreement, validity of the lien securing the loan, and other similar matters. We may be required to repurchase certain loans sold with identified defects, indemnify the investor, or reimburse the investor for any credit losses incurred. We establish mortgage repurchase reserves related to various representations and warranties that reflect management's estimate for which we could have repurchase obligations. The reserves are established by a charge to other operating expense in our consolidated statements of operation. At March 31, 2013 and December 31, 2012, this reserve totaled \$3.0 million and \$3.6 million, respectively, and is included in other liabilities on our consolidated balance sheets.

The repurchase reserve is applicable to loans we originated and sold with representations and warranties, which is representative of the entire sold portfolio. Originations for agency and non-agency for vintages 2005 through March 31, 2013 were approximately \$4.2 billion and \$3.4 billion, respectively. Representations and warranties relating to borrower fraud generally are enforceable for the life of the loan, whereas early payment default clauses generally expire after 90 days, depending on the sales contract. We estimate that loans outstanding and sold that have early payment default clauses as of March 31, 2013 approximate \$186.6 million.

The repurchase loss liability is estimated by origination year to capture certain characteristics of each vintage. To the extent that repurchase demands are made by investors, we may be able to successfully appeal such repurchase demands. However, our appeals success may be affected by the reasons for repurchase demands, the quality of the demands, and our appeals strategies. Repurchase and loss estimates are stratified by vintage, based on actual experience and certain assumptions relative to potential investor demand volume, appeals success rates, and losses recognized on successful repurchase demands.



We did not repurchase any loans during the three months ended March 31, 2013. Repurchase activity by vintage and investor type are depicted in the table below.

Repurchase Demands, Appeals, Repurchased and Pending Resolution [1]  
Three Months Ended March 31,  
2013

| Vintage        | Government Sponsored Entities |          |             |                    | Non-GSE Investors  |          |             |                    |
|----------------|-------------------------------|----------|-------------|--------------------|--------------------|----------|-------------|--------------------|
|                | Repurchase Demands            | Appealed | Repurchased | Pending Resolution | Repurchase Demands | Appealed | Repurchased | Pending Resolution |
| 2005 and prior | -                             | -        | -           | -                  | -                  | -        | -           | -                  |
| 2006           | -                             | -        | -           | -                  | -                  | -        | -           | -                  |
| 2007           | 4                             | 1        | -           | 3                  | -                  | -        | -           | -                  |
| 2008           | 1                             | 1        | -           | -                  | -                  | -        | -           | -                  |
| 2009           | 1                             | -        | -           | 1                  | -                  | -        | -           | -                  |
| 2010           | -                             | -        | -           | -                  | -                  | -        | -           | -                  |
| 2011           | -                             | -        | -           | -                  | -                  | -        | -           | -                  |
| 2012           | 1                             | 1        | -           | -                  | 1                  | -        | -           | 1                  |
| 2013           | -                             | -        | -           | -                  | -                  | -        | -           | -                  |
| Total          | 7                             | 3        | -           | 4                  | 1                  | -        | -           | 1                  |

[1] Based on repurchase requests received between January 1, 2013 and March 31, 2013.

The reserve for residential mortgage loan repurchase losses of \$3.0 million at March 31, 2013 represents our best estimate of the probable loss that we may incur due to the representations and warranties in our loan sales contracts with investors. This represents a decrease of \$0.5 million from December 31, 2012. The table below shows changes in the repurchase losses liability since initial establishment.

|                              | Three Months Ended     |                |
|------------------------------|------------------------|----------------|
|                              | March 31, 2013         | March 31, 2012 |
|                              | (Dollars in thousands) |                |
| Balance, beginning of period | \$ 3,552               | \$ 6,802       |
| Change in estimate           | (632 )                 | 628            |
| Utilizations                 | 100                    | (591 )         |
| Balance, end of period       | \$ 3,020               | \$ 6,839       |

Our capacity to estimate repurchase losses is advancing as we record additional experience. Repurchase losses depend upon economic factors and other external conditions that may change over the life of the underlying loans. Additionally, lack of access to the servicing records of loans sold on a service released basis adds difficulty to the estimation process, thus requiring considerable management judgment. To the extent that future investor repurchase



demand and appeals success differ from past experience, we could have increased demands and increased loss severities on repurchases, causing future additions to the repurchase reserve.

#### Other Intangible Assets

Other intangible assets include a core deposit premium and mortgage servicing rights.

We utilize the amortization method to measure our mortgage servicing rights. Under the amortization method, we amortize our mortgage servicing rights in proportion to and over the period of net servicing income. Income generated as the result of new mortgage servicing rights is reported as gains on sales of loans. Amortization of the servicing rights is reported as amortization of other intangible assets in our consolidated statements of operations. Ancillary income is recorded in other income. Mortgage servicing rights are recorded when loans are sold to third-parties with servicing of those loans retained and we classify our entire mortgage servicing rights into one class.

Initial fair value of the servicing right is calculated by a discounted cash flow model prepared by a third party service provider based on market value assumptions at the time of origination and we assess the servicing right for impairment using current market value assumptions at each reporting period. Critical assumptions used in the discounted cash flow model include mortgage prepayment speeds, discount rates, costs to service and ancillary income. Variations in our assumptions could materially affect the estimated fair values. Changes to our assumptions are made when current trends and market data indicate that new trends have developed. Current market value assumptions based on loan product types (fixed rate, adjustable rate and balloon loans) include average discount rates and national prepayment speeds. Many of these assumptions are subjective and require a high level of management judgment. Our mortgage servicing rights portfolio and valuation assumptions are periodically reviewed by management.

Prepayment speeds may be affected by economic factors such as home price appreciation, market interest rates, the availability of other credit products to our borrowers and customer payment patterns. Prepayment speeds include the impact of all borrower prepayments, including full payoffs, additional principal payments and the impact of loans paid off due to foreclosure liquidations.

We perform an impairment assessment of our other intangible assets whenever events or changes in circumstance indicate that the carrying value of those assets may not be recoverable. Our impairment assessments involve, among other valuation methods, the estimation of future cash flows and other methods of determining fair value. Estimating future cash flows and determining fair values is subject to judgments and often involves the use of significant estimates and assumptions. The variability of the factors we use to perform our impairment tests depend on a number of conditions, including the uncertainty about future events and cash flows. All such factors are interdependent and, therefore, do not change in isolation. Accordingly, our accounting estimates may materially change from period to period due to changing market factors.

