CENTRAL PACIFIC FINANCIAL CORP
Form 10-K
February 29, 2008

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

FORM 10-K

(Mark One)
T Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the Fiscal year ended December 31, 2007
or

£ Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission file number: 0-10777

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 (Address of principal executive offices)	96813 (Zip Code)

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

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

Title of each class	Name of each exchange on which registered
Common Stock, No Par Value	New York Stock Exchange
Preferred Share Purchase Rights	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:
None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yesx Noo

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the

Act. Yeso Nox

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. Yesx Noo

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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. Large Accelerated Filer x Accelerated Filer o Non-Accelerated Filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).Yeso Nox

As of June 30, 2007, the aggregate market value of the common stock held by non-affiliates of the registrant was approximately $943,695,000. As of January 31, 2008, the number of shares of common stock of the registrant outstanding was 28,757,998 shares.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's proxy statement for the 2007 annual meeting of shareholders are incorporated by reference into Part II of this Annual Report on Form 10-K to the extent stated herein. The proxy statement will be filed within 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K.

PART I

Forward-Looking Statements and Factors that Could Affect Future Results

Certain statements contained in this Annual Report on Form 10-K that are not statements of historical fact constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 (the “Act”), notwithstanding that such statements are not specifically identified. In addition, certain statements may be contained in our future filings with the U.S. Securities and Exchange Commission (“SEC”), in press releases and in oral and written statements made by or with the approval of us that are not statements of historical fact and constitute forward-looking statements within the meaning of the Act. Examples of forward-looking statements include but are not limited to: (i) projections of revenues, expenses, income or loss, earnings or loss per share, the payment or nonpayment of dividends, capital structure and other financial items; (ii) statements of plans, objectives and expectations of Central Pacific Financial Corp. or its management or Board of Directors, including those relating to products or services; (iii) statements of future economic performance; and (iv) statements of assumptions underlying such statements. Words such as “believes,” “anticipates,” “expects,” “intends,” “targeted,” “continue,” “remain,” “will,” “shou and other similar expressions are intended to identify forward-looking statements but are not the exclusive means of identifying such statements.

Forward-looking statements involve risks and uncertainties that may cause actual results to differ materially from those in such statements. Factors that could cause actual results to differ from those discussed in the forward-looking statements include but are not limited to:

- Local, regional, national and international economic conditions and events (including natural disasters such as wildfires, tsunamis and earthquakes) and the impact they may have on us and our customers and our assessment of that impact;
- Changes in the economy affecting real estate values;
- Oversupply of inventory and continued slowing in the California real estate market;
- A significant portion of our loan portfolio consists of construction loans and any slowdown in construction activity may materially and negatively affect our business;
- Changes in the financial performance and/or condition of our borrowers;
- Changes in the level of non-performing assets and charge-offs;
- The effects of and changes in trade and monetary and fiscal policies and laws, including the interest rate policies of the Federal Reserve Board (“FRB”);
- Changes in estimates of future reserve requirements based upon the periodic review thereof under relevant regulatory and accounting requirements;
- Long-term negative trends in our market capitalization;
- Inflation, interest rate, securities market and monetary fluctuations;
- Political instability;
- Acts of war or terrorism;

- The timely development and acceptance of new products and services and perceived overall value of these products and services by users;
- Changes in consumer spending, borrowings and savings habits;
- Technological changes;

- Acquisitions and integration of acquired businesses;
- The ability to increase market share and control expenses;
- Changes in the competitive environment among financial holding companies and other financial service providers;
- The effect of changes in laws and regulations (including laws and regulations concerning taxes, banking, securities and insurance) with which we and our subsidiaries must comply;
- 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;
- Changes in our organization, compensation and benefit plans;
- 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;
- Greater than expected costs or difficulties related to the integration of new products and lines of business; and
- Our success at managing the risks involved in the foregoing items.

Forward-looking statements speak only as of the date on which such statements are made. We undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made, or to reflect the occurrence of unanticipated events.

ITEM 1. BUSINESS

General

Central Pacific Financial Corp., a Hawaii corporation and bank holding company registered under the Bank Holding Company Act of 1956 (as amended), was organized on February 1, 1982. Our principal business is to serve as a holding company for our bank subsidiary, Central Pacific Bank, which was incorporated in its present form in the state of Hawaii on March 16, 1982 in connection with the holding company reorganization, and its predecessor entity was incorporated in the state of Hawaii on January 15, 1954.

When we refer to “the Company,” “we,” “us” or “our,” we mean Central Pacific Financial Corp. & Subsidiaries (consolidated) When we refer to “Central Pacific Financial Corp.” or to the holding company, we are referring to the parent company on a standalone basis, and we refer to Central Pacific Bank herein as our bank or the bank.

In October 2007, we closed our two loan production offices in the state of Washington. This decision was based on an evaluation of the future growth prospects for this area and our belief that exiting this market will allow us to better focus our efforts on the Hawaii and California markets.

Through our bank and its subsidiaries, we offer full-service commercial banking with 38 bank branches and more than 95 ATMs located throughout the state of Hawaii. Our administrative and main offices are located in Honolulu and we have a total of 32 branches on the island of Oahu. In addition, we operate three branches on the island of Maui, one branch on the island of Kauai and two branches on the island of Hawaii. We also have four loan production offices serving customers in California. Our bank’s deposits are insured by the Federal Deposit Insurance Corporation (“FDIC”) up to applicable limits. The bank is not a member of the Federal Reserve System.

Central Pacific Bank is a full-service community bank offering a broad range of banking 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. We derive our income primarily from interest and fees on loans, interest on investment securities and fees received in connection with deposit and other services. Our major operating expenses are the interest paid by our bank on deposits and borrowings, salaries and employee benefits and general operating expenses. Our bank relies on a foundation of locally generated deposits. Our operations, like those of other financial institutions that operate in our markets, are significantly influenced by economic conditions in Hawaii and California, including the strength of the real estate market, as well as the fiscal and regulatory policies of the federal and state government and the regulatory authorities that govern financial institutions. For more information about the regulation of our holding company and bank, see "Supervision and Regulation."

We are committed to maintaining a premier, relationship-based community bank in Hawaii that serves the needs of small to medium-sized businesses and the owners and employees of those businesses. In addition, we provide geographic diversification of our credit risk through our loan production offices in California. The strategy for serving our target markets is the delivery of a finely focused set of value-added products and services that satisfy the primary needs of our customers, emphasizing superior service and relationships.

Our Services

We offer a full range of banking services and products to businesses, professionals and individuals. We provide our customers with an array of commercial and consumer loan products, including commercial real estate and construction loans, residential mortgage loans, commercial loans and lines of credit, and consumer loans and lines of credit.

Through our bank, we concentrate our lending activities in four principal areas:

(1) Commercial Real Estate Lending. Loans in this category consist of loans secured by commercial real estate, including but not limited to, structures and facilities to support activities designated as industrial, warehouse, general office, retail, health care, religious and multi-family dwellings. Our underwriting policy generally requires net cash flow from the property to cover the debt service while maintaining an appropriate amount of reserve. Additionally, liquidation of the collateral is available as a secondary source of repayment.

We have teams of highly experienced officers in Hawaii and California who specialize in commercial real estate lending and have long-established relationships with major real estate developers.

(2) Construction Lending. Construction lending encompasses the financing of both residential and commercial construction projects. Residential projects include the construction of single-family residential developments, apartment buildings and condominiums, while commercial projects include the construction of office buildings, warehouses and retail complexes. Our underwriting standards for residential construction projects generally require minimum pre-sale contracts, maintenance of appropriate reserves and demonstrated experience with previous development projects. We generally consider projected net cash flows, market feasibility, borrower net worth and experience, as well as collateral value as the primary factors in underwriting commercial construction projects.

As with our commercial real estate lending model, our staff of highly experienced officers specialize in construction lending and maintain close relationships with major real estate developers in all of our markets.

(3) Residential Mortgage Lending. Residential mortgage loans include both fixed and adjustable-rate loans primarily secured by single-family owner-occupied residences. We typically require loan-to-value ratios of not more than 80%, although higher levels are permitted with accompanying mortgage insurance. First mortgage loans secured by residential properties generally carry a moderate level of credit risk. With an average loan size of approximately $248,000, readily marketable collateral and a historically stable residential real estate market, credit losses on residential mortgages had been minimal during the past several years. However, current changes in interest rates and other market factors have impacted, and future changes may continue to impact the marketability of collateral and thus the level of credit risk inherent in the portfolio.

Since our August 2005 acquisition of Hawaii HomeLoans, Inc., now known as Central Pacific HomeLoans, Inc., we have grown our market position in the residential mortgage arena with dedicated mortgage lending specialists on all major islands in Hawaii.

(4) Commercial Lending and Leasing. Loans in this category consist primarily of term loans, lines of credit and equipment leases to small and middle-market businesses and professionals in the state of Hawaii. The borrower's

business is typically regarded as the principal source of repayment, although our underwriting policies and practices generally require additional sources of collateral, including real estate and other business assets, as well as personal guarantees where possible to mitigate risk. Risks of credit losses are greater in this loan category relative to secured loans, such as commercial and residential mortgages where a greater percentage of the loan amount is usually covered by collateral. Nonetheless, collateral and personal guarantees obtained on commercial loans can mitigate the increased risk and help to reduce credit losses.

Our commercial lending and leasing model involves teams of experienced personnel with established networks of business contacts who focus on marketing loans, deposits and other bank services to new and existing commercial clients.

In addition, we offer deposit products and services including checking, savings and time deposits, cash management and internet banking services, trust services and retail brokerage services.

Our Market Area and Competition

Based on deposit market share among FDIC-insured financial institutions in Hawaii, Central Pacific Bank, with $4.0 billion in deposits, was the fourth-largest depository institution in the state of Hawaii at December 31, 2007.

The banking and financial services industry in the state of Hawaii generally, and in our target market areas, is highly competitive. We compete for loans, deposits and customers with other commercial banks, savings and loan associations, securities and brokerage companies, mortgage companies, insurance companies, finance companies, credit unions and other nonbank financial service providers. Many of these competitors are much larger in total assets and capitalization and have greater access to capital markets.

In order to compete with the other financial services providers in the state of Hawaii, we principally rely upon local promotional activities, personal relationships between customers and our officers, directors and employees, and specialized services tailored to meet the needs of our customers and the communities we serve. We remain competitive by offering flexibility and superior service levels, coupled with competitive interest rates and pricing.

Our loan production offices in California likewise face strong competition in the commercial real estate lending sector. Competitors range from large national banks to regional and community banks. Nonbanks, including brokerage firms, conduits and insurance companies, also compete for commercial real estate lending business. Some of these competitors compete by pricing aggressively and by lowering their underwriting standards. To mitigate these competitive pressures and credit risks, we rely upon our teams of experienced commercial real estate lenders and outside consultants to guide our lending approach. For further discussion of factors affecting our operations in California, see “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

Business Concentrations

No individual or single group of related accounts is considered material in relation to the assets or deposits of our bank, or in relation to the overall business of the Company. However, approximately 84% of our loan portfolio held for investment at December 31, 2007 consisted of real estate-related loans, including construction loans, residential mortgage loans and commercial mortgage loans. See “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations—Financial Condition—Loan Portfolio.” Our business activities are currently focused primarily in Hawaii and California. Consequently, our results of operations and financial condition are affected by the general economic trends in Hawaii and California, particularly in the commercial and residential real estate markets. While during periods of economic strength, the real estate market and the real estate industry typically perform well, during periods of economic weakness, they typically slow down. In 2007, the weakening of the real estate industry, as a result of market interest rates and other economic conditions, adversely impacted the performance of our real estate loan portfolio in California.

Our Subsidiaries

Central Pacific Bank is the principal wholly-owned subsidiary of Central Pacific Financial Corp. Other wholly-owned subsidiaries include: Datatronix Financial Services, Inc., an item processing company that ceased operations in 2006; CPB Capital Trust I; CPB Capital Trust II; CPB Statutory Trust III; CPB Capital Trust IV; CPB Statutory Trust V; CB Technology, Inc.; CPB Real Estate, Inc.; Citibank Properties, Inc.; CB Technology, Inc. and Central Pacific HomeLoans, Inc.

Central Pacific Bank or its wholly-owned subsidiary, Central Pacific HomeLoans, Inc., also owns 50% of the following Hawaii limited liability corporations: Pacific Access Mortgage, LLC; Lokahi Mortgage, LLC; Gentry HomeLoans, LLC; Towne Island Mortgage, LLC; Pacific Island HomeLoans, LLC; Hawaii Resort Lending, LLC and Laulima Financial, LLC.

Supervision and Regulation

Set forth below is a description of the significant elements of the laws and regulations applicable to us and our bank. The description is qualified in its entirety by reference to the full text of the statutes, regulations and policies that are described. Also, such statutes, regulations and policies are continually under review by Congress and state legislatures and federal and state regulatory agencies. A change in statutes, regulations or regulatory policies applicable to us and our bank could have a material effect on our business.

Regulatory Agencies

Central Pacific Financial Corp. is a legal entity separate and distinct from its subsidiaries. As a bank holding company, Central Pacific Financial Corp. is regulated under the Bank Holding Company Act of 1956, as amended ("BHC Act"), and is subject to inspection, examination and supervision by the Board of Governors of the Federal Reserve System.

The Company is also under the jurisdiction of the SEC and is subject to the disclosure and regulatory requirements of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended, as administered by the SEC. Our common stock is listed on the New York Stock Exchange ("NYSE") under the trading symbol "CPF," and we are subject to the rules of the NYSE for companies listed there.

Central Pacific Bank, as a Hawaii-chartered bank, is subject to primary supervision, periodic examination and regulation by the State of Hawaii Division of Financial Institutions ("DFI") and the FDIC. The bank is also subject to certain regulations promulgated by the FRB. If, as a result of an examination of the bank, the FDIC should determine that the financial condition, capital resources, asset quality, earnings prospects, management, liquidity or other aspects of its operations are unsatisfactory, or that it or its management is violating or has violated any law or regulation, various remedies are available to the FDIC. Such remedies include the power to enjoin "unsafe or unsound" practices, to require affirmative action to correct any conditions resulting from any violation or practice, to issue an administrative order that can be judicially enforced, to direct an increase in capital, to restrict its growth, to assess civil monetary penalties, to remove officers and directors, and ultimately to terminate its deposit insurance, which for a Hawaii-chartered bank would result in a revocation of its charter. The DFI separately enjoys many of the same remedial powers.

Bank Holding Company Activities

In general, the BHC Act limits the business of bank holding companies to banking, managing or controlling banks and other activities that the FRB has determined to be so closely related to banking as to be a proper incident thereto. As a result of the Gramm-Leach-Bliley Act of 1999, which amended the BHC Act, bank holding companies that are financial holding companies may engage in any activity, or acquire and retain the shares of a company engaged in any activity that is either (i) financial in nature or incidental to such financial activity or (ii) complementary to a financial activity and that does not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally (as solely determined by the FRB). Activities that are financial in nature include securities underwriting and dealing, insurance underwriting and making merchant banking investments.

If a bank holding company seeks to engage in the broader range of activities that are permitted under the BHC Act for financial holding companies, (i) all of its depository institution subsidiaries must be "well capitalized" and "well managed" and (ii) it must file a declaration with the FRB that it elects to be a "financial holding company." A depository institution subsidiary is considered to be "well capitalized" if it satisfies the requirements for this status discussed in the section captioned "Capital Adequacy and Prompt Corrective Action" included elsewhere in this item. A depository institution subsidiary is considered "well managed" if it received a composite rating and management rating of at least "satisfactory" in its most recent examination.

In order for a financial holding company to commence any new activity permitted by the BHC Act or to acquire a company engaged in any new activity permitted by the BHC Act, each insured depository institution subsidiary of the financial holding company must have received a rating of at least "satisfactory" in its most recent examination under the Community Reinvestment Act. See the section captioned "Community Reinvestment Act" included elsewhere in this item.

The BHC Act generally limits acquisitions by bank holding companies that are not qualified as financial holding companies to commercial banks and companies engaged in activities that the FRB has determined to be so closely related to banking as to be a proper incident thereto. Financial holding companies are also permitted to acquire companies engaged in activities that are financial in nature and in activities that are incidental and complementary to financial activities without prior FRB approval. Central Pacific has not filed a declaration electing Financial Holding Company status and has no current intention to do so.

The BHC Act, the Federal Bank Merger Act, Hawaii law and other federal and state statutes regulate acquisitions of commercial banks. The BHC Act requires the prior approval of the FRB for the direct or indirect acquisition of more than 5.0% of the voting shares of a commercial bank or its parent holding company. In reviewing applications seeking approval of merger and acquisition transactions, the bank regulatory authorities will consider, among other things, the competitive effect and public benefits of the transactions, the capital position of the combined organization, the applicant's performance record under the Community Reinvestment Act (see the section captioned "Community Reinvestment Act" included elsewhere in this item) and fair housing laws and the effectiveness of the subject organizations in combating money laundering activities.

Dividends

The principal source of Central Pacific Financial Corp.'s cash revenues is from dividends from its subsidiary bank. The ability of our subsidiary bank to pay dividends or make other capital distributions to us is subject to the Hawaii state law that prohibits a state-chartered bank from declaring or paying dividends greater than its retained earnings. As of December 31, 2007, Central Pacific Bank's retained earnings totaled $216.9 million. In addition, federal law generally prohibits a depository institution from making any capital distributions (including payment of a dividend) or paying any management fee to its parent holding company if the depository institution would thereafter be undercapitalized. As of December 31, 2007, the total risk-based capital maintained by Central Pacific Bank in excess of minimum capital requirements was $204.3 million.

Affiliate Transactions

There are various restrictions on the ability of the holding company and its non-bank subsidiaries to borrow from and engage in certain other transactions with our subsidiary bank. In general, these restrictions require that any extensions of credit must be secured by designated amounts of specified collateral and are limited, as to any one of the holding company or its non-bank subsidiaries, to 10% of our subsidiary bank's capital stock and surplus, and, as to the holding company and all such non-bank subsidiaries in the aggregate, to 20% of our subsidiary bank's capital stock and surplus.

Federal law also provides that extensions of credit and other transactions between our subsidiary bank and the holding company or one of its non-bank subsidiaries must be on terms and conditions, including credit standards, that are substantially the same or at least as favorable to our subsidiary bank as those prevailing at the time for comparable transactions involving other non-affiliated companies or, in the absence of comparable transactions, on terms and conditions, including credit standards, that in good faith would be offered to or would apply to non-affiliated companies.

Source of Strength Doctrine

FRB policy requires bank holding companies to act as a source of financial and managerial strength to their subsidiary banks. Under this policy, we are expected to commit resources to support our subsidiary bank, including at times when we may not be in a financial position to provide it. Any capital loan by a bank holding company to any of its subsidiary banks is subordinate in right of payment to deposits and to certain other indebtedness of such subsidiary banks. The BHC Act provides that in the event of a bank holding company's bankruptcy, any commitment by the bank holding company to a federal bank regulatory agency to maintain the capital of a subsidiary bank will be assumed by the bankruptcy trustee and entitled to priority of payment.

Capital Adequacy and Prompt Corrective Action

Banks and bank holding companies are subject to various regulatory capital requirements administered by state and federal banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations involve quantitative measures of assets, liabilities and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators about components, risk weighting and other factors.

The FDIC and the DFI have substantially similar risk-based capital ratio and leverage ratio guidelines for banking organizations. The guidelines are intended to ensure that banking organizations have adequate capital given the risk levels of assets and off-balance sheet financial instruments. Under the guidelines, banking organizations are required to maintain minimum ratios for Tier 1 capital and total capital to risk-weighted assets (including certain off-balance sheet items, such as letters of credit). For purposes of calculating the ratios, a banking organization's assets and some of its specified off-balance sheet commitments and obligations are assigned to various risk categories. A depository institution's or holding company's capital, in turn, is classified in one of three tiers depending on type:

- Core Capital (Tier 1). Tier 1 capital includes common equity, retained earnings, qualifying non-cumulative perpetual preferred stock, a limited amount of qualifying cumulative perpetual stock at the holding company level, minority interests in equity accounts of consolidated subsidiaries, less goodwill, most intangible assets and certain other assets.

- Supplementary Capital (Tier 2). Tier 2 capital includes, among other things, perpetual preferred stock not meeting the Tier 1 definition, qualifying mandatory convertible debt securities, qualifying subordinated debt and allowances for possible loan losses, subject to limitations.

- Market Risk Capital (Tier 3). Tier 3 capital includes qualifying unsecured subordinated debt.

We, like other bank holding companies, are required to maintain Tier 1 capital and “total capital” (the sum of Tier 1, Tier 2 and Tier 3 capital) equal to at least 4.0% and 8.0%, respectively, of total risk-weighted assets (including various off-balance-sheet items, such as standby letters of credit). Our subsidiary bank, like other depository institutions, is required to maintain similar capital levels under capital adequacy guidelines. For a depository institution to be considered “well capitalized” under the regulatory framework for prompt corrective action, it’s Tier 1 and total capital ratios must be at least 6.0% and 10.0% on a risk-adjusted basis, respectively.

Bank holding companies and banks subject to the market risk capital guidelines are required to incorporate market and interest rate risk components into their risk-based capital standards. Under the market risk capital guidelines, capital is allocated to support the amount of market risk related to a financial institution’s ongoing trading activities.

Bank holding companies and banks are also required to comply with minimum leverage ratio requirements. The leverage ratio is the ratio of a banking organization's Tier 1 capital to its total adjusted quarterly average assets (as defined for regulatory purposes). The requirements necessitate a minimum leverage ratio of 3.0% for financial holding companies and national banks that either have the highest supervisory rating or have implemented the appropriate federal regulatory authority's risk-adjusted measure for market risk. All other financial holding companies and banks are required to maintain a minimum leverage ratio of 4.0%, unless a different minimum is specified by an appropriate regulatory authority. For a depository institution to be considered "well capitalized" under the regulatory framework for prompt corrective action, it's leverage ratio must be at least 5.0%. The FRB has not advised Central Pacific of any specific minimum leverage ratio applicable to it.

The Federal Deposit Insurance Act, as amended ("FDIA"), requires among other things, the federal banking agencies to take "prompt corrective action" in respect of depository institutions that do not meet minimum capital requirements. The FDIA sets forth the following five capital tiers: "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized" and "critically undercapitalized." A depository institution's capital tier will depend upon how its capital levels compare with various relevant capital measures and certain other factors as established by regulation. The relevant capital measures are the total capital ratio, the Tier 1 capital ratio and the leverage ratio.

Under the regulations adopted by the federal regulatory authorities, a bank will be: (i) "well capitalized" if the institution has a total risk-based capital ratio of 10.0% or greater, a Tier 1 risk-based capital ratio of 6.0% or greater, a leverage ratio of 5.0% or greater and is not subject to any order or written directive by any such regulatory authority to meet and maintain a specific capital level for any capital measure; (ii) "adequately capitalized" if the institution has a total risk-based capital ratio of 8.0% or greater, a Tier 1 risk-based capital ratio of 4.0% or greater, a leverage ratio of 4.0% or greater (3.0% in certain circumstances) and is not "well capitalized"; (iii) "undercapitalized" if the institution has a total risk-based capital ratio of less than 8.0%, a Tier 1 risk-based capital ratio of less than 4.0% or a leverage ratio of less than 4.0% (3.0% in certain circumstances); (iv) "significantly undercapitalized" if the institution has a total risk-based capital ratio of less than 6.0%, a Tier 1 risk-based capital ratio of less than 3.0% or a leverage ratio of less than 3.0%; and (v) "critically undercapitalized" if the institution's tangible equity is equal to or less than 2.0% of average quarterly tangible assets. An institution may be downgraded to or deemed to be in a capital category that is lower than indicated by its capital ratios if it is determined to be in an unsafe or unsound condition or if it receives an unsatisfactory examination rating with respect to certain matters. A bank's capital category is determined solely for the purpose of applying prompt corrective action regulations and the capital category may not constitute an accurate representation of the bank's overall financial condition or prospects for other purposes.

The FDIA generally prohibits a depository institution from making any capital distributions (including payment of a dividend) or paying any management fee to its parent holding company if the depository institution would thereafter be "undercapitalized." "Undercapitalized" institutions are subject to growth limitations and are required to submit a capital restoration plan. The agencies may not accept such a plan without determining, among other things, that the plan is based on realistic assumptions and is likely to succeed in restoring the depository institution's capital. In addition, for a capital restoration plan to be acceptable, the depository institution's parent holding company must guarantee that the institution will comply with such capital restoration plan. The aggregate liability of the parent holding company is limited to the lesser of (i) an amount equal to 5.0% of the depository institution's total assets at the time it became undercapitalized and (ii) the amount which is necessary (or would have been necessary) to bring the institution into compliance with all capital standards applicable with respect to such institution as of the time it fails to comply with the plan. If a depository institution fails to submit an acceptable plan, it is treated as if it is "significantly undercapitalized."

"Significantly undercapitalized" depository institutions may be subject to a number of requirements and restrictions, including orders to sell sufficient voting stock to become "adequately capitalized," requirements to reduce total assets and cessation of receipt of deposits from correspondent banks. "Critically undercapitalized" institutions are subject to the appointment of a receiver or conservator.

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As of December 31, 2007, our capital ratios and the capital ratios of our bank exceeded the minimum thresholds for a "well-capitalized" institution. The following table sets forth actual and required capital ratios as of December 31, 2007 and 2006:

	Actual		Minimum required for capital adequacy purposes		Minimum required to be well-capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
			(Dollars in thousands)			
Company						
As of December 31, 2007:						
Tier 1 risk-based capital	$ 535,670	11.5%	$ 187,049	4.0%	$ 280,574	6.0%
Total risk-based capital	594,620	12.7	374,098	8.0	467,623	10.0
Leverage capital	535,670	9.8	218,477	4.0	273,096	5.0
As of December 31, 2006:						
Tier 1 risk-based capital	$ 552,141	12.3%	$ 179,248	4.0%	$ 268,872	6.0%
Total risk-based capital	607,079	13.6	358,496	8.0	448,120	10.0
Leverage capital	552,141	10.9	202,494	4.0	253,117	5.0
Central Pacific Bank						
As of December 31, 2007:						
Tier 1 risk-based capital	$ 518,923	11.1%	$ 186,743	4.0%	$ 280,115	6.0%
Total risk-based capital	577,779	12.4	373,487	8.0	466,859	10.0
Leverage capital	518,923	9.5	218,143	4.0	272,679	5.0
As of December 31, 2006:						
Tier 1 risk-based capital	$ 525,115	11.8%	$ 178,724	4.0%	$ 268,087	6.0%
Total risk-based capital	580,053	13.0	357,449	8.0	446,811	10.0
Leverage capital	525,115	10.3	203,281	4.0	254,101	5.0

The federal regulatory authorities' risk-based capital guidelines are based upon the 1988 capital accord of the Basel Committee on Banking Supervision, or the BIS. The BIS is a committee of central banks and bank supervisors/regulators from the major industrialized countries that develops broad policy guidelines for use by each country's supervisors in determining the supervisory policies they apply. In 2004, the BIS published a new capital accord to replace its 1988 capital accord, with an update in November 2005 ("BIS II"). BIS II provides two approaches for setting capital standards for credit risk—an internal ratings-based approach tailored to individual institutions' circumstances (which for many asset classes is itself broken into a "foundation" approach and an "advanced or A-IRB" approach, the availability of which is subject to additional restrictions) and a standardized approach that bases risk weightings on external credit assessments to a much greater extent than permitted in existing risk-based capital guidelines. BIS II also would set capital requirements for operational risk and refine the existing capital requirements for market risk exposures.

The U.S. banking and thrift agencies are developing proposed revisions to their existing capital adequacy regulations and standards based on BIS II. In September 2006, the agencies issued a notice of proposed rulemaking setting forth a definitive proposal for implementing BIS II in the United States that would apply only to internationally active banking organizations—defined as those with consolidated total assets of $250 billion or more or consolidated on-balance sheet foreign exposures of $10 billion or more—but that other U.S. banking organizations could elect but would not be required to apply. In December 2006, the agencies issued a notice of proposed rulemaking describing proposed amendments to their existing risk-based capital guidelines to make them more risk-sensitive, generally following aspects of the standardized approach of BIS II. These latter proposed amendments, often referred to as "BIS I-A," would apply to banking organizations that are not internationally active banking organizations subject to the A-IRB approach for internationally active banking organizations and do not "opt in" to that approach.

The comment periods for both of the agencies' notices of proposed rulemakings expired on March 26, 2007. The agencies have indicated their intent to have the new requirements first become effective in 2009 and that those provisions and the BIS I-A provisions for others will be implemented on similar timeframes.

The Company is not an internationally active banking organization and does not expect to opt-in to the A-IRB provisions once they become effective.

Deposit Insurance

Substantially all of the deposits of our bank subsidiary are insured up to applicable limits by the Deposit Insurance Fund ("DIF") of the FDIC and are subject to deposit insurance assessments to maintain the DIF. Our bank subsidiary paid no insurance assessments on these deposits during the most recent semi-annual period. However, in November 2006, the FDIC issued a final rule that became effective on January 1, 2007 that creates a new assessment system designed to more closely tie what banks pay for deposit insurance to the risks they pose and adopts a new base schedule of rates that the FDIC can adjust up or down, depending on the revenue needs of the insurance fund. This new assessment system is expected to result in increased annual assessments on deposits of our bank subsidiary of 5 to 7 cents for each $100 of domestically held deposits. An FDIC credit for prior contributions is expected to offset the assessment for 2007 and may offset a portion of the assessment for 2008. Significant increases in the insurance assessments our bank subsidiary pays will increase our costs once the credit is utilized or otherwise disposed of.

Depositor Preference

The FDIA provides that, in the event of the "liquidation or other resolution" of an insured depository institution, the claims of depositors of the institution, including the claims of the FDIC as subrogee of insured depositors, and certain claims for administrative expenses of the FDIC as a receiver, will have priority over other general unsecured claims against the institution. If an insured depository institution fails, insured and uninsured depositors, along with the FDIC, will have priority in payment ahead of unsecured, non-deposit creditors, including the parent bank holding company, with respect to any extensions of credit they have made to such insured depository institution.

Community Reinvestment Act

The Community Reinvestment Act of 1977, or the CRA, requires depository institutions to assist in meeting the credit needs of their market areas consistent with safe and sound banking practice. Under the CRA, each depository institution is required to help meet the credit needs of its market areas by, among other things, providing credit to low- and moderate-income individuals and communities. Depository institutions are periodically examined for compliance with the CRA and are assigned ratings. In order for a financial holding company to commence any new activity permitted by the BHC Act or to acquire any company engaged in any new activity permitted by the BHC Act, each insured depository institution subsidiary of the financial holding company must have received a rating of at least "satisfactory" in its most recent examination under the CRA. Furthermore, banking regulators take into account CRA ratings when considering approval of a proposed transaction.

Financial Privacy

In accordance with the GLB Act, federal banking regulators adopted rules that limit the ability of banks and other financial institutions to disclose non-public information about consumers to nonaffiliated third parties. These limitations require disclosure of privacy policies to consumers and in some circumstances allow consumers to prevent disclosure of certain personal information to a nonaffiliated third party. The privacy provisions of the GLB Act affect how consumer information is transmitted through diversified financial companies and conveyed to outside vendors.

Anti-Money Laundering Initiatives and the USA Patriot Act

A major focus of governmental policy on financial institutions in recent years has been aimed at combating money laundering and terrorist financing. The USA PATRIOT Act of 2001, or the USA Patriot Act, substantially broadened the scope of United States anti-money laundering laws and regulations by imposing significant new compliance and due diligence obligations, creating new crimes and penalties and expanding the extra-territorial jurisdiction of the United States. The United States Treasury Department has issued a number of regulations that apply various requirements of the USA Patriot Act to financial institutions such as our bank and broker-dealer subsidiaries. These regulations impose obligations on financial institutions to maintain appropriate policies, procedures and controls to detect, prevent and report money laundering and terrorist financing and to verify the identity of their customers. Failure of a financial institution to maintain and implement adequate programs to combat money laundering and terrorist financing or to comply with all of the relevant laws or regulations, could have serious legal and reputational consequences for the institution.

In November 2006, Central Pacific Bank agreed to a cease and desist order (the “Order”) with the FDIC and the DFI. The Order required the bank to take steps to improve its Bank Secrecy Act (“BSA”) program including detecting, monitoring and reporting large currency transactions and suspicious activity. Since receiving the order, the bank has implemented numerous improvements to address the requirements of the Order with regulatory guidance. The bank’s improvements to its BSA program included a new automated system designed to detect, monitor and report large currency transactions and suspicious activity. In November 2007, the bank was successful in having the Order terminated by the FDIC and DFI.

Office of Foreign Assets Control Regulation

The United States has imposed economic sanctions that affect transactions with designated foreign countries, nationals and others. These are typically known as the “OFAC” rules based on their administration by the U.S. Treasury Department Office of Foreign Assets Control (“OFAC”). The OFAC-administered sanctions targeting countries take many different forms. Generally, however, they contain one or more of the following elements: (i) restrictions on trade with or investment in a sanctioned country, including prohibitions against direct or indirect imports from and exports to a sanctioned country and prohibitions on “U.S. persons” engaging in financial transactions relating to making investments in or providing investment-related advice or assistance to a sanctioned country; and (ii) a blocking of assets in which the government or specially designated nationals of the sanctioned country have an interest by prohibiting transfers of property subject to U.S. jurisdiction (including property in the possession or control of U.S. persons). Blocked assets (e.g., property and bank deposits) cannot be paid out, withdrawn, set off or transferred in any manner without a license from OFAC. Failure to comply with these sanctions could have serious legal and reputational consequences.

Legislative Initiatives

From time to time, various legislative and regulatory initiatives are introduced in Congress and state legislatures, as well as by regulatory agencies. Such initiatives may include proposals to expand or contract the powers of bank holding companies and depository institutions or proposals to substantially change the financial institution regulatory system. Such legislation could change banking statutes and our operating environment in substantial and unpredictable ways. If enacted, such legislation could increase or decrease the cost of doing business, limit or expand permissible activities or affect the competitive balance among banks, savings associations, credit unions and other financial institutions. We cannot predict whether any such legislation will be enacted, and if enacted, the effect that it or any implementing regulations would have on our financial condition or results of operations. A change in statutes, regulations or regulatory policies applicable to us or any of our subsidiaries could have a material effect on our business.

Employees

At January 31, 2008, we employed 1,085 persons, 1,021 on a full-time basis and 64 on a part-time basis. We are not a party to any collective bargaining agreement.

Available Information

Our internet website can be found at www.centralpacificbank.com. Our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to those reports can be found on our internet website as soon as reasonably practicable after such material is electronically filed with or furnished to the SEC. Copies of the Company’s filings with the SEC may also be obtained directly from the SEC’s website at www.sec.gov. These documents may also be obtained in print upon request by our shareholders to our Investor Relations Department.

Also posted on our website and available in print upon request of any shareholder to our Investor Relations Department, are the charters for our Audit Committee, our Compensation Committee and our Corporate Governance and Nominating Committee, as well as our Corporate Governance Guidelines and our Code of Business Conduct and Ethics. Within the time period required by the SEC and the NYSE, we will post on our website any amendment to the Code of Business Conduct and Ethics and any waiver applicable to our senior financial officers, as defined by the SEC, and our executive officers or directors. In addition, our website includes information concerning purchases and sales of our equity securities by our executive officers and directors, as well as disclosure relating to certain non-GAAP financial measures (as defined in the SEC’s Regulation G) that we may make public orally, telephonically, by webcast, by broadcast or by similar means from time to time.

ITEM 1A. RISK FACTORS

An investment in our common stock is subject to risks inherent to our business. The material risks and uncertainties that management believes affect us are described below. Before making an investment decision, you should consider carefully the risks and uncertainties described below together with all of the other information included or incorporated by reference in this report. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties that management is not aware of or focused on or that management currently deems immaterial may also impair our business operations. This report is qualified in its entirety by these risk factors.

If any of the following risks actually occurs, our financial condition and results of operations could be materially and adversely affected. If this were to happen, the value of our common stock could decline significantly and you could lose all or part of your investment.

Factors That May Affect Our Business

The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties that we are unaware of, or that we currently deem immaterial, also may become important factors that affect us. If any one or a combination of these risks occurs, our business, financial condition or results of operations could be materially and adversely affected.

Changes in economic conditions, in particular an economic slowdown in Hawaii or a continued slowdown in California, could materially hurt our business.

Our business is directly affected by factors such as economic, political and market conditions, broad trends in industry and finance, legislative and regulatory changes, changes in government monetary and fiscal policies and inflation, all of which are beyond our control. The current deterioration in economic conditions in the United States generally, and any economic slowdown in Hawaii or a continued slowdown in California given the concentration of our loan portfolio in the region, could result in the following consequences, any of which could materially hurt our business:

- Loan delinquencies may continue to increase;
- Problem assets and foreclosures may continue to increase leading to more loan charge-offs;
- Demand for our products and services may decline;
- Low cost or non-interest bearing deposits may continue to decrease; and
- Collateral for loans made by us, especially involving real estate, may continue to decline in value, in turn reducing customers' borrowing power and reducing the value of assets and collateral associated with our existing loans.

A large percentage of our loans are collateralized by real estate and an adverse change in the real estate market may result in losses and adversely affect our profitability.

As we have seen in the last half of 2007 with the deteriorating market conditions of the California residential construction market, our results of operations in future periods may be significantly impacted by the economies in Hawaii, California and other markets we serve. Approximately 84% of our loan portfolio as of December 31, 2007 was comprised of loans primarily collateralized by real estate, 66% of these loans are concentrated in Hawaii, 30% in California and 4% in Washington. The continued deterioration of the California residential construction market, deterioration of the economic environment in Hawaii, California or other markets we serve, including a material decline in the real estate market, further declines in single-family home resales or a material external shock, may significantly impair the value of our collateral and our ability to sell the collateral upon foreclosure. In the event of a default with respect to any of these loans, amounts received upon sale of the collateral may be insufficient to recover outstanding principal and interest on the loan. As a result, we expect that our profitability would be negatively impacted by an adverse change in the real estate market.

A large percentage of our real estate loans are construction loans which involve the additional risk that a project may not be completed, increasing the risk of loss.

Approximately 35% of our real estate loan portfolio as of December 31, 2007 was comprised of construction loans. Fifty-one percent of these construction loans are in California, 42% are in Hawaii and the remaining 7% are in Washington. Repayment of construction loans is dependent upon the successful completion of the construction project, on time and within budget, and the successful sale of the completed project. If a borrower is unable to complete a construction project or if the marketability of the completed development is impaired, proceeds from the sale of the subject property may be insufficient to repay the loan. The continued decline in the California real estate market or a deterioration of the real estate market in any market we serve is likely to damage the marketability of these projects, as a result, we may incur loan losses which will adversely affect our profitability. We have had to increase our provision for loan and lease losses substantially over the latter part of 2007 and may have to do so again.

Our business is subject to interest rate risk and fluctuations in interest rates may adversely affect our earnings.

The majority of our assets and liabilities are monetary in nature and subject to risk from changes in interest rates. Like most financial institutions, our earnings and profitability depend significantly on our net interest income, which is the difference between interest income on interest-earning assets such as loans and investment securities and interest expense on interest-bearing liabilities such as deposits and borrowings. We expect that we will periodically experience "gaps" in the interest rate sensitivities of our assets and liabilities, meaning that either our interest-bearing liabilities will be more sensitive to changes in market interest rates than our interest-earning assets, or vice versa. If market interest rates should move contrary to our position, this "gap" will work against us and our earnings may be negatively affected. In light of our current volume and mix of interest-earning assets and interest-bearing liabilities, our interest rate spread could be expected to increase during periods of rising interest rates and, conversely, to decline during periods of falling interest rates. We are unable to predict or control fluctuations of market interest rates, which are affected by many factors including the following:

- Inflation;
- Recession;
- Changes in unemployment;
- The money supply; and
- International disorder and instability in domestic and foreign financial markets.

Our asset/liability management strategy may not be able to control our risk from changes in market interest rates and it may not be able to prevent changes in interest rates from having a material adverse effect on our results of operations and financial condition. From time to time, we may reposition our investment portfolio, as we have done in 2007 and 2006, to reduce our net interest income volatility.

Our allowance for loan and lease losses may not be sufficient to cover actual loan losses, which could adversely affect our results of operations. Additional loan losses will likely occur in the future and may occur at a rate greater than we have experienced to date.

As a lender, we are exposed to the risk that our loan customers may not repay their loans according to their terms and that the collateral or guarantees securing these loans may be insufficient to assure repayment. We recently increased our loan loss provision and our current allowance may not be sufficient. We may experience significant loan losses that could have a material adverse effect on our operating results. Management makes various assumptions and judgments about the collectibility of our loan portfolio, which are regularly reevaluated and are based in part on:

- Current economic conditions and their estimated effects on specific borrowers;
- An evaluation of the existing relationships among loans, potential loan losses and the present level of the allowance for loan and lease losses;
- Results of examinations of our loan portfolios by regulatory agencies; and
- Management's internal review of the loan portfolio.

In determining the size of the allowance, we rely on an analysis of our loan portfolio, our experience and our evaluation of general economic conditions. If our assumptions prove to be incorrect, our current allowance may not be sufficient. We have recently made significant adjustments and additional adjustments may continue to be necessary if the local or national real estate markets continue their deterioration. Material additions to the allowance would materially decrease our net income. In addition, federal regulators periodically evaluate the adequacy of our allowance and may require us to increase our provision for loan and lease losses or recognize further loan charge-offs based on judgments different than those of our management. Any further increase in our allowance or loan charge-offs could have a material adverse effect on our results of operations.

We operate in a highly competitive industry and market area.

We face substantial competition in all areas of our operations from a variety of different competitors, many of which are larger and may have more financial resources. Such competitors primarily include national, regional and community banks within the various markets we operate. Additionally, various out-of-state banks conduct significant business in the market areas in which we currently operate. We also face competition from many other types of financial institutions, including, without limitation, savings and loans, credit unions, finance companies, brokerage firms, insurance companies, factoring companies and other financial intermediaries.

The financial services industry could become even more competitive as a result of legislative, regulatory and technological changes and continued consolidation. Banks, securities firms and insurance companies can merge under the umbrella of a financial holding company, which can offer virtually any type of financial service, including banking, securities underwriting, insurance (both agency and underwriting) and merchant banking. Also, technology has lowered barriers to entry and made it possible for non-banks to offer products and services traditionally provided by banks such as automatic transfer and automatic payment systems. Many of our competitors have fewer regulatory constraints and may have lower cost structures. Additionally, due to their size, many competitors may be able to achieve economies of scale and, as a result, may offer a broader range of products and services as well as better pricing for those products and services than we can.

Our ability to compete successfully depends on a number of factors, including, among other things:

- The ability to develop, maintain and build upon long-term customer relationships based on top quality service, high ethical standards and safe, sound assets;
- The ability to expand our market position;
- The scope, relevance and pricing of products and services offered to meet customer needs and demands;
- The rate at which we introduce new products and services relative to its competitors;
- Customer satisfaction with our level of service; and
- Industry and general economic trends.

Failure to perform in any of these areas could significantly weaken our competitive position, which could adversely affect our growth and profitability, which, in turn, could have a material adverse effect on our financial condition and results of operations.

Our deposit customers may pursue alternatives to bank deposits or seek higher yielding deposits causing us to incur increased funding costs.

We are facing increasing deposit-pricing pressures. Checking and savings account balances and other forms of deposits can decrease when our deposit customers perceive alternative investments such as the stock market or other non-depository investments as providing superior expected returns. Furthermore, technology and other changes have made it more convenient for bank customers to transfer funds into alternative investments including products offered by other financial institutions or non-bank service providers. Additional increases in short-term interest rates could increase transfers of deposits to higher yielding deposits. Efforts and initiatives we undertake to retain and increase deposits, including deposit pricing, can increase our costs. When bank customers move money out of bank deposits in favor of alternative investments or into higher yielding deposits, we can lose a relatively inexpensive source of funds, thus increasing our funding costs.

Operations in our California loan production offices have a considerable affect on our results of operations, and sustaining these operations and growing loans may be more difficult than we expect, which could adversely affect our results of operations.

Expanding our loan production in California depends on a number of factors including improvement of the California real estate market. As we have seen in the California residential construction market during the second half of 2007, the strength of the real estate market and the results of our operations could continue to be negatively affected by an economic downturn and increases in market interest rates.

Because we have a limited operating history with respect to our California loan production offices, it is more difficult to predict our future prospects and financial performance, which may impair our ability to manage our business.

Our first California loan production office commenced operations in the first quarter of 2003. Consequently, our mainland offices have a limited history upon which we can rely in planning and making decisions that will affect our future operating results.

Because we have a limited operating history with respect to our California loan production offices, it is more difficult to predict our future prospects and financial performance, which may impair our ability to manage our business.

Our first California loan production office commenced operations in the first quarter of 2003. Consequently, our mainland offices have a limited history upon which we can rely in planning and making decisions that will affect our future operating results.

The loans made by our California loan production offices are generally unseasoned and any defaults on such loans would adversely affect our financial condition, results of operations and prospects.

At December 31, 2007, loans originated in our California loan production offices totaled $1.1 billion, or 25% of our total loan portfolio. In light of the limited operating history of our mainland loan production offices described in the previous risk factor, we note that all of those loans were originated after January 1, 2003. The payment on such loans is typically dependent on the cash flows generated by the projects, which are affected by the supply and demand for commercial property within the relative market. Declines in the market for commercial property are causing commercial borrowers to suffer losses on their projects and they may be unable to repay their loans. Our reevaluation of these unseasoned loans that were originated in California has been a significant factor in the recent increase in our provision for loan and lease losses. Defaults of these loans or further deterioration in the credit worthiness of any of these borrowers would further negatively affect our financial condition, results of operations and prospects.

The loans made by our California loan production offices are concentrated among a limited number of customers and difficulty with a customer or loss of a customer could affect our results of operations and our ability to grow loans and deposits in the mainland.

Our California operations are dependent on a concentration of loans with a small number of key customers with whom individuals on our mainland loan staff have built strong relationships. Such a concentration of borrowers carries certain risks. Among other things, financial difficulty at one mortgaged real property could cause a borrower to defer maintenance at another mortgaged real property in order to satisfy current expenses with respect to the troubled mortgaged real property. A borrower could attempt to avert foreclosure on one mortgaged real property by filing a bankruptcy petition that might have the effect of interrupting monthly payments for an indefinite period on all of the related mortgage loans. Furthermore, the average size of loans in our mainland portfolio, especially those originated in Southern California, is larger than that of loans in our Hawaii portfolio, and such larger average loan size could make potential losses related to concentration risk more severe.

Loan growth from our California operations is dependent on relationships between certain key customers and our current mainland loan staff who in turn have forged relationships with certain key members of our management team, and the departure of these individuals could adversely affect our business.

Our California operations are dependent on the relationships with customers built by our experienced teams of lenders, many of whom have worked with each other and with key individuals on our senior management team. The February 2008 departure of a senior member of our management team in California could negatively impact the Company's relationship with certain customers and our ability to expand or maintain our California operations at current levels. If any additional California loan officers or the members of our senior management staff who coordinate California operations were to leave the Company, it could also adversely affect our mainland operations.

We are subject to environmental liability risk associated with lending activities.

A significant portion of our loan portfolio is secured by real property. During the ordinary course of business, we may foreclose on and take title to properties securing certain loans. In doing so, there is a risk that hazardous or toxic substances could be found on these properties. If hazardous or toxic substances are found, we may be liable for remediation costs as well as for personal injury and property damage. Environmental laws may require us to incur substantial expenses and may materially reduce the affected property's value or limit our ability to use or sell the affected property. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws may increase our exposure to environmental liability. Although we require an environmental review before initiating any foreclosure action on real property, these other financial liabilities associated with an environmental hazard could have a material adverse effect on our financial condition and results of operations.

Governmental regulation may impair our operations or restrict our growth.

We are subject to significant governmental supervision and regulation. These regulations are intended primarily for the protection of depositors. Statutes and regulations affecting our business may be changed at any time and the interpretation of these statutes and regulations by examining authorities may also change. Within the last several years, Congress and the President have passed and enacted significant changes to these statutes and regulations. There can be no assurance that such changes to the statutes and regulations or to their interpretation will not adversely affect our business. In addition to governmental supervision and regulation, we are subject to changes in other federal and state laws, including changes in tax laws, which could materially affect the banking industry. We are subject to the rules and regulations of the FRB. If we fail to comply with federal and state bank regulations, the regulators may limit our activities or growth, fine us or ultimately put us out of business. Banking laws and regulations change from time to time. Bank regulations can hinder our ability to compete with financial services companies that are not regulated in the same manner or are less regulated. Federal and state bank regulatory agencies regulate many aspects of our operations. These areas include:

- The capital that must be maintained;
- The kinds of activities that can be engaged in;
- The kinds and amounts of investments that can be made;
- The locations of offices;
- Insurance of deposits and the premiums that we must pay for this insurance; and
- How much cash we must set aside as reserves for deposits.

We may be unsuccessful in our federal or Hawaii state tax appeals, or ongoing tax audits may result in additional tax liabilities.

We are currently appealing certain tax assessments by the Internal Revenue Service and the State of Hawaii Department of Taxation. While we believe that we have properly applied the relevant income tax statutes and have obtained supporting opinions from tax consultants, we may be unsuccessful in one or more of our appeals. While we have established contingency reserves as deemed appropriate, adverse decisions or settlements could result in income tax and related interest exposure in excess of amounts reserved.

Our controls and procedures may fail or be circumvented.

Management regularly reviews and updates our internal controls, disclosure controls and procedures, and corporate governance policies and procedures. Any system of controls, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Any failure or circumvention of our controls and procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect on our business, results of operations and financial condition.

We face risks associated with future acquisitions.

Our ability to obtain regulatory approval of acquisitions is subject to constraints related to the BSA and the CRA, as described below in “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” Subject to our ability to successfully address these regulatory concerns, we may pursue future acquisition opportunities. Risks commonly encountered in existing and future acquisitions include, among other things:

- The difficulty of integrating the operations and personnel of acquired companies and branches;
- The potential disruption of our ongoing business;
- The potential diversion of our management's time and attention;
- The inability of our management to maximize our financial and strategic position by the successful implementation of uniform product offerings and the incorporation of uniform technology into our product offerings and control systems;

- The inability of our management to comply with reporting requirements;
- The inability to maintain uniform standards, controls, procedures and policies and the impairment of relationships with employees and customers as a result of changes in management;
- The potential exposure to unknown or contingent liabilities of the acquired company;
- Exposure to potential asset quality issues of the acquired company;
- The possible loss of key employees and customers of the acquired company;
- Difficulty in estimating the value of the acquired company;
- Incurring expenses related to impairment of goodwill and amortization of intangible assets; and
- Potential changes in banking or tax laws or regulations that may affect the acquired company.

We may not be successful in overcoming these risks or any other problems encountered in connection with acquisitions. Our integration of operations of banks or branches that we acquire may not be successfully accomplished and may take a significant amount of time. Our inability to improve the operating performance of banks and branches we have acquired or to successfully integrate their operations could have a material adverse effect on our business, financial condition, results of operations and cash flows. We expect to hire additional employees and retain consultants to assist with integrating our operations and we cannot assure you that those individuals or firms will perform as expected or be successful in addressing these issues.

Our growth and expansion may strain our ability to manage our operations and our financial resources.

Continued growth may present operating and other problems that could adversely affect our business, financial condition and results of operations. Our growth may place a strain on our administrative, operational, personnel and financial resources and increase demands on our systems and controls. We anticipate that our business growth may require continued enhancements to and expansion of our operating and financial systems and controls and may strain or significantly challenge them. Our inability to continue to upgrade or maintain effective operating and financial control systems and to recruit and hire necessary personnel or to successfully integrate new personnel into our operations could adversely impact our financial condition, results of operations and cash flows. In addition, we cannot assure you that our existing operating and financial control systems and infrastructure will be adequate to maintain and effectively monitor future growth.

New lines of business or new products and services may subject us to additional risks.

From time to time, we may implement new lines of business or offer new products and services within existing lines of business. There are substantial risks and uncertainties associated with these efforts particularly in instances where the markets are not fully developed. In developing and marketing new lines of business and/or new products and services, we may invest significant time and resources. Initial timetables for the introduction and development of new lines of business and/or new products or services may not be achieved and our price and profitability targets may not prove feasible. External factors such as compliance with regulations, competitive alternatives and shifting market preferences, may also impact the successful implementation of a new line of business or a new product or service. Furthermore, any new line of business and/or new product or service could have a significant impact on the effectiveness of our system of internal controls. Failure to successfully manage these risks in the development and implementation of new lines of business or new products or services could have a material adverse effect on our business, results of operations and financial condition.

We rely on dividends from our subsidiaries for most of our revenue.

Because we are a holding company with no significant assets other than our bank, we currently depend upon dividends from our bank for a substantial portion of our revenues. Our ability to pay dividends will therefore continue to depend in large part upon our receipt of dividends or other capital distributions from our bank. Our ability to pay dividends is subject to the restrictions of the Hawaii law.

The ability of the bank to pay dividends or make other capital distributions to us is also subject to the regulatory authority of the FDIC and Hawaii law as further described in the Supervision and Regulation section of Item 1. Business. As of December 31, 2007, Central Pacific Bank could have paid, in the aggregate, approximately $204.3 million in dividends without the prior approval of the FDIC.

We may not be able to attract and retain skilled people.

Our success depends in large part on our ability to attract and retain key people and there are a limited number of qualified persons with knowledge of and experience in the banking industry in each of our markets. Furthermore, recent demand for skilled finance and accounting personnel among publicly traded companies has increased the importance of attracting and retaining these people. Competition for the best people can be intense given the tight labor market in Hawaii and we may not be able to hire people or to retain them. The unexpected loss of services of one or more of our key personnel could have a material adverse impact on our business because of their skills, knowledge of our market, years of industry experience and the difficulty of promptly finding qualified replacement personnel.

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

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

We continually encounter technological change.

The financial services industry is continually undergoing rapid technological change with frequent introductions of new technology-driven products and services. The effective use of technology increases efficiency and enables financial institutions to better serve customers and to reduce costs. Our future success depends, in part, upon our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands, as well as to create additional efficiencies in our operations. Many of our competitors have substantially greater resources to invest in technological improvements. We may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to its customers. Failure to successfully keep pace with technological change affecting the financial services industry could have a material adverse impact on our business and, in turn, our financial condition and results of operations.

We are subject to claims and litigation pertaining to fiduciary responsibility.

From time to time, customers make claims and take legal action pertaining to our performance of our fiduciary responsibilities. Regardless of whether customer claims and legal action related to our performance of our fiduciary responsibilities are founded or unfounded, if such claims and legal actions are not resolved in a manner favorable to us, they may result in significant financial liability and/or adversely affect the market perception of us and our products and services, as well as impact customer demand for our products and services. Any financial liability or reputational damage could have a material adverse effect on our business, which, in turn, could have a material adverse effect on our financial condition and results of operations.

Severe weather, natural disasters, acts of war or terrorism and other external events could significantly impact our business.

Severe weather, natural disasters, such as wildfires, tsunamis and earthquakes, acts of war or terrorism and other adverse external events could have a significant impact on our ability to conduct business. Such events could affect the stability of our deposit base, impair the ability of borrowers to repay outstanding loans, impair the value of collateral securing loans, cause significant property damage, result in loss of revenue and/or cause us to incur additional expenses. Although management has established disaster recovery policies and procedures, the occurrence of any such event could have a material adverse effect on our business, which, in turn, could have a material adverse effect on our financial condition and results of operations.

The earnings of financial services companies are significantly affected by general business and economic conditions.

Our operations and profitability are impacted by general business and economic conditions in the United States and abroad. These conditions include short-term and long-term interest rates, inflation, money supply, political issues, legislative and regulatory changes, fluctuations in both debt and equity capital markets, broad trends in industry and finance, and the strength of the U.S. economy and the local economies in which we operate, all of which are beyond our control. Deterioration in economic conditions could result in an increase in loan delinquencies and non-performing assets, decreases in loan collateral values and a decrease in demand for our products and services, among other things, any of which could have a material adverse impact on our financial condition and results of operations.

Financial services companies depend on the accuracy and completeness of information about customers and counterparties.

In deciding whether to extend credit or enter into other transactions, we may rely on information furnished by or on behalf of customers and counterparties, including financial statements, credit reports and other financial information. We may also rely on representations of those customers, counterparties or other third parties, such as independent auditors, as to the accuracy and completeness of that information. Reliance on inaccurate or misleading financial statements, credit reports or other financial information could have a material adverse impact on our business and, in turn, our financial condition and results of operations.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

Certifications

We have filed the required certifications under Section 302 of the Sarbanes-Oxley Act of 2002 as Exhibits 31.1 and 31.2 to this annual report on Form 10-K for the fiscal year ended December 31, 2007. Last year, we submitted to the New York Stock Exchange on May 29, 2007 our annual CEO certification regarding the Company’s compliance with the NYSE’s corporate governance listing standards required by NYSE rule 303A.12. This year, we intend to submit to the NYSE our annual CEO certification within 30 days of the Company’s annual meeting of shareholders, which is scheduled for May 27, 2008.

ITEM 2. PROPERTIES

We hold title to the land and building in which our headquarters, Kaimuki branch office, Hilo branch office, Kailua-Kona branch office, Pearl City branch office and certain operations offices are located. We also hold title to the buildings in which our Moiliili, McCully, Kalihi and Beretania branch offices and operations center are located, a portion of the land underlying a commercial office building in which our residential mortgage lending subsidiary is housed, as well as a portion of land on which the Moiliili branch office and the data processing operations offices are located. The remaining lands on which the Moiliili branch and the data processing operations offices are located, as well as all of the land on which the McCully, Kalihi and Beretania branch offices are located, are leased. We also own four floors of a commercial office condominium in downtown Honolulu where certain administrative and support operations are located.

We occupy or hold leases for approximately 50 other properties including our remaining branch offices and four loan production offices in California. These leases expire on various dates through 2038 and generally contain renewal options for periods ranging from five to 15 years. For additional information relating to lease rental expense and commitments, see Note 16 to the Consolidated Financial Statements.

ITEM 3. LEGAL PROCEEDINGS

Certain claims and lawsuits have been filed or are pending against us. In the opinion of management, all such matters are without merit or are of a nature that if disposed of unfavorably, would not have a material adverse effect on our consolidated results of operations or financial position.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to our shareholders for a vote during the fourth quarter of 2007.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock is traded on the New York Stock Exchange ("NYSE") under the ticker symbol "CPF." Set forth below is a line graph comparing the cumulative total stockholder return on the Company's common stock, based on the market price of the common stock and assuming reinvestment of dividends, with the Russell 2000 Index and the S&P SmallCap 600 Commercial Bank Index for the five year period commencing December 31, 2002 and ending December 31, 2007. The graph assumes the investment of $100 on December 31, 2002.

Indexed Total Annual Return
(as of December 31, 2007)

The following table sets forth information on the range of high and low sales prices of our common stock, as reported by the NYSE, for each full quarterly period within 2007 and 2006:

	Year Ended December 31,			
	2007		2006	
	High	Low	High	Low
First quarter	$ 40.50	$ 34.60	$ 39.33	$ 33.55
Second quarter	36.50	32.83	40.15	33.30
Third quarter	33.60	27.69	39.48	34.34
Fourth quarter	30.63	18.24	39.79	35.50

As of December 31, 2007, there were 3,594 shareholders of record, excluding individuals and institutions for which shares were held in the names of nominees and brokerage firms.

Dividends

We have paid regular quarterly cash dividends since 1988. The following table sets forth information on dividends declared per share of common stock for each quarterly period within 2007 and 2006:

	Year Ended December 31,	
	2007	2006
First quarter	$ 0.24	$ 0.21
Second quarter	0.24	0.21
Third quarter	0.25	0.23
Fourth quarter	0.25	0.23

The holders of our common stock share proportionately, on a per share basis, in all dividends and other distributions declared by our Board of Directors. We expect to continue to pay regular quarterly cash dividends. However, since substantially all of the funds available for the payment of dividends are derived from our bank, future dividends will depend upon our bank's earnings, financial condition and capital needs, applicable governmental policies and regulations and such other matters as our Board of Directors may deem to be appropriate.

Our ability to pay cash dividends is further subject to our continued payment of interest that we owe on our junior subordinated debentures. As of December 31, 2007, we had approximately $108 million of our junior subordinated debentures outstanding. We have the right to defer payment of interest on the junior subordinated debentures for a period not exceeding 20 consecutive quarters. If we defer or fail to make interest payments on the junior subordinated debentures or if we fail to comply with certain covenants under the related indentures, we will be prohibited, subject to certain exceptions, from paying cash dividends on our common stock until we pay all deferred interest and resume interest payments on the junior subordinated debentures and until we comply with the covenants under the related indentures.

Our ability to pay dividends is also limited by certain restrictions imposed on Hawaii corporations. We may pay dividends out of funds legally available at such times as our Board of Directors determines are appropriate. For information regarding the dividend payments made by Central Pacific Financial Corp. and its subsidiaries, see the discussion under the section captioned “Capital Resources” included in “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations” and Note 23 in the Notes to Consolidated Financial Statements included in “Item 8. Financial Statements and Supplementary Data.”

Recent Sale of Unregistered Securities

None.

Issuer Purchases of Equity Securities

During 2007, we repurchased a total of 2,156,000 shares of our common stock, at a weighted average price of $25.47 per share and an aggregate cost of approximately $54.9 million. A portion of these purchases were made under a prior share repurchase authorization which expired on April 26, 2007. A new repurchase plan was authorized by the Company’s Board of Directors in January of 2008 authorizing the repurchase of up to 1,200,000 shares of the Company’s common stock.

The following table sets forth information with respect to repurchases of our common stock during the quarter ended December 31, 2007:

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1)	Maximum Number of Shares that May Yet be Purchased Under the Plans or Programs (1)
October 1, 2007 through October 31, 2007	35,000	$ 30.21	35,000	1,147,300
November 1, 2007 through November 30, 2007	811,800	19.70	811,800	335,500
December 1, 2007 through December 31, 2007	335,500	20.21	335,500	-

(1) Repurchase plan announced on April 26, 2007 for an aggregate repurchase and retirement of up to 600,000 shares (“2007 Repurchase Plan”). Repurchase plan increased by an additional 1,500,000 shares on July 25, 2007. As of December 31, 2007, no shares remain available under the 2007 Repurchase Plan.

Information relating to compensation plans under which equity securities of the Registrant are authorized for issuance is set forth in Part III, Item 12 of this Annual Report on Form 10-K.

SELECTED CONSOLIDATED FINANCIAL DATA

ITEM
6.

The following table sets forth selected financial information for each of the years in the five-year period ended December 31, 2007. This information is not necessarily indicative of results of future operations and should be read in conjunction with "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" and the Consolidated Financial Statements and related Notes to Consolidated Financial Statements contained in "Item 8. Financial Statements and Supplementary Data."

Selected Financial Data	2007	2006	2005	2004	2003
	Year Ended December 31, (Dollars in thousands, except per share data)				
Statement of Income Data:					
Total interest income	$ 349,877	$ 320,381	$ 263,250	$ 150,389	$ 110,231
Total interest expense	137,979	109,532	66,577	30,217	20,178
Net interest income	211,898	210,849	196,673	120,172	90,053
Provision for loan and lease losses	53,001	1,350	3,917	2,083	700
Net interest income after provision for loan and lease losses	158,897	209,499	192,756	118,089	89,353
Other operating income	45,804	43,156	41,002	22,018	15,834
Goodwill impairment	48,000	-	-	-	-
Other operating expense (excluding goodwill impairment)	128,556	132,163	124,772	86,131	55,578
Income before income taxes	28,145	120,492	108,986	53,976	49,609
Income taxes	22,339	41,312	36,527	16,582	15,669
Net income	5,806	79,180	72,459	37,394	33,940
Balance Sheet Data (Year-End):					
Interest-bearing deposits in other banks	$ 241	$ 5,933	$ 9,813	$ 52,978	$ 5,145
Investment securities (1)	881,254	898,358	925,285	850,821	540,785
Loans and leases	4,141,705	3,846,004	3,552,749	3,099,830	1,443,154
Allowance for loan and lease losses	92,049	52,280	52,936	50,703	24,774
Goodwill	244,702	298,996	303,358	284,712	-
Core deposit premium	28,750	31,898	35,795	49,188	-
Total assets	5,680,386	5,487,192	5,239,139	4,651,902	2,170,268
Core deposits (2)	2,833,317	2,860,926	2,814,435	2,716,973	1,419,100
Total deposits	4,002,719	3,844,483	3,642,244	3,327,026	1,753,284
Long-term debt	916,019	740,189	749,258	587,380	184,184
Total shareholders' equity	674,403	738,139	676,234	567,862	194,599
Per Share Data:					
Basic earnings per share	$ 0.19	$ 2.60	$ 2.42	$ 1.90	$ 2.12
Diluted earnings per share	0.19	2.57	2.38	1.87	2.07
Cash dividends declared	0.98	0.88	0.73	0.64	0.64
Book value	23.45	24.04	22.22	20.17	12.11
Diluted weighted average shares outstanding (in thousands)	30,406	30,827	30,487	20,017	16,397
Financial Ratios:					
Return on average assets	0.10%	1.50%	1.48%	1.25%	1.64%
Return on average shareholders' equity	0.77	11.16	11.16	12.37	18.33
	1.35	21.01	22.88	18.45	18.33

Net income to average tangible shareholders' equity					
Average equity to average assets	13.58	13.45	13.29	10.08	8.95
Efficiency ratio (3)	47.80	49.67	49.59	57.77	51.94
Net interest margin (4)	4.33	4.55	4.63	4.51	4.79
Net charge-offs to average loans	0.33	0.05	0.05	0.06	0.01
Nonperforming assets to year-end loans & other real estate (5)	1.48	0.23	0.35	0.35	0.25
Allowance for loan and lease losses to year-end loans	2.22	1.36	1.49	1.64	1.72
Allowance for loan and lease losses to nonaccrual loans	149.57	583.61	421.77	492.79	688.74
Dividend payout ratio	515.79	33.85	30.17	33.68	30.19

(1) Held-to-maturity securities at amortized cost, available-for-sale securities at fair value.

(2) Noninterest-bearing demand, interest-bearing demand and savings deposits, and time deposits under $100,000.

(3) Efficiency ratio is derived by dividing other operating expense excluding amortization and impairment of intangible assets and goodwill by net operating revenue (net interest income on a taxable equivalent basis plus other operating income before securities transactions).

(4) Computed on a taxable equivalent basis using an assumed income tax rate of 35%.

(5) Nonperforming assets include nonaccrual loans, nonaccrual loans held for sale and other real estate.

Five Year Performance Comparison

The significant items affecting the comparability of the five years' performance include: (1) $53.0 million in provision for loan and lease losses in 2007; (2) $48.0 million goodwill impairment charge in 2007; (3) $2.4 million charge associated with the settlement of a tax contingency in 2007; (4) $2.0 million in income tax benefit related to true up adjustments recognized in 2007; (5) $2.0 million and $2.3 million in stock option expense recognized in 2007 and 2006, respectively, in accordance with Statement of Financial Accounting Standards No. 123R, "Share-Based Payment" ("SFAS 123R"); (6) $2.1 million in executive retirement expenses incurred in 2006; (7) $1.2 million in tax charges for income tax liability adjustments in 2006; (8) $5.5 million, $9.3 million and $1.4 million in nonrecurring integration, severance and merger-related expenses incurred in 2005, 2004 and 2003, respectively; (9) incremental earnings of Hawaii HomeLoans, Inc. ("HHL") since August 17, 2005 and of CB Bancshares, Inc. ("CBBI") since September 15, 2004, the effective dates of the respective acquisitions; (10) issuance of 2.0 million shares of common stock in a public offering in March 2005 and 11.9 million shares of common stock in September 2004 in connection with the CBBI acquisition; and (11) net amortization of core deposit premium and other purchase accounting valuation adjustments, and interest expense on trust preferred securