CENTRAL PACIFIC FINANCIAL CORP
Form 10-Q
August 06, 2009

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

FORM 10-Q

(Mark One)

T QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2009

or

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

Commission file number 0-10777

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

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

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes T No £

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes T No £

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

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

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

The number of shares outstanding of registrant's common stock, no par value, on August 4, 2009 was 28,750,573 shares.

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

Item 1. Financial Statements

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

(Dollars in thousands)	June 30, 2009	December 31, 2008
Assets		
Cash and due from banks	$ 161,985	$ 107,270
Interest-bearing deposits in other banks	23,071	475
Federal funds sold	19,000	-
Investment securities:		
Available for sale	1,049,949	742,600
Held to maturity (fair value of $6,907 at June 30, 2009 and $8,759 at December 31, 2008)	6,830	8,697
Total investment securities	1,056,779	751,297
Loans held for sale	84,748	40,108
Loans and leases	3,688,519	4,030,266
Less allowance for loan and lease losses	166,071	119,878
Net loans and leases	3,522,448	3,910,388
Premises and equipment, net	77,142	81,059
Accrued interest receivable	18,724	20,079
Investment in unconsolidated subsidiaries	17,534	15,465
Other real estate	17,862	11,220
Goodwill	152,689	152,689
Other intangible assets	44,713	39,783
Bank-owned life insurance	137,946	135,371
Federal Home Loan Bank stock	48,797	48,797
Income tax receivable	53,443	42,400
Other assets	88,406	75,960
Total assets	$ 5,525,287	$ 5,432,361
Liabilities and Equity		
Deposits:		
Noninterest-bearing demand	$ 623,698	$ 627,094
Interest-bearing demand	548,166	472,269
Savings and money market	1,428,881	1,057,881
Time	1,365,779	1,754,322
Total deposits	3,966,524	3,911,566
Short-term borrowings	267,155	279,450
Long-term debt	608,554	649,257
Other liabilities	57,970	55,748
Total liabilities	4,900,203	4,896,021
Equity:		

Preferred stock, no par value, authorized 1,000,000 shares; issued and outstanding 135,000 shares at June 30, 2009 and none at December 31, 2008		128,239		-
Common stock, no par value, authorized 100,000,000 shares, issued and outstanding 28,745,214 shares at June 30, 2009 and 28,732,259 shares at December 31, 2008		403,219		403,176
Surplus		62,549		55,963
Retained earnings		28,083		63,762
Accumulated other comprehensive income (loss)		(7,043)		3,390
Total shareholders' equity		615,047		526,291
Non-controlling interest		10,037		10,049
Total equity		625,084		536,340
Total liabilities and equity	$	5,525,287	$	5,432,361

See accompanying notes to consolidated financial statements.

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

(Amounts in thousands, except per share data)	Three Months Ended June 30, 2009	Three Months Ended June 30, 2008	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
Interest income:				
Interest and fees on loans and leases	$ 54,218	$ 65,677	$ 110,723	$ 135,971
Interest and dividends on investment securities:				
Taxable interest	9,058	9,308	17,787	18,579
Tax-exempt interest	1,146	1,416	2,317	2,805
Dividends	2	11	5	35
Interest on deposits in other banks	11	3	11	7
Interest on Federal funds sold and securities purchased under agreements to resell	6	22	6	43
Dividends on Federal Home Loan Bank stock	-	171	-	293
Total interest income	64,441	76,608	130,849	157,733
Interest expense:				
Interest on deposits:				
Demand	355	179	676	316
Savings and money market	3,414	2,980	6,277	6,765
Time	8,219	11,706	18,113	26,435
Interest on short-term borrowings	34	2,357	272	4,280
Interest on long-term debt	6,359	8,002	12,978	17,696
Total interest expense	18,381	25,224	38,316	55,492
Net interest income	46,060	51,384	92,533	102,241
Provision for loan and lease losses	74,324	87,800	101,074	122,072
Net interest loss after provision for loan and lease losses	(28,264)	(36,416)	(8,541)	(19,831)
Other operating income:				
Service charges on deposit accounts	3,948	3,511	7,485	7,054
Other service charges and fees	3,584	3,710	6,904	7,125
Income from fiduciary activities	999	990	1,969	1,995
Equity in earnings of unconsolidated subsidiaries	205	131	479	414
Fees on foreign exchange	145	112	261	306
Investment securities gains (losses)	1	253	(149)	253
Other than temporary impairment on securities (net of $7,888 recognized in OCI in 2009)	(2,565)	-	(2,565)	-
Loan placement fees	312	213	560	366
Net gain on sales of residential loans	4,539	2,241	8,548	4,039

Income from bank-owned life insurance	1,514	845	2,584	2,715
Other	1,917	(75)	4,207	1,943
	14,599	11,931	30,283	26,210
Other operating expense:				
Salaries and employee benefits	17,684	18,648	33,944	36,012
Net occupancy	3,101	3,266	6,380	6,119
Equipment	1,562	1,433	3,074	2,828
Amortization and impairment of other intangible assets	1,550	1,281	2,971	2,450
Communication expense	975	1,125	2,114	2,210
Legal and professional services	2,846	2,615	5,562	5,028
Computer software expense	840	809	1,752	1,672
Advertising expense	713	700	1,468	1,382
Goodwill impairment	-	94,279	-	94,279
Foreclosed asset expense	2,294	3,984	2,429	6,574
Loss on sales of commercial real estate loans	-	1,671	-	1,671
Write down of assets	904	22,424	1,339	22,424
Other	13,349	8,048	22,483	9,094
Total other operating expense	45,818	160,283	83,516	191,743
Loss before income taxes	(59,483)	(184,768)	(61,774)	(185,364)
Income tax benefit	(25,041)	(38,510)	(29,961)	(40,764)
Net loss	(34,442)	(146,258)	(31,813)	(144,600)
Preferred stock dividends and accretion	1,999	-	3,866	-
Net loss available to common shareholders	$ (36,441)	$ (146,258)	$ (35,679)	$ (144,600)
Per common share data:				
Basic and diluted loss per share	$ (1.27)	$ (5.10)	$ (1.24)	$ (5.04)
Cash dividends declared	-	0.25	-	0.50
Shares used in computation:				
Basic and diluted shares	28,687	28,652	28,684	28,670

See accompanying notes to consolidated financial statements.

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

	Six Months Ended June 30,	
(Dollars in thousands)	2009	2008
Cash flows from operating activities:		
Net loss	$ (31,813)	$ (144,600)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Provision for loan and lease losses	101,074	122,072
Depreciation and amortization	4,251	3,881
Gain on sale of premises and equipment	(3,612)	-
Goodwill impairment	-	94,279
Write down of assets	1,339	22,424
Foreclosed asset expense	2,429	6,574
Amortization and impairment of other intangible assets	2,971	2,450
Net amortization of investment securities	1,580	691
Share-based compensation	(164)	1,164
Net (gain) loss on investment securities	149	(253)
Other than temporary impairment on securities	2,565	-
Deferred income tax benefit	(24,815)	(4,504)
Net gain on sales of residential loans	(8,548)	(4,039)
Loss on sale of commercial real estate loans	-	1,671
Ineffective portion of derivatives	(2,106)	-
Proceeds from sales of loans held for sale	1,056,794	817,958
Originations of loans held for sale	(1,087,734)	(721,898)
Tax benefits from share-based compensation	-	(40)
Equity in earnings of unconsolidated subsidiaries	(479)	(414)
Increase in cash surrender value of bank-owned life insurance	(2,574)	(2,706)
Increase in income tax receivable	(11,043)	(48,051)
Net change in other assets and liabilities	5,893	(13,159)
Net cash provided by operating activities	6,157	133,500
Cash flows from investing activities:		
Proceeds from maturities of and calls on investment securities available for sale	117,283	311,868
Proceeds from sales of investment securities available for sale	7,241	-
Purchases of investment securities available for sale	(391,916)	(292,694)
Proceeds from maturities of and calls on investment securities held to maturity	1,839	20,058
Net principal repayments (loan originations)	112,591	(351,783)
Proceeds from sales of loans originated for investment	107,244	64,901
Proceeds from sales of securitized residential mortgage loans	-	20,838
Proceeds from sale of other real estate	1,406	-
Proceeds from bank-owned life insurance	-	843
Proceeds from sale of premises and equipment	7,207	-
Purchases of premises and equipment	(3,930)	(3,764)
Distributions from unconsolidated subsidiaries	562	632
Contributions to unconsolidated subsidiaries	(3,548)	(845)
Acquisition of businesses and minority interests	-	(3,150)
Net cash used in investing activities	(44,021)	(233,096)

Cash flows from financing activities:		
Net increase (decrease) in deposits	54,958	(82,089)
Proceeds from long-term debt	-	30,000
Repayments of long-term debt	(40,540)	(60,736)
Net increase (decrease) in short-term borrowings	(12,295)	259,186
Cash dividends paid on common stock	-	(14,367)
Cash dividends paid on preferred stock	(2,362)	-
Tax benefits from share-based compensation	-	40
Repurchases of common stock	-	(1,824)
Net proceeds from issuance of common stock and stock option exercises	85	359
Net proceeds from issuance of preferred stock and warrants	134,329	-
Net cash provided by financing activities	134,175	130,569
Net increase in cash and cash equivalents	96,311	30,973
Cash and cash equivalents at beginning of period	107,745	82,129
Cash and cash equivalents at end of period	$ 204,056	$ 113,102
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Interest	$ 39,690	$ 61,371
Income taxes	1,532	12,920
Cash received during the period for:		
Income taxes	2,492	-
Supplemental disclosure of noncash investing and financing activities:		
Net change in common stock held by directors' deferred compensation plan	$ 42	$ 44
Net reclassification of loans to other real estate	9,761	7,401
Net transfer of loans to loans held for sale	5,152	162,984
Securitization of residential mortgage loans into trading mortgage backed securities	-	4,995
Securitization of residential mortgage loans into available for sale mortgage backed securities	50,146	-
Dividends accrued on preferred stock	844	-
Accretion of preferred stock discount	660	-

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. (referred to herein 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/A for the fiscal year ended December 31, 2008. 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. RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

On January 1, 2009, we adopted the following new accounting pronouncements:

- FSP FAS 157-2 – FASB Staff Position FAS No. 157-2, "Effective Date of FASB Statement No. 157,"
- FSP FAS 142-3 - FASB Staff Position FAS No. 142-3, "Determination of the Useful Life of Intangible Assets,"
- SFAS 141(R) – Statement of Financial Accounting Standards No. 141(R), "Business Combinations,"
- SFAS 160 – Statement of Financial Accounting Standards No. 160, "Noncontrolling Interests in Consolidated Financial Statements—an amendment of ARB No. 51,"
- SFAS 161 – Statement of Financial Accounting Standards No. 161, "Disclosures about Derivative Instruments and Hedging Activities - an amendment of FASB Statement No. 133," and
- FSP EITF 03-6-1 – FASB Staff Position EITF No. 03-6-1, "Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities."

The adoption of these pronouncements did not have a material impact on our consolidated financial statements.

In April 2009, the FASB issued three Staff Positions ("FSPs") that are intended to provide additional application guidance and enhance disclosures about fair value measurements and impairments of securities. FSP FAS 157-4 clarifies the objective and method of fair value measurement even when there has been a significant decrease in market activity for the asset being measured. FSP FAS 115-2 and FAS 124-2 establishes a new model for measuring other-than-temporary impairments for debt securities, including establishing criteria for when to recognize a write-down through earnings versus other comprehensive income ("OCI"). FSP FAS 107-1 and APB 28-1 expands the fair value disclosures required for all financial instruments within the scope of SFAS No. 107, "Disclosures about Fair Value of Financial Instruments," to interim periods. We adopted the provisions of these FSPs effective beginning April 1, 2009 (see Note 3 for the impact of the adoption of these FSPs).

In May 2009, the FASB issued SFAS No. 165, "Subsequent Events" ("SFAS 165"). SFAS 165 is intended to establish general standards of accounting for and disclosures of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. It requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for selecting that date, that is, whether that date represents the date the financial statements were issued or were available to be issued. We adopted the provisions of SFAS 165 during the quarter ended June 30, 2009 and the adoption did not have a material impact on our consolidated financial statements.

In June 2009, the FASB issued SFAS No. 166, "Accounting for Transfers of Financial Assets - An Amendment of FASB Statement No. 140" ("SFAS 166"), which will require more information about transfers of financial assets and where companies have continuing exposure to the risks related to transferred financial assets. SFAS 166 is effective for fiscal years and interim periods beginning after November 15, 2009. Earlier application is prohibited. We do not expect the adoption of this statement to have a material impact on our consolidated financial statements.

In June 2009, the FASB issued SFAS No. 167, "Amendments to FASB Interpretation No. 46(R)" ("SFAS 167"), which will change how a company determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. Under SFAS 167, determining whether a company is required to consolidate an entity will be based on, among other things, an entity's purpose and design and a company's ability to direct the activities of the entity that most significantly impact the entity's economic performance. SFAS 167 is effective for fiscal years and interim periods beginning after November 15, 2009. Earlier application is prohibited. We do not expect the adoption of this statement to have a material impact on our consolidated financial statements.

In June 2009, the FASB issued SFAS No. 168, "The FASB Accounting Standards CodificationTM and the Hierarchy of Generally Accepted Accounting Principles" ("SFAS 168" or the "Codification"). SFAS 168 represents the last numbered standard to be issued by FASB under the old (pre-codification) numbering system and amends the GAAP hierarchy. On July 1, 2009 the FASB launched the new Codification, which will supersede existing GAAP for nongovernmental entities effective for financial statements issued for interim and annual periods ending after September 15, 2009. This pronouncement impacts only the GAAP references in our filings.

3. INVESTMENT SECURITIES

A summary of investment securities is as follows:

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
		(Dollars in thousands)		
June 30, 2009				
Held to Maturity				
States and political subdivisions	$ 1,419	$ 7	$ -	$ 1,426
U.S. Government sponsored entities mortgage-backed securities	5,411	70	-	5,481
Total	$ 6,830	$ 77	$ -	$ 6,907
Available for Sale				
U.S. Government sponsored entities debt securities	$ 198,414	$ 1,412	$ (864)	$ 198,962
States and political subdivisions	114,262	1,055	(1,114)	114,203
U.S. Government sponsored entities mortgage-backed securities	648,652	9,833	(4,049)	654,436
Non-agency collateralized mortgage obligations	91,651	-	(10,140)	81,511
Other	983	-	(146)	837
Total	$ 1,053,962	$ 12,300	$ (16,313)	$ 1,049,949
December 31, 2008				
Held to Maturity				
States and political subdivisions	$ 1,984	$ 8	$ -	$ 1,992
	6,713	68	(14)	6,767

U.S. Government sponsored entities mortgage-backed securities								
Total	$	8,697	$	76	$	(14)	$	8,759
Available for Sale								
U.S. Government sponsored entities debt securities	$	98,819	$	1,335	$	(225)	$	99,929
States and political subdivisions		126,427		1,003		(3,040)		124,390
U.S. Government sponsored entities mortgage-backed securities		403,031		8,615		(338)		411,308
Non-agency collateralized mortgage obligations		111,308		-		(5,217)		106,091
Other		1,106		-		(224)		882
Total	$	740,691	$	10,953	$	(9,044)	$	742,600

The amortized cost and estimated fair value of investment securities at June 30, 2009 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.

	June 30, 2009 Amortized Cost	June 30, 2009 Estimated Fair Value
	(Dollars in thousands)	
Held to Maturity		
Due in one year or less	$ 920	$ 923
Due after one year through five years	499	503
Mortgage-backed securities	5,411	5,481
Total	$ 6,830	$ 6,907
Available for Sale		
Due in one year or less	$ 12,304	$ 12,697
Due after one year through five years	136,419	136,675
Due after five years through ten years	127,787	128,648
Due after ten years	36,166	35,145
Mortgage-backed securities	648,652	654,436
Non-agency collateralized mortgage obligations	91,651	81,511
Other	983	837
Total	$ 1,053,962	$ 1,049,949

Proceeds from sales of investment securities available for sale were $5.1 million and $7.2 million for the three and six months ended June 30, 2009, respectively, resulting in gross realized gains of less than $0.1 million during the three and six months ended June 30, 2009, no gross realized losses during the three months ended June 30, 2009 and gross realized losses of $0.2 million in the six months ended June 30, 2009. There were no sales of available for sale securities during the three and six months ended June 30, 2008. The basis on which the cost of all securities sold was determined using the specific identification method.

Investment securities of $801.2 million at June 30, 2009 were pledged to secure public funds on deposit, securities sold under agreements to repurchase and other long-term and short-term borrowings.

Provided below is a summary of investment securities which were in an unrealized loss position at June 30, 2009 and December 31, 2008. There were a total of 63 and 67 securities in an unrealized loss position at June 30, 2009 and December 31, 2008, respectively.

	Less than 12 months		12 months or longer		Total	
Description of Securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
			(Dollars in thousands)			
At June 30, 2009:						
U.S. Government sponsored entities debt securities	$ 79,017	$ (864)	$ -	$ -	$ 79,017	$ (864)
States and political subdivisions	32,250	(1,105)	545	(9)	32,795	(1,114)
U.S. Government sponsored entities mortgage-backed securities	215,573	(4,018)	6,029	(31)	221,602	(4,049)

Non-agency collateralized mortgage obligations	2,471	(37)	79,040	(10,103)	81,511	(10,140)
Other	837	(146)	-	-	837	(146)
Total temporarily impaired securities	$ 330,148	$ (6,170)	$ 85,614	$ (10,143)	$ 415,762	$ (16,313)
At December 31, 2008:						
U.S. Government sponsored entities debt securities	$ 9,969	$ (31)	$ 13,598	$ (194)	$ 23,567	$ (225)
States and political subdivisions	44,933	(3,021)	536	(19)	45,469	(3,040)
U.S. Government sponsored entities mortgage-backed securities	7,525	(30)	18,956	(322)	26,481	(352)
Non-agency collateralized mortgage obligations	53,388	(3,343)	52,703	(1,874)	106,091	(5,217)
Other	882	(224)	-	-	882	(224)
Total temporarily impaired securities	$ 116,697	$ (6,649)	$ 85,793	$ (2,409)	$ 202,490	$ (9,058)

The declines in market value were primarily attributable to changes in interest rates and disruptions in the credit and financial markets. Because we have the ability and intent to hold all of these investments until a recovery of fair value, which may be maturity, and expect to receive all future principal and interest payments, we do not consider these investments to be other-than-temporarily impaired, except as described below.

Other-than-temporary impairment ("OTTI")

Unrealized losses for all investment securities are reviewed to determine whether the losses are "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.

Nationally, residential real estate values have declined significantly since 2007. These declines in value, coupled with the reduced ability of certain homeowners to refinance or repay their residential real estate obligations, have led to elevated delinquencies and losses in residential real estate loans. Many of these loans have previously been securitized and sold to investors as private label mortgage-backed and other private label mortgage-related securities. Due to current market conditions, all of our privately-issued mortgage-backed securities are considered to be illiquid, and as such, we determined that these securities are Level 3 securities in accordance with SFAS 157, "Fair Value Measurements."

In the second quarter of 2009, we identified three non-agency collateralized mortgage obligations that were considered other-than-temporarily impaired. The total "other than temporary" impairment on these securities as of June 30, 2009 was approximately $10.5 million, of which $2.6 million was determined to be credit related and recognized through earnings. The remaining $7.9 million was recognized as a component of AOCI. There were no OTTI associated with any of our investment securities at December 31, 2008 and March 31, 2009.

The following table sets forth information regarding the changes in OTTI losses related to credit and recognized in earnings for the period indicated:

	Three Months Ended June 30, 2009 (Dollars in thousands)	
Balance at beginning of period	$	-

Additions:		
Initial credit impairments		2,565
Balance at end of period	$	2,565

To determine the write down on these securities, we projected cash flows for each of the non-agency collateralized mortgage obligations and discounted the cash flows at the original purchased yield. We analyzed each security's underlying collateral, year of origination, deal structure, geographic location of loan pools, credit scores, and actual loss severity percentages, among other inputs, to assign a probability of default and loss severity for each security. These default assumptions were then used to determine the projected cash flow of these securities. If the net present value of the cash flows were less than the cost basis of the respective securities, the difference was considered credit related losses and recorded through earnings.

4. LOANS AND LEASES

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

	June 30, 2009	December 31, 2008
	(Dollars in thousands)	
Commercial, financial and agricultural	$ 312,812	$ 384,473
Real estate:		
Construction	1,089,127	1,127,162
Mortgage - residential	913,059	1,073,039
Mortgage - commercial	1,172,860	1,215,857
Consumer	156,886	180,131
Leases	50,694	58,411
	3,695,438	4,039,073
Unearned income	(6,919)	(8,807)
Total loans and leases	$ 3,688,519	$ 4,030,266

Impaired loans requiring an allowance for loan and lease losses at June 30, 2009 and December 31, 2008 amounted to $189.8 million and $90.6 million, respectively, and included all nonaccrual and restructured loans greater than $0.5 million. Impaired loans not requiring an allowance for loan and lease losses at June 30, 2009 and December 31, 2008 amounted to $52.0 million and $82.5 million, respectively.

On February 20, 2009, we sold certain residential mortgage loans originated for investment with an aggregate carrying value of $98.4 million. No gain or loss was recorded on the sale as the carrying value of these loans equaled the proceeds received.

As of June 30, 2009, certain real estate loans totaling $2.2 billion have been pledged as collateral on our lines of credit with the FHLB and the Federal Reserve discount window.

5. ALLOWANCE FOR LOAN AND LEASE LOSSES

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

	Three Months Ended June 30, 2009	Three Months Ended June 30, 2008	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
	(Dollars in thousands)			
Balance, beginning of period	$ 122,286	$ 72,108	$ 119,878	$ 92,049
Provision for loan and lease losses	74,324	87,800	101,074	122,072
	196,610	159,908	220,952	214,121
Charge-offs	(30,943)	(74,257)	(55,758)	(129,067)
Recoveries	404	399	877	996
Net charge-offs	(30,539)	(73,858)	(54,881)	(128,071)
Balance, end of period	$ 166,071	$ 86,050	$ 166,071	$ 86,050

The increase in the Allowance in the second quarter and first half of 2009 was primarily due to downward risk rating migration in a number of Hawaii commercial construction loans and an overall increase in nonaccrual loans. The increase in our Allowance was deemed appropriate in response to uncertain economic conditions and continued deterioration in the Hawaii and California real estate markets. In accordance with generally accepted accounting principles in the United States, loans held for sale and other real estate assets are not included in our assessment of the Allowance.

6. SECURITIZATIONS

During the three and six months ended June 30, 2009, we securitized certain residential mortgage loans with an outstanding principal balance of $34.3 million and $50.1 million, respectively, with a U.S. Government sponsored entity. After the securitizations, we continued to hold mortgage-backed securities and service the residential mortgage loans. We recorded $0.4 million and $0.5 million of servicing assets related to these securitizations during the three and six months ended June 30, 2009, respectively. The servicing assets were recorded at their respective fair values at the time of securitization. The fair value of the servicing assets were determined using a discounted cash flow model based on market value assumptions at the time of securitization and is amortized in proportion to and over the period of net servicing income in accordance with SFAS 156.

All unsold mortgage-backed securities were categorized as available for sale securities and were therefore recorded at their fair value of $59.2 million and $11.1 million at June 30, 2009 and December 31, 2008, respectively. The fair values of these mortgage-backed securities were based on quoted prices of similar instruments in active markets in accordance with SFAS 157. Unrealized gains on unsold mortgage-backed securities were recorded in accumulated other comprehensive income (loss) and were $0.1 million and $0.3 million at June 30, 2009 and December 31, 2008, respectively.

7. GOODWILL AND OTHER INTANGIBLE ASSETS

At the end of the second quarter of 2009, we experienced a decline in our market capitalization which we determined to be an indicator that an impairment test was required under SFAS 142. As a result of the impairment test performed, we determined that our goodwill was not impaired. All remaining goodwill at June 30, 2009 is attributable to our Hawaii Market reporting unit.

Other intangible assets include a core deposit premium, mortgage servicing rights, customer relationships and non-compete agreements. The following table presents changes in other intangible assets for the six months ended June 30, 2009:

	Core Deposit Premium	Mortgage Servicing Rights	Customer Relationships	Non-Compete Agreements	Total
	(Dollars in thousands)				
Balance, beginning of period	$ 26,076	$ 12,107	$ 1,330	$ 270	$ 39,783
Additions	-	7,901	-	-	7,901
Amortization	(1,337)	(1,534)	(70)	(30)	(2,971)
Balance, end of period	$ 24,739	$ 18,474	$ 1,260	$ 240	$ 44,713

Income generated as the result of new mortgage servicing rights is reported as gains on sales of loans and totaled $3.1 million and $7.9 million for the three and six months ended June 30, 2009, respectively, compared to $2.7 million and $3.5 million for the three and six months ended June 30, 2008. The fair value of our mortgage servicing rights was $21.2 million and $12.1 million at June 30, 2009 and December 31, 2008, respectively.

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

	June 30, 2009			December 31, 2008		
	Gross Carrying Value	Accumulated Amortization	Net	Gross Carrying Value	Accumulated Amortization	Net

(Dollars in thousands)

Core deposit premium	$	44,642	$	(19,903)	$	24,739	$	44,642	$	(18,566)	$	26,076
Mortgage servicing rights		31,528		(13,054)		18,474		23,627		(11,520)		12,107
Customer relationships		1,400		(140)		1,260		1,400		(70)		1,330
Non-compete agreements		300		(60)		240		300		(30)		270
	$	77,870	$	(33,157)	$	44,713	$	69,969	$	(30,186)	$	39,783

Based on the core deposit premium, mortgage servicing rights, customer relationships and non-compete agreements held as of June 30, 2009, estimated amortization expense for the remainder of fiscal 2009, the next five succeeding fiscal years and all years thereafter are as follows:

	Estimated Amortization Expense				
	Core Deposit Premium	Mortgage Servicing Rights	Customer Relationships	Non-Compete Agreements	Total
	(Dollars in thousands)				
2009 (remainder)	$ 1,337	$ 1,022	$ 70	$ 30	$ 2,459
2010	2,674	2,377	140	60	5,251
2011	2,674	2,072	140	60	4,946
2012	2,674	1,822	140	60	4,696
2013	2,674	1,613	140	30	4,457
2014	2,674	1,431	140	-	4,245
Thereafter	10,032	8,137	490	-	18,659
	$ 24,739	$ 18,474	$ 1,260	$ 240	$ 44,713

8. 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. As required by SFAS 133, “Accounting for Derivative Instruments and Hedging Activities,” we measure all derivatives at fair value on our consolidated balance sheet. At 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 under SFAS 133, we record the effective portion of the changes in the fair value of the derivative in accumulated other comprehensive income (loss), 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 Swap

In January 2008, we entered into a derivative transaction to hedge future cash flows from a portion of our then existing variable rate loan portfolio. Effective January 2008 through January 2013, we will receive payments equal to a fixed interest rate of 6.25% from the counterparty on a notional amount of $400 million. In return, we will pay to the counterparty a floating rate, namely our prime rate, on the same notional amount. The purpose of this derivative transaction is to minimize the risk of fluctuations in interest payments received on our variable rate loan portfolio. The derivative transaction has been designated as a cash flow hedge.

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 June 30, 2009, we were a party to interest rate lock and forward sale commitments on $95.8 million and $86.3 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:

		Asset Derivatives		Liability Derivatives	
Derivatives designated as hedging instruments under SFAS 133	Balance Sheet Location	Fair Value at June 30, 2009	Fair Value at December 31, 2008	Fair Value at June 30, 2009	Fair Value at December 31, 2008
		(Dollars in thousands)			
Interest rate contracts	Other assets	$ 16,438	$ 26,903	$ -	$ -
Derivatives not designated as hedging instruments under SFAS 133					
Interest rate contracts	Other assets / other liabilities	$ 1,372	$ 3,815	$ 488	$ 1,314
Total derivatives		$ 17,810	$ 30,718	$ 488	$ 1,314

The following tables present the impact of derivative instruments and their location within the consolidated statements of operations:

Derivatives in SFAS 133 Cash Flow Hedging Relationship	Amount of Loss Recognized in AOCI on Derivative (Effective Portion)	Amount of Loss Reclassified from AOCI into Earnings (Effective Portion)	Amount of Gain Recognized in Earnings on Derivative (Ineffective Portion)
	(Dollars in thousands)		
Three Months Ended June 30, 2009			
Interest rate contracts	$ (8,763)	$ (3,786)	$ 2,290
Six Months Ended June 30, 2009			
Interest rate contracts	$ (7,533)	$ (1,794)	$ 2,106

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 operations. The ineffective portion has been recognized as other operating income in the consolidated statements of operations.

Derivatives not in SFAS 133 Cash Flow Hedging Relationship	Location of Loss Recognized in Earnings on Derivatives	Amount of Loss Recognized in Earnings on Derivatives
		(Dollars in thousands)
Three Months Ended June 30, 2009		
Interest rate contracts		$ (803)

	Other operating income		
Six Months Ended June 30, 2009			
Interest rate contracts	Other operating income	$	(2,497)

9. EQUITY

In January 2009, as part of the Troubled Asset Relief Program ("TARP") Capital Purchase Plan ("CPP") of the Emergency Stabilization Act of 2008, we issued and sold to the United States Department of the Treasury ("U.S. Treasury") (i) 135,000 shares of the Company's Fixed Rate Cumulative Perpetual Preferred Stock, no par value, having a liquidation preference of $1,000 per share and (ii) a ten-year warrant to purchase up to 1,585,748 shares of the Company's voting common stock, no par value, at an exercise price of $12.77 per share, for an aggregate purchase price of $135.0 million in cash. This capital is considered Tier 1 capital and ranks senior to common stock.

The preferred stock pays a dividend of 5% per year for the first five years and resets to 9% per year thereafter. The preferred stock is non-voting, other than class voting rights on matters that could adversely affect the shares. The preferred stock can be redeemed at the issuer's option after three years for the liquidation amount plus any accrued and unpaid dividends. Prior to the end of three years, the preferred stock may be redeemed at the issuer's option with the proceeds from a qualifying equity offering of any Tier 1 perpetual preferred stock or common stock. Redemption of the preferred stock can occur only if the stock is replaced with a similar class of capital. Dividends paid on the preferred stock are cumulative. The warrant has a ten year term and is exercisable immediately, in whole or in part, over the term of ten years. Any common shares issued under the exercise of the warrant are voting shares. If the Company raises common or perpetual preferred equity equal to or at least 100% of the preferred stock issued under TARP by December 31, 2009, the number of convertible shares relating to the warrant shall be reduced by 50%. The terms of TARP also include certain limitation on executive compensation.

In conjunction with the issuance of the preferred stock and stock warrant, the stock warrant was allocated a portion of the $135.0 million issuance proceeds as required by current accounting standards. The proceeds were allocated to the preferred stock and surplus based on their relative fair values. Accordingly, the value of the stock warrant was determined to be $6.75 million, which was allocated from the proceeds and recorded in surplus on our consolidated balance sheet. This non-cash amount is considered a discount on the preferred stock and is accreted against retained earnings over a five year period using the interest method and is reflected in our consolidated statement of operations as preferred stock dividends and accretion. For the three and six months ended June 30, 2009, we recorded $0.3 million and $0.7 million, respectively, in accretion of the preferred stock discount. The warrant is included in our diluted average common shares outstanding (subject to anti-dilution).

10. SHARE-BASED COMPENSATION

Stock Option Activity

The following is a summary of stock option activity for the Company's stock option plans for the six months ended June 30, 2009:

	Shares	Weighted Average Exercise Price
Outstanding at January 1, 2009	902,398	$ 26.48
Changes during the period:		
Granted	141,561	3.97
Expired	(21,803)	26.41
Forfeited	(14,252)	25.22
Outstanding at June 30, 2009	1,007,904	23.29

We estimate the fair value of stock options granted using the Black-Scholes option pricing formula and a single option award approach. This fair value is then amortized on a straight-line basis over the requisite service periods of the awards, which is generally the vesting period. The fair value of the Company's stock options granted to employees for the three and six months ended June 30, 2009 and 2008 was estimated using the following weighted-average assumptions:

	Three Months Ended June 30,	Six Months Ended June 30,

	2009	2008	2009	2008
Expected volatility	58.6%	32.5%	54.7%	32.0%
Risk free interest rate	3.7%	4.9%	2.6%	2.8%
Expected dividends	1.0%	8.0%	0.8%	5.4%
Expected life (in years)	6.5	6.5	5.5	6.5
Weighted average fair value	$ 2.94	$ 1.89	$ 1.87	$ 3.47

Restricted Stock Awards

The table below presents the activity of restricted stock awards for the six months ended June 30, 2009:

	Shares	Weighted Average Grant Date Fair Value
Nonvested at January 1, 2009	33,620	$ 34.23
Changes during the period:		
Vested	(3,500)	35.21
Nonvested at June 30, 2009	30,120	34.12

We awarded restricted stock awards to our non-officer directors and certain senior management personnel. The awards typically vest over a three or five year period. Compensation expense is measured as the market price of the stock awards on the grant date, and is recognized over the specified vesting periods.

Performance Shares and Stock Appreciation Rights

In 2005 and 2008, we established Long Term Incentive Plans (the “2005 LTIP” and “2008 LTIP”) that covers certain executive and senior management personnel. Awards granted under the 2005 LTIP are comprised of three components: performance shares, stock appreciation rights (“SARs”) and cash awards, while awards granted under the 2008 LTIP consists of performance shares and SARs. All performance shares and SARs awarded under both the 2005 LTIP and 2008 LTIP are granted from the Company’s 2004 Stock Compensation Plan.

No performance shares or SARs were granted under the 2005 LTIP and 2008 LTIP during the six months ended June 30, 2009.

The table below presents activity of performance shares for both the 2005 LTIP and 2008 LTIP during the six months ended June 30, 2009:

	Shares	Weighted Average Grant Date Fair Value
Nonvested at January 1, 2009	96,054	$ 18.88
Changes during the period:		
Forfeited	(4,290)	18.88
Nonvested at June 30, 2009	91,764	18.88

The table below presents activity of SARs under both the 2005 LTIP and 2008 LTIP for the six months ended June 30, 2009:

	Shares	Weighted Average Exercise Price
Outstanding at January 1, 2009	237,935	$ 20.74
Changes during the period:		
Vested	(22,147)	35.17
Forfeited	(180)	35.90
Outstanding at June 30, 2009	215,608	19.25

11. ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

Components of accumulated other comprehensive income (loss), net of taxes, were as follows:

	June 30, 2009	December 31, 2008
	(Dollars in thousands)	
Available for sale securities:		
Unrealized losses due to other-than-temporary impairment related to factors other than credit	$ (7,888)	$ -
All other unrealized gains	3,875	1,909
Unrealized holding gains on derivatives	12,234	24,806
Pension adjustments	(19,977)	(21,058)
Tax effect	4,713	(2,267)
Accumulated other comprehensive income (loss), net of tax	$ (7,043)	$ 3,390

Components of comprehensive loss for the periods indicated were as follows:

	Three Months Ended June 30, 2009	Three Months Ended June 30, 2008	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
	(Dollars in thousands)			
Net loss	$ (34,442)	$ (146,258)	$ (31,813)	$ (144,600)
Unrealized gain (loss) on investment securities, net of taxes	1,896	(7,147)	(3,547)	(3,202)
Unrealized loss on derivatives, net of taxes	(8,763)	(7,785)	(7,533)	(5,050)
Pension adjustments, net of taxes	324	113	647	224
Comprehensive loss	$ (40,985)	$ (161,077)	$ (42,246)	$ (152,628)

Unrealized gain (loss) on investment securities included in comprehensive loss for the three and six months ended June 30, 2009 were net of reclassification of $2.6 million ($1.5 million net of taxes) of other-than-temporary impairment losses included in earnings.

12. PENSION PLANS

Central Pacific Bank, our bank subsidiary, 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 June 30, 2009	Three Months Ended June 30, 2008	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
	(Dollars in thousands)			
Interest cost	$ 450	$ 451	$ 900	$ 902
Expected return on assets	(350)	(574)	(700)	(1,148)
Amortization of unrecognized loss	525	186	1,050	372
Net periodic cost	$ 625	$ 63	$ 1,250	$ 126

Central Pacific Bank also established Supplemental Executive Retirement Plans ("SERPs"), which provide certain officers of Central Pacific Bank with supplemental retirement benefits. The following table sets forth the components of net periodic benefit cost for the SERPs:

	Three Months Ended June 30, 2009	Three Months Ended June 30, 2008	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
	(Dollars in thousands)			
Service cost	$ 26	$ 75	$ 52	$ 150
Interest cost	116	138	232	276
Amortization of unrecognized transition obligation	9	5	18	10
Amortization of prior service cost	5	5	10	10
Amortization of unrecognized (gain) loss	1	(8)	2	(16)
Net periodic cost	$ 157	$ 215	$ 314	$ 430

13. LOSS PER SHARE

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

	Three Months Ended June 30, 2009	Three Months Ended June 30, 2008	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
	(In thousands, except per share data)			
Net loss	$ (34,442)	$ (146,258)	$ (31,813)	$ (144,600)
Preferred stock dividends and accretion	1,999	-	3,866	-
Net loss available to common shareholders	$ (36,441)	$ (146,258)	$ (35,679)	$ (144,600)
Weighted average shares outstanding - basic	28,687	28,652	28,684	28,670
Dilutive effect of employee stock options and awards	-	-	-	-
Weighted average shares outstanding - diluted	28,687	28,652	28,684	28,670
Basic and diluted loss per share	$ (1.27)	$ (5.10)	$ (1.24)	$ (5.04)

A total of 2,953,291 potentially dilutive securities have been excluded from the dilutive share calculation for the three and six months ended June 30, 2009, as their effect was antidilutive, compared to 1,330,096 for the three and six months ended June 30, 2008.

14. FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

SFAS 107, 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, federal funds sold, 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.

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 based on the higher of discounted value of contractual cash flows or carrying value. 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, primarily FHLB advances, 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.

	June 30, 2009		December 31, 2008	
	Carrying/ notional amount	Estimated fair value	Carrying/ notional amount	Estimated fair value
	(Dollars in thousands)			
Financial assets				
Cash and due from banks	$ 161,985	$ 161,985	$ 107,270	$ 107,270
Interest-bearing deposits in other banks	23,071	23,071	475	475
Federal funds sold	19,000	19,000	-	-
Investment securities	1,056,779	1,056,855	751,297	751,360
Net loans and leases, including loans held for sale	3,607,196	3,478,781	3,950,496	3,951,627
Accrued interest receivable	18,724	18,724	20,079	20,079
Financial liabilities				
Deposits:				
Noninterest-bearing deposits	623,698	623,698	627,094	627,094
Interest-bearing demand and savings deposits	1,977,047	1,977,047	1,530,150	1,530,150
Time deposits	1,365,779	1,371,256	1,754,322	1,763,388
Total deposits	3,966,524	3,972,001	3,911,566	3,920,089
Short-term borrowings	267,155	267,172	279,450	279,452
Long-term debt	608,554	540,713	649,257	593,492
Accrued interest payable (included in other liabilities)	11,487	11,487	12,861	12,861
Off-balance sheet financial instruments				
Commitments to extend credit	633,785	3,169	835,579	4,178
Standby letters of credit and financial guarantees written	46,744	351	59,147	444
Interest rate options	95,850	226	388,934	3,574
Interest rate swaps	400,000	16,438	400,000	26,903
Forward interest rate contracts	86,347	658	91,378	(1,074)
Forward foreign exchange contracts	-	-	150	149

SFAS 157, Fair Value Measurements

Effective January 1, 2008, we partially adopted the provisions of SFAS 157. The statement defines fair value, establishes a consistent framework for measuring fair value and expands disclosure requirements for fair value measurements.

Under SFAS 157, 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.

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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.

Under SFAS 157, 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. As required under SFAS 157, we 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.

The following table below presents the balances of assets and liabilities measured at fair value on a recurring basis as of June 30, 2009 and December 31, 2008:

	Level 1	Level 2	Level 3	Total
		(Dollars in thousands)		
June 30, 2009				
Available for sale securities:				
U.S. Government sponsered entities debt securities	$ -	$ 198,962	$ -	$ 198,962
States and political subdivisions	-	100,228	13,975	114,203
U.S. Government sponsered entities mortgage-backed securities	-	654,436	-	654,436
Non-agency collateralized mortgage obligations	-	-	81,511	81,511
Other	837	-	-	837
Net derivatives	-	17,322	-	17,322
Total	$ 837	$ 970,948	$ 95,486	$ 1,067,271
December 31, 2008				
Available for sale securities				
U.S. Government sponsered entities debt securities	$ -	$ 99,929	$ -	$ 99,929
States and political subdivisions	-	110,146	14,244	124,390
U.S. Government sponsered entities mortgage-backed securities	-	411,308	-	411,308
Non-agency collateralized mortgage obligations	-	-	106,091	106,091
Other	882	-	-	882
Net derivatives	-	29,403	-	29,403
Total	$ 882	$ 650,786	$ 120,335	$ 772,003

For the six months ended June 30, 2009 and 2008, the changes in Level 3 assets and liabilities measured at fair value on a recurring basis are summarized as follows:

	Available for sale securities	Available for sale non-agency collateralized mortgage obligations (1)
	(Dollars in thousands)	
Balance at January 1, 2009	$ 14,244	$ 106,091
Principal payments received	(269)	(19,657)
Unrealized net losses included in other comprehensive income		