#### Deferred Tax Assets and Tax Contingencies

Deferred tax assets (“DTAs”) and liabilities are recognized for the estimated future tax effects attributable to temporary differences and carryforwards. A valuation allowance may be required if, based on the weight of available evidence, it is more likely than not that some portion or all of the DTAs will not be realized. In determining whether a valuation allowance is necessary, we consider the level of taxable income in prior years, to the extent that carrybacks are permitted under current tax laws, as well as estimates of future taxable income and tax planning strategies that could be implemented to accelerate taxable income, if necessary. If our estimates of future taxable income were materially overstated or if our assumptions regarding the tax consequences of tax planning strategies were inaccurate, some or all of our DTAs may not be realized, which would result in a charge to earnings. In the third quarter of 2009, we established a full valuation allowance against our net DTAs. See “— Results of Operations — Income Taxes” below. The quarter ended March 31, 2013 marked our ninth consecutive quarter of profitability. Based on this earnings performance trend, improvements in our financial condition, asset quality and capital ratios and the expectation of continued profitability, the Company determined that it was more likely than not that our net DTA would be realized. As a result, in the first quarter of 2013, the Company reversed a significant portion of the valuation allowance.

We have established income tax contingency reserves for potential tax liabilities related to uncertain tax positions. Tax benefits are recognized when we determine that it is more likely than not that such benefits will be realized. Where uncertainty exists due to the complexity of income tax statutes and where the potential tax amounts are significant, we generally seek independent tax opinions to support our positions. If our evaluation of the likelihood of the realization of benefits is inaccurate, we could incur additional income tax and interest expense that would adversely impact earnings, or we could receive tax benefits greater than anticipated which would positively impact earnings.

#### Financial Summary

Net income for the first quarter of 2013 was \$137.3 million, or \$3.25 per diluted share, compared to \$13.5 million, or \$0.32 per diluted share, for the first quarter of 2012. Net income in the first quarter of 2013 included a non-cash income tax benefit of \$119.8 million related to the reversal of a significant portion of a valuation allowance that was established on the Company's net DTAs during the third quarter of 2009. Excluding this income tax benefit, net income for the quarter was \$17.5 million, or \$0.41 per diluted share.

The following table shows our net income calculated on a GAAP basis, and then excluding our income tax benefit, which is a non-GAAP disclosure. Management believes that this financial disclosure which excludes the impact of our tax benefit provides useful supplemental information for investors regarding our ongoing operating results.

| (Dollars in thousands, except per share data)             | Three Months Ended<br>March 31, |             |
|-----------------------------------------------------------|---------------------------------|-------------|
|                                                           | 2013                            | Diluted EPS |
| GAAP net income                                           | \$ 137,309                      | \$ 3.25     |
| Non-GAAP adjustment:                                      |                                 |             |
| Release of valuation allowance on net deferred tax assets | (119,802)                       | (2.84 )     |
| Non-GAAP net income                                       | \$ 17,507                       | \$ 0.41     |

Our net income in the first quarter of 2013 was also driven by a significant reduction in our total credit costs as we experienced continued improvement in our credit risk profile. Total credit costs, which includes the Provision, write-downs of loans classified as held for sale, write-downs of foreclosed property and the change in the reserve for unfunded commitments, were reduced from a credit of \$5.1 million in the first quarter of 2012, to a credit of \$8.7 million in the first quarter of 2013.

The following table presents annualized returns on average assets, average shareholders' equity, average tangible equity and basic and diluted earnings per share for the periods indicated. Average tangible equity is calculated as average shareholders' equity less average intangible assets, which includes goodwill, core deposit premium, customer relationships and non-compete agreements. Average intangible assets were \$15.1 million and \$18.8 million for the three months ended March 31, 2013 and 2012, respectively.

|                                        | Three Months Ended<br>March 31, |         |
|----------------------------------------|---------------------------------|---------|
|                                        | 2013                            | 2012    |
| Return on average assets               | 12.41 %                         | 1.31 %  |
| Return on average shareholders' equity | 105.72                          | 11.66   |
| Return on average tangible equity      | 108.89                          | 12.15   |
| Basic earnings per common share        | \$ 3.28                         | \$ 0.32 |
| Diluted earnings per common share      | 3.25                            | 0.32    |

#### Material Trends

While there remains continued uncertainty in the global macroeconomic environment, the U.S. economy has continued to stabilize following the economic downturn caused by disruptions in the financial system in 2008.

Despite recent signs of stabilization, concerns about the global and U.S. economies still remain, including concerns over the European sovereign debt crisis. Growing U.S. government indebtedness, elevated unemployment rates, a large budget deficit and ongoing concerns over the federal debt ceiling continue to add to the uncertainty surrounding a sustained economic recovery. In addition, downgrades of ratings in U.S. and foreign debt instruments could raise borrowing costs and adversely impact the mortgage and housing markets.

The majority of our operations are concentrated in the state of Hawaii. As a result, our performance is significantly influenced by conditions in the banking industry, macroeconomic conditions and the real estate markets in Hawaii. A

favorable business environment is generally characterized by expanding gross state product, low unemployment and rising personal income; while an unfavorable business environment is characterized by the reverse.

In 2012, we saw signs of improvement in Hawaii's general economic conditions. Tourism continues to be Hawaii's center of strength and remains its most significant economic driver. Hawaii's visitor industry broke records for arrivals and visitor spending in 2012. According to the Hawaii Tourism Authority ("HTA"), 2.1 million visitors visited the state in the first three months of 2013. This was an increase of 7.1% from the number of visitor arrivals in the first three months of 2012. The HTA also reported that total spending by visitors increased to \$3.9 billion in the first three months of 2013, an increase of \$279.3 million, or 7.6%, from the first three months of 2012. According to the Hawaii Department of Business Economic Development & Tourism ("DBEDT"), total visitor arrivals and visitor spending are expected to gain 3.9% and 5.2% in 2013, respectively.

The Department of Labor and Industrial Relations reported that Hawaii's seasonally adjusted annual unemployment rate improved to 5.1% in March 2013, compared to 6.2% in March 2012. In addition, Hawaii's unemployment rate in March 2013 remained below the national seasonally adjusted unemployment rate of 7.6%. DBEDT projects real personal income and real gross state product to grow by a modest 2.3% and 2.4%, respectively, in 2013. DBEDT expects that Hawaii's economy will continue its positive growth in 2013 based on recent developments in the national and global economy, the performance of Hawaii's tourism industry, the labor market conditions in the state and growth of personal income and tax revenues.

Historically, real estate lending has been a primary focus for us, including construction, residential mortgage and commercial mortgage loans. As a result, we are dependent on the strength of Hawaii's real estate market. According to the Honolulu Board of Realtors, Oahu unit sales volume increased 7.3% for single-family homes and 37.7% for condominiums for the three months ended March 31, 2013 compared to the three months ended March 31, 2012. The median sales price for single-family homes on Oahu for the month ended March 31, 2013 was \$640,000, representing an increase of 2.4% from the prior year. The median sales price for condominiums on Oahu for the month ended March 31, 2013 was \$346,700, representing an increase of 11.2% compared to the same prior year period. While some economists and real estate professionals believe that the Hawaii real estate market will continue to show improvements in 2013, there can be no assurance that this will occur.

As we have seen in the past, our operating results are significantly impacted by the economy in Hawaii, and to a lesser extent, California and the composition of our loan portfolio. Loan demand, deposit growth, Provision, asset quality, noninterest income and noninterest expense are all affected by changes in economic conditions. If the residential and commercial real estate markets we have exposure to deteriorate as they did in 2008 through 2010, our results of operations would be negatively impacted.

## Results of Operations

## Net Interest Income

Net interest income, when expressed as a percentage of average interest earning assets, is referred to as “net interest margin.” Interest income, which includes loan fees and resultant yield information, is expressed on a taxable equivalent basis using an assumed income tax rate of 35%. A comparison of net interest income on a taxable equivalent basis (“net interest income”) for the three months ended March 31, 2013 and 2012 is set forth below.

|                                                     | Three Months Ended March 31, |                               |                                                 |                    |                               |                       |
|-----------------------------------------------------|------------------------------|-------------------------------|-------------------------------------------------|--------------------|-------------------------------|-----------------------|
|                                                     | Average<br>Balance           | 2013<br>Average<br>Yield/Rate | Amount<br>of Interest<br>(Dollars in thousands) | Average<br>Balance | 2012<br>Average<br>Yield/Rate | Amount<br>of Interest |
| <b>Assets</b>                                       |                              |                               |                                                 |                    |                               |                       |
| <b>Interest earning assets:</b>                     |                              |                               |                                                 |                    |                               |                       |
| Interest-bearing deposits in other banks            | \$ 144,773                   | 0.25 %                        | \$ 89                                           | \$ 130,335         | 0.25 %                        | \$ 81                 |
| Taxable investment securities (1)                   | 1,477,887                    | 1.90                          | 7,036                                           | 1,512,470          | 2.01                          | 7,617                 |
| Tax-exempt investment securities (1)                | 175,850                      | 3.59                          | 1,580                                           | 13,741             | 8.81                          | 303                   |
| Loans and leases, including loans held for sale (2) | 2,258,951                    | 4.36                          | 24,443                                          | 2,095,910          | 4.79                          | 25,008                |
| Federal Home Loan Bank stock                        | 47,860                       | -                             | -                                               | 48,797             | -                             | -                     |
| Total interest earning assets                       | 4,105,321                    | 3.25                          | 33,148                                          | 3,801,253          | 3.48                          | 33,009                |
| Nonearning assets                                   | 320,727                      |                               |                                                 | 301,165            |                               |                       |
| Total assets                                        | \$ 4,426,048                 |                               |                                                 | \$ 4,102,418       |                               |                       |
| <b>Liabilities and Equity</b>                       |                              |                               |                                                 |                    |                               |                       |
| <b>Interest-bearing liabilities:</b>                |                              |                               |                                                 |                    |                               |                       |
| Interest-bearing demand deposits                    | \$ 673,662                   | 0.05 %                        | \$ 81                                           | \$ 570,005         | 0.06 %                        | \$ 86                 |
| Savings and money market deposits                   | 1,171,953                    | 0.08                          | 217                                             | 1,145,837          | 0.10                          | 299                   |
| Time deposits under \$100,000                       | 300,992                      | 0.51                          | 375                                             | 344,409            | 0.67                          | 577                   |
| Time deposits \$100,000 and over                    | 710,221                      | 0.22                          | 384                                             | 651,508            | 0.31                          | 496                   |
| Short-term borrowings                               | -                            | -                             | -                                               | 11                 | 0.76                          | -                     |
| Long-term debt                                      | 108,278                      | 3.25                          | 869                                             | 114,339            | 3.32                          | 943                   |
| Total interest-bearing liabilities                  | 2,965,106                    | 0.28                          | 1,926                                           | 2,826,109          | 0.34                          | 2,401                 |
| Noninterest-bearing deposits                        | 821,213                      |                               |                                                 | 727,674            |                               |                       |
| Other liabilities                                   | 110,276                      |                               |                                                 | 76,103             |                               |                       |
| Total liabilities                                   | 3,896,595                    |                               |                                                 | 3,629,886          |                               |                       |
| Shareholders' equity                                | 519,498                      |                               |                                                 | 462,554            |                               |                       |
| Non-controlling interests                           | 9,955                        |                               |                                                 | 9,978              |                               |                       |
| Total equity                                        | 529,453                      |                               |                                                 | 472,532            |                               |                       |
| Total liabilities and equity                        | \$ 4,426,048                 |                               |                                                 | \$ 4,102,418       |                               |                       |

|                     |           |           |
|---------------------|-----------|-----------|
| Net interest income | \$ 31,222 | \$ 30,608 |
|---------------------|-----------|-----------|

|                     |        |        |
|---------------------|--------|--------|
| Net interest margin | 3.06 % | 3.23 % |
|---------------------|--------|--------|

(1) At amortized cost.

(2) Includes nonaccrual loans.



Net interest income expressed on a taxable-equivalent basis of \$31.2 million for the first quarter of 2013, increased by \$0.6 million, or 2.0%, from the first quarter of 2012. The increase was primarily attributable to a significant increase in average tax-exempt investment securities and loans and leases, partially offset by the average yields earned on our other interest-earning assets. The increase in net interest income for the current quarter also reflects a 6 basis point (“bp”) decline in average rates paid on our interest-bearing liabilities, which partially offset the 23 bp decline in average yields earned on our interest-earning assets. The significant decrease in average yields earned on our interest earning assets was directly attributable to the depressed interest rate environment, reductions in our higher yielding commercial real estate loan portfolios and the corresponding increase in our lower yielding investment securities portfolio.

#### Interest Income

Taxable-equivalent interest income of \$33.1 million for the first quarter of 2013 increased by \$0.1 million, or 0.4%, from the first quarter of 2012. The increase was primarily attributable to a significant increase in average tax-exempt investment securities and loans and leases, partially offset by a decrease in average yields earned on our interest-earning assets and a decrease in average taxable investment securities balances as described above. Average tax-exempt investment securities and loans and leases increased by \$162.1 million and 163.0 million, respectively, compared to the first quarter of 2012, accounting for approximately \$3.6 million and \$2.0 million of the current quarter’s increase, respectively. Average yields earned on loans and leases and taxable investment securities decreased by 43 bp and 11 bp, respectively, in the current quarter, lowering interest income by approximately \$2.3 million and \$0.4 million.

#### Interest Expense

Interest expense of \$1.9 million for the first quarter of 2013 decreased by \$0.5 million, or 19.8%, from the comparable prior year quarter. The decrease was attributable to the overall decline in average rates paid on interest-bearing liabilities. The 9 bp and 16 bp decline in average rates paid on time deposits \$100,000 and over and time deposits under \$100,000, respectively, each contributed to \$0.1 million of the current quarter decrease in interest expense.

#### Net Interest Margin

Our net interest margin was 3.06% for the first quarter of 2013, compared to 3.23% for the first quarter of 2012. As described above, the decrease in the net interest margin reflected the depressed interest rate environment and was primarily attributable to lower yields earned on our loans and leases and investment securities portfolios.

The historically low interest rate environment that we continue to operate in is the result of the target Fed Funds rate of 0% to 0.25% initially set by the Federal Reserve in the fourth quarter of 2008 and other economic policies implemented by the FRB, which continued through the first quarter of 2013.

# Nonperforming Assets, Accruing Loans Delinquent for 90 Days or More, Restructured Loans Still Accruing Interest

The following table sets forth nonperforming assets, accruing loans delinquent for 90 days or more and restructured loans still accruing interest as of the dates indicated.

|                                                                                                                                                             | March 31,<br>2013      | December 31,<br>2012 |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------|----------------------|
|                                                                                                                                                             | (Dollars in thousands) |                      |
| Nonperforming Assets                                                                                                                                        |                        |                      |
| Nonaccrual loans (including loans held for sale):                                                                                                           |                        |                      |
| Commercial, financial and agricultural                                                                                                                      | \$ 4,605               | \$ 3,510             |
| Real estate:                                                                                                                                                |                        |                      |
| Construction                                                                                                                                                | 18,272                 | 38,742               |
| Mortgage-residential                                                                                                                                        | 24,842                 | 27,499               |
| Mortgage-commercial                                                                                                                                         | 17,462                 | 9,487                |
| Leases                                                                                                                                                      | 59                     | 94                   |
| Total nonaccrual loans                                                                                                                                      | 65,240                 | 79,332               |
| Other real estate                                                                                                                                           | 10,068                 | 10,686               |
| Total nonperforming assets                                                                                                                                  | 75,308                 | 90,018               |
| Accruing loans delinquent for 90 days or more:                                                                                                              |                        |                      |
| Commercial, financial and agricultural                                                                                                                      | -                      | -                    |
| Real estate:                                                                                                                                                |                        |                      |
| Construction                                                                                                                                                | -                      | -                    |
| Mortgage-residential                                                                                                                                        | -                      | 387                  |
| Consumer                                                                                                                                                    | -                      | 116                  |
| Total accruing loans delinquent for 90 days or more                                                                                                         | -                      | 503                  |
| Restructured loans still accruing interest:                                                                                                                 |                        |                      |
| Commercial, financial and agricultural                                                                                                                      | 437                    | 447                  |
| Real estate:                                                                                                                                                |                        |                      |
| Construction                                                                                                                                                | 20,742                 | 9,522                |
| Mortgage-residential                                                                                                                                        | 15,383                 | 15,366               |
| Mortgage-commercial                                                                                                                                         | 6,202                  | 6,425                |
| Total restructured loans still accruing interest                                                                                                            | 42,764                 | 31,760               |
| Total nonperforming assets, accruing loans delinquent for 90 days or more and restructured loans still accruing interest                                    | \$ 118,072             | \$ 122,281           |
| Total nonperforming assets as a percentage of loans and leases, loans held for sale and other real estate                                                   | 3.27                   | % 4.00               |
| Total nonperforming assets and accruing loans delinquent for 90 days or more as a percentage of loans and leases, loans held for sale and other real estate | 3.27                   | % 4.02               |
| Total nonperforming assets, accruing loans delinquent for 90 days or more and restructured loans still accruing interest as a percentage                    |                        |                      |

|                                                                |      |   |      |   |
|----------------------------------------------------------------|------|---|------|---|
| of loans and leases, loans held for sale and other real estate | 5.13 | % | 5.43 | % |
|----------------------------------------------------------------|------|---|------|---|

Nonperforming assets, which includes nonaccrual loans and leases, nonperforming loans classified as held for sale and foreclosed real estate, totaled \$75.3 million at March 31, 2013, compared to \$90.0 million at December 31, 2012. The decrease from December 31, 2012 was attributable to \$11.7 million in repayments, \$13.0 million in loans restored to accrual status, \$1.4 million in sales of foreclosed properties and \$1.0 million in charge-offs, partially offset by \$12.4 million in gross additions.

Net changes to nonperforming assets by category included net decreases in U.S. Mainland construction and development assets totaling \$20.7 million, Hawaii residential mortgage assets totaling \$3.0 million, Hawaii commercial mortgage assets totaling \$57,000, Hawaii construction and development assets totaling \$45,000 and Hawaii leasing assets totaling \$35,000. Partially offsetting these net decreases were net increases in U.S. Mainland commercial mortgage assets totaling \$8.0 million and Hawaii commercial assets totaling \$1.1 million.

Restructured loans included in nonperforming assets at March 31, 2013 consisted of 57 Hawaii residential mortgage loans with a combined principal balance of \$17.7 million, a U.S. Mainland commercial mortgage loan with a principal balance of \$2.2 million, six Hawaii construction and development loans with a combined principal balance of \$1.8 million and two Hawaii commercial loans with a combined principal balance of \$1.5 million. Concessions made to the original contractual terms of these loans consisted primarily of the deferral of interest and/or principal payments due to deterioration in the borrowers' financial condition. The principal balances on these restructured loans matured and/or were in default at the time of restructuring and we have no commitments to lend additional funds to any of these borrowers. There were \$42.8 million of restructured loans still accruing interest at March 31, 2013, none of which were more than 90 days delinquent.

#### Provision and Allowance for Loan and Lease Losses

The following table sets forth certain information with respect to the Allowance as of the dates and for the periods indicated:

|                                              | Three Months Ended<br>March 31, |            |
|----------------------------------------------|---------------------------------|------------|
|                                              | 2013                            | 2012       |
|                                              | (Dollars in thousands)          |            |
| Allowance for loan and lease losses:         |                                 |            |
| Balance at beginning of period               | \$ 96,413                       | \$ 122,093 |
| Provision (credit) for loan and lease losses | (6,561 )                        | (4,990 )   |
| Charge-offs:                                 |                                 |            |
| Commercial, financial and agricultural       | 244                             | 1,682      |
| Real estate:                                 |                                 |            |
| Construction                                 | 78                              | 1,626      |
| Mortgage-residential                         | 414                             | 200        |
| Mortgage-commercial                          | 3,674                           | -          |
| Consumer                                     | 315                             | 426        |
| Leases                                       | -                               | 28         |
| Total charge-offs                            | 4,725                           | 3,962      |
| Recoveries:                                  |                                 |            |
| Commercial, financial and agricultural       | 492                             | 270        |
| Real estate:                                 |                                 |            |
| Construction                                 | 485                             | 425        |
| Mortgage-residential                         | 231                             | 117        |
| Mortgage-commercial                          | 254                             | 2          |
| Consumer                                     | 216                             | 366        |
| Leases                                       | 1                               | 1          |
| Total recoveries                             | 1,679                           | 1,181      |

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|                                                      |           |            |
|------------------------------------------------------|-----------|------------|
| Net charge-offs                                      | 3,046     | 2,781      |
| Balance at end of period                             | \$ 86,806 | \$ 114,322 |
| Annualized ratio of net charge-offs to average loans | 0.54 %    | 0.53 %     |

Our Allowance at March 31, 2013 totaled \$86.8 million, a decrease of \$9.6 million, or 10.0%, from year-end 2012. The decrease in our Allowance was a direct result of a credit to the Provision of \$6.6 million and \$3.0 million in net loan charge-offs.

Our Provision was a credit of \$6.6 million during the first quarter of 2013, compared to a credit of \$5.0 million in the first quarter of 2012. Our net charge-offs were \$3.0 million during the first quarter of 2013, compared to \$2.8 million in the first quarter of 2012.

Our Allowance as a percentage of our total loan portfolio decreased from 4.37% at December 31, 2012 to 3.82% at March 31, 2013. Our Allowance as a percentage of our nonperforming assets increased from 107.10% at December 31, 2012 to 115.27% at March 31, 2013.

The decrease in the Allowance is consistent with our improved credit risk profile as evidenced by a decrease in our nonperforming assets, lower net loan charge-off activity, and is consistent with our belief that we have begun to see signs of stabilization in our loan portfolio, the overall economy and the commercial real estate markets both in Hawaii and on the U.S. Mainland.

Depending on the overall performance of the local and national economies, the strength of the Hawaii and California commercial real estate markets and the accuracy of our assumptions and judgments concerning our loan portfolio, further adverse credit migration may continue due to the upcoming maturity of additional loans, the possibility of further declines in collateral values and the potential impact of continued financial stress on our borrowers, sponsors and guarantors as they attempt to endure the challenges of the current economic environment. While we have seen preliminary signs of stabilization, we cannot determine when, or if, the challenging economic conditions that we experienced over the past four years will improve and whether or not recent signs of an economic recovery will continue.

In accordance with GAAP, loans held for sale and other real estate assets are not included in our assessment of the Allowance.

#### Other Operating Income

Total other operating income of \$12.5 million for the first quarter of 2013 decreased by \$0.8 million, or 5.7%, from the comparable prior year period. The decrease was primarily due to lower rental income from foreclosed properties that were sold of \$1.3 million and lower service charges on deposit accounts of \$0.7 million, partially offset by higher gains on sales of residential mortgage loans of \$1.2 million.

#### Other Operating Expense

Total other operating expense for the first quarter of 2013 was \$32.2 million, compared to \$35.2 million in the comparable prior year period. The decrease was primarily attributable to lower net credit-related charges (which include write-downs of loans held for sale, foreclosed asset expense, and changes in the reserve for unfunded commitments) of \$2.1 million, lower legal and professional services of \$1.7 million, a lower reserve for repurchased residential mortgage loans of \$1.3 million and lower Federal Deposit Insurance Corporation ("FDIC") insurance expense of \$0.5 million, partially offset by higher salaries and employee benefits of \$1.9 million and higher amortization of other intangible assets of \$0.5 million.

#### Income Taxes

In the first quarter of 2013, the Company reversed a significant portion of the valuation allowance that was established against our net DTA during the third quarter of 2009. The valuation allowance was established during 2009 due to uncertainty at the time regarding our ability to generate sufficient future taxable income to fully realize the benefit of our net DTA. The quarter ended March 31, 2013 marked our ninth consecutive quarter of profitability. Based on this earnings performance trend, improvements in our financial condition, asset quality and capital ratios, and the expectation of continued profitability, the Company determined that it was more likely than not that a significant

portion of our net DTA would be realized.

The Company does not expect to recognize any income tax expense until the first quarter of 2014 as a portion of the remaining deferred tax asset valuation allowance is expected to offset income tax expense for the remainder of 2013. The net impact of reversing the valuation allowance and recording the provision for income tax expense was a net income tax benefit of \$119.8 million. The Company did not recognize any income tax expense in the comparable prior period. As of March 31, 2013, the remaining valuation allowance on our net DTA totaled \$14.3 million. Net of this valuation allowance, as of March 31, 2013, the Company's net DTA totaled \$130.0 million, compared to a fully reserved net deferred tax asset of \$147.5 million as of December 31, 2012, and is included in other assets on our consolidated balance sheets.

#### Financial Condition

Total assets at March 31, 2013 of \$4.6 billion increased by \$210.7 million from \$4.4 billion at December 31, 2012.

## Loans and Leases

Loans and leases, net of unearned income, of \$2.3 billion at March 31, 2013, increased by \$70.7 million, or 3.2%, from December 31, 2012. The increase was primarily due to net increases in the commercial, residential mortgage and consumer loan portfolios totaling \$70.7 million, \$39.0 million and \$6.6 million, respectively, partially offset by a net reduction in the commercial mortgage loan, construction and development loan and leases portfolios totaling \$35.9 million, \$8.1 million and \$1.6 million, respectively. The net increases in these portfolios reflect transfers of two portfolio loans to other real estate totaling \$0.6 million and charge-offs of loans and leases of \$4.7 million.

## Deposits

Total deposits of \$3.8 billion at March 31, 2013 reflected an increase of \$83.9 million, or 2.3%, from December 31, 2012. The increase was primarily attributable to increases in non-interest bearing demand deposits, interest-bearing demand deposits and time deposits of \$14.1 million, \$19.7 million and \$67.1 million, respectively. These increases were partially offset by a decrease in savings and money market deposits of \$17.0 million.

Core deposits, which we define as demand deposits, savings and money market deposits, and time deposits less than \$100,000, totaled \$3.0 billion at March 31, 2013 and increased by \$7.3 million from December 31, 2012.

## Capital Resources

### Common Stock

Shareholders' equity totaled \$650.1 million at March 31, 2013, compared to \$504.8 million at December 31, 2012. The increase in total shareholders' equity was attributable to the \$137.3 million in net income recognized during the first quarter of 2013.

### Trust Preferred Securities

We have five statutory trusts, CPB Capital Trust I, CPB Capital Trust II, CPB Statutory Trust III, CPB Capital Trust IV and CPB Statutory Trust V, which issued a total of \$105.0 million in trust preferred securities. Our obligations with respect to the issuance of the trust preferred securities constitute a full and unconditional guarantee by the Company of each trust's obligations with respect to its trust preferred securities. Subject to certain exceptions and limitations, we may elect from time to time to defer subordinated debenture interest payments, which would result in a deferral of dividend payments on the related trust preferred securities, for up to 20 consecutive quarterly periods without default or penalty.

We began deferring interest and dividend payments on the subordinated debentures and the trust preferred securities in the third quarter of 2009. In March 2013, the Company elected to pay all deferred interest on its subordinated debentures and related dividend payments on its trust preferred securities and resume quarterly payments for each outstanding trust. As a result, the deferred accrued interest in the amount of \$13.0 million was paid in full and the next quarterly dividend is due in June and July 2013.

### Holding Company Capital Resources

CPF is required to act as a source of strength to the bank under the Dodd-Frank Act. As described above, CPF deferred the payment of dividends on our trust preferred securities (along with interest on the related junior subordinated debentures) beginning in the third quarter of 2009. As mentioned in the previous section, in March 2013, the Company elected to resume quarterly payments for each outstanding trust and all deferred interest on its subordinated debentures and related dividend payments on its trust preferred securities were paid in full.



In the past, CPF has primarily relied upon dividends from the bank for its cash flow needs. CPF has not received dividends from the bank since September 2008. As a Hawaii state-chartered bank, the bank may only pay dividends to the extent it has retained earnings as defined under Hawaii banking law (“Statutory Retained Earnings”), which differs from GAAP retained earnings. As of March 31, 2013, the bank had Statutory Retained Earnings of \$160.9 million. In light of the Company's improved capital position and financial condition, our Board of Directors and management, in consultation with our regulators, are currently evaluating a variety of alternatives to strategically manage the Company's capital levels, including the Company's prospects and ability to pay cash dividends to our stockholders. Any decision to pay dividends or take any action with respect to our capital position, including, but not limited to, repurchasing any of our securities, is subject to the discretion of our Board of Directors as well as any applicable regulatory and contractual limitations.

As of March 31, 2013, on a stand-alone basis, CPF had an available cash balance of approximately \$34.6 million in order to meet its ongoing obligations.

## Capital Ratios

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

FDIC-insured institutions must maintain leverage, Tier 1 and total risk-based capital ratios of at least 5%, 6% and 10%, respectively, and not be subject to a regulatory capital directive to be considered “well capitalized” under the prompt corrective action provisions of the FDIC Improvement Act of 1991. The Company’s and the bank’s leverage capital, Tier 1 and total risk-based capital ratios as of March 31, 2013 were above the levels required for a “well capitalized” regulatory designation.

The following table sets forth the Company’s and the bank’s capital ratios, as well as the minimum capital adequacy requirements applicable to all financial institutions as of the dates indicated.

|                             | Actual     |       |   | Minimum Required<br>for Capital<br>Adequacy Purposes |       |   | Minimum Required<br>to be<br>Well Capitalized |       |   |
|-----------------------------|------------|-------|---|------------------------------------------------------|-------|---|-----------------------------------------------|-------|---|
|                             | Amount     | Ratio |   | Amount                                               | Ratio |   | Amount                                        | Ratio |   |
| (Dollars in thousands)      |            |       |   |                                                      |       |   |                                               |       |   |
| <b>Company</b>              |            |       |   |                                                      |       |   |                                               |       |   |
| At March 31, 2013:          |            |       |   |                                                      |       |   |                                               |       |   |
| Tier 1 risk-based capital   | \$ 636,153 | 22.9  | % | \$ 111,382                                           | 4.0   | % | \$ 167,073                                    | 6.0   | % |
| Total risk-based capital    | 671,677    | 24.1  |   | 222,765                                              | 8.0   |   | 278,456                                       | 10.0  |   |
| Leverage capital            | 636,153    | 14.9  |   | 171,295                                              | 4.0   |   | 214,119                                       | 5.0   |   |
| At December 31, 2012:       |            |       |   |                                                      |       |   |                                               |       |   |
| Tier 1 risk-based capital   | \$ 609,394 | 22.5  | % | \$ 108,128                                           | 4.0   | % | \$ 162,192                                    | 6.0   | % |
| Total risk-based capital    | 644,044    | 23.8  |   | 216,256                                              | 8.0   |   | 270,320                                       | 10.0  |   |
| Leverage capital            | 609,394    | 14.3  |   | 170,176                                              | 4.0   |   | 212,720                                       | 5.0   |   |
| <b>Central Pacific Bank</b> |            |       |   |                                                      |       |   |                                               |       |   |
| At March 31, 2013:          |            |       |   |                                                      |       |   |                                               |       |   |
| Tier 1 risk-based capital   | \$ 603,523 | 21.7  | % | \$ 111,530                                           | 4.0   | % | \$ 167,295                                    | 6.0   | % |
|                             | 639,063    | 22.9  |   | 223,061                                              | 8.0   |   | 278,826                                       | 10.0  |   |

|                           |            |        |  |            |       |            |       |
|---------------------------|------------|--------|--|------------|-------|------------|-------|
| Total risk-based capital  |            |        |  |            |       |            |       |
| Leverage capital          | 603,523    | 14.0   |  | 171,992    | 4.0   | 214,990    | 5.0   |
| At December 31, 2012:     |            |        |  |            |       |            |       |
| Tier 1 risk-based capital |            |        |  |            |       |            |       |
|                           | \$ 580,860 | 21.5 % |  | \$ 108,229 | 4.0 % | \$ 162,343 | 6.0 % |
| Total risk-based capital  |            |        |  |            |       |            |       |
|                           | 615,523    | 22.7   |  | 216,457    | 8.0   | 270,572    | 10.0  |
| Leverage capital          | 580,860    | 13.6   |  | 170,274    | 4.0   | 212,843    | 5.0   |

### Liquidity and Borrowing Arrangements

Our objective in managing liquidity is to maintain a balance between sources and uses of funds in order to economically meet the cash requirements of customers for loans and deposit withdrawals and participate in lending and investment opportunities as they arise. We monitor our liquidity position in relation to changes in loan and deposit balances on a daily basis to ensure maximum utilization, maintenance of an adequate level of readily marketable assets and access to short-term funding sources.

Core deposits have historically provided us with a sizeable source of relatively stable and low cost funds, but are subject to competitive pressure in our market. In addition to core deposit funding, 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 FHLB, secured repurchase agreements, federal funds borrowings and the Federal Reserve discount window, available to meet our liquidity needs. While we historically have had access to these alternative funding sources, access to these sources is not guaranteed and may be influenced by market conditions, our financial position, and the terms of the respective agreements with such sources, as discussed below.

The bank is a member of and maintained an \$862.4 million line of credit with the FHLB as of March 31, 2013. Long-term borrowings under this arrangement totaled \$27,000 at March 31, 2013, compared to \$32,000 at December 31, 2012. There were no short-term borrowings under this arrangement at March 31, 2013 and December 31, 2012.

As of March 31, 2013, the bank's pledged assets to the FHLB included investment securities with a fair value of \$97.7 million and certain real estate loans totaling \$1.2 billion. These assets can be used to secure future advances in accordance with the collateral provisions of the Advances, Security and Deposit Agreement with the FHLB.

Besides its line of credit with the FHLB, the bank also maintained a \$20.9 million line of credit with the Federal Reserve discount window. There were no borrowings under this arrangement at March 31, 2013 and December 31, 2012. Advances under this arrangement would have been secured by certain commercial and commercial real estate loans with a carrying value of \$34.8 million at March 31, 2013. The Federal Reserve does not have the right to sell or repledge these loans.

Our ability to maintain adequate levels of liquidity is dependent on our ability to continue to improve our risk profile, maintain our capital base, and comply with the provisions of our agreement with the regulators. Beyond the challenges specific to our situation, our liquidity may also be negatively impacted by weakness in the financial markets and industry-wide reductions in liquidity.

#### Contractual Obligations

Information regarding our contractual obligations is provided in Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations" of our Annual Report on Form 10-K for the year ended December 31, 2012. There have been no material changes in our contractual obligations since December 31, 2012.

#### Regulatory Matters

On July 2, 2010, we entered into the Written Agreement with the FRBSF and DFI. The Written Agreement provided that unless we receive the consent of the FRBSF and DFI, we cannot: (i) pay dividends; (ii) receive dividends or payments representing a reduction in capital from the bank; (iii) directly or through our non-bank subsidiaries make any payments on subordinated debentures or trust preferred securities; (iv) directly or through any non-bank subsidiaries incur, increase or guarantee any debt; or (v) purchase or redeem any shares of our stock. On February 12, 2013, the Written Agreement was terminated. Accordingly, we are no longer subject to any of its requirements.

On October 9, 2012, the bank entered into a separate Memorandum of Understanding (the "Compliance MOU") with the FDIC to improve the bank's compliance management system ("CMS"). Under the Compliance MOU, we are required to, among other things, (i) improve the Board of Directors' oversight of the bank's CMS; (ii) ensure the establishment and implementation of the bank's CMS is commensurate with the complexity of the bank's operations; (iii) perform a full review of all compliance policy and procedures, then revise and adopt policy and procedures to ensure compliance with all consumer protection regulations; (iv) enhance the bank's training program relating to consumer protection and fair lending regulations; (v) develop and implement an effective internal monitoring program to ensure compliance with all applicable laws and regulations; (vi) strengthen the compliance audit function to ensure that the compliance

audits are appropriately and comprehensively scoped; (vii) develop and implement internal controls for the bank's third-party payment processing activity; (viii) strengthen the Board of Directors and senior management's oversight of third-party relationships and (ix) enhance the bank's overdraft payment program. The bank believes it has already taken substantial steps to comply with the Compliance MOU. In addition to the steps taken to comply with the Compliance MOU, the bank received an "Outstanding" rating in a recently completed Community Reinvestment performance evaluation that measures how financial institutions support their communities in the areas of lending, investment and service.

We cannot provide any assurance on whether or when the Company and the bank will be in full compliance with the Compliance MOU or whether or when the Compliance MOU will be terminated. Even if terminated, we may still be subject to other agreements with regulators that restrict our activities and may also continue to impose capital ratios or other requirements on our business. The requirements and restrictions of the Compliance MOU are judicially enforceable and the Company or the bank's failure to comply with such requirements and restrictions may subject the Company and the bank to additional regulatory restrictions including: the imposition of additional regulatory requirements or orders; limitations on our activities; the imposition of civil monetary penalties; and further directives which affect our business, including, in the most severe circumstances, termination of the bank's deposit insurance or appointment of a conservator or receiver for the bank.

#### Iran Sanctions Related Disclosure

Under the Iran Threat Reduction and Syrian Human Rights Act of 2012, which added Section 13(r) to the Securities Exchange Act of 1934, as amended, we are required to include certain disclosures in our periodic reports if we or any of our "affiliates" knowingly engaged in certain specified activities during the period covered by this Quarterly Report on Form 10-Q. Because the SEC defines the term "affiliate" broadly, it includes any entity controlled by us as well as any person or entity that controls us or is under common control with us. We do not believe we and our consolidated subsidiaries have knowingly engaged in any transaction or dealing reportable under Section 13(r) of the Exchange Act during the first quarter ended March 31, 2013.

We have been advised by The Carlyle Group L.P., which may be considered one of our affiliates, that it intends to include disclosure in substantially the following form (the "Applus Disclosure") in its Quarterly Report on Form 10-Q for the quarter ended March 31, 2013. We have no involvement in or control over the activities of Applus Servicios Technologicos S.L.U., any of its predecessor companies or any of its subsidiaries, and we have not independently verified or participated in the preparation of the following Applus Disclosure. The Carlyle Group has also advised us that the final Applus Disclosure, which will be contained in its Form 10-Q for the quarter ended March 31, 2013, may be modified or otherwise change depending on additional information provided to the Carlyle Group between the date hereof and the filing of its Form 10-Q.

"We have been advised by Applus Servicios Technologicos S.L.U. ("Applus"), a European company in which our private equity funds have invested and which may be considered our affiliate, that during the period January 1, 2013 until March 31, 2013, a subsidiary of Applus provided certain services to customers that could be affiliated with the Industrial Development and Renovation Organization (IDRO), which has been designated as an agency of the Government of Iran. For this period, gross revenue attributable to such sales was €86,633, with estimated net profits to Applus of approximately €15,593. At this time, we are unable to determine whether the IDRO, directly or indirectly, controls these customers. Although these activities were not prohibited by U.S. law at the time they were conducted, Applus has advised us that its subsidiary has discontinued its dealings with such customers, and that it does not otherwise intend to continue or enter into any Iran-related activity. All such dealings (including limited wind-down activities) were discontinued prior to March 8, 2013, in accordance with the requirements of Section 218 of the Iran Threat Reduction and Syria Human Rights Act of 2012, as amended."

### Item 3. Quantitative and Qualitative Disclosures about Market Risk

Market risk is the risk of loss in a financial instrument arising from adverse changes in market rates/prices such as interest rates, foreign currency rates, commodity prices and equity prices. Our primary market risk exposure is interest rate risk that occurs when rate-sensitive assets and rate-sensitive liabilities mature or reprice during different periods or in differing amounts. Asset/liability management attempts to coordinate our rate-sensitive assets and rate-sensitive liabilities to meet our financial objectives. The Asset/Liability Committee (“ALCO”) monitors interest rate risk through the use of interest rate sensitivity gap, net interest income and market value of portfolio equity simulation, and rate shock analyses. Adverse interest rate risk exposures are managed through the shortening or lengthening of the duration of assets and liabilities.

The primary analytical tool we use to measure and manage our interest rate risk is a simulation model that projects changes in net interest income (“NII”) as market interest rates change. Our ALCO policy requires that simulated changes in NII should be within certain specified ranges, or steps must be taken to reduce interest rate risk. The results of the model indicate that the mix of rate-sensitive assets and liabilities at March 31, 2013 would not result in a fluctuation of NII that would exceed the established policy limits.

### Item 4. Controls and Procedures

#### Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this report and pursuant to Rule 13a-15 of the Securities Exchange Act of 1934, as amended, (the “Exchange Act”), the Company's management, including the Chief Executive Officer and Principal Financial and Accounting Officer, conducted an evaluation of the effectiveness and design of the Company's disclosure controls and procedures (as that term is defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act). Based upon that evaluation, the Company's Chief Executive Officer and Principal Financial and Accounting Officer concluded, as of the end of the period covered by this report, that the Company's disclosure controls and procedures were effective.

#### Changes in Internal Controls

As of the end of the period covered by this report, there have been no changes in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) and 15d-15(f) of the Exchange Act) during the quarter to which this report relates that have materially affected or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1A. Risk Factors

There have been no material changes from the Risk Factors as previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2012, as filed with the SEC on February 28, 2013.

Item 6. Exhibits

| Exhibit No. | Document                                                                                                                   |
|-------------|----------------------------------------------------------------------------------------------------------------------------|
| 31.1        | Rule 13a-14(a) Certification of Chief Executive Officer in accordance with Section 302 of the Sarbanes-Oxley Act of 2002 * |
| 31.2        | Rule 13a-14(a) Certification of Chief Financial Officer in accordance with Section 302 of the Sarbanes-Oxley Act of 2002 * |
| 32.1        | Section 1350 Certification of Chief Executive Officer in accordance with Section 906 of the Sarbanes-Oxley Act of 2002 **  |
| 32.2        | Section 1350 Certification of Chief Financial Officer in accordance with Section 906 of the Sarbanes-Oxley Act of 2002 **  |
| 101.INS     | XBRL Instance Document*                                                                                                    |
| 101.SCH     | XBRL Taxonomy Extension Schema Document*                                                                                   |
| 101.CAL     | XBRL Taxonomy Extension Calculation Linkbase Document*                                                                     |
| 101.LAB     | XBRL Taxonomy Extension Label Linkbase Document*                                                                           |
| 101.PRE     | XBRL Taxonomy Extension Presentation Linkbase Document*                                                                    |
| 101.DEF     | XBRL Taxonomy Extension Definition Linkbase Document*                                                                      |

\* Filed herewith.

\*\* Furnished herewith.



SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CENTRAL PACIFIC FINANCIAL CORP.  
(Registrant)

Date: May 7, 2013

/s/ John C. Dean  
John C. Dean  
President and Chief Executive Officer

Date: May 7, 2013

/s/ Denis K. Isono  
Denis K. Isono  
Executive Vice President and Chief Financial  
Officer

Central Pacific Financial Corp.  
Exhibit Index

| Exhibit No. | Description                                                                                                              |
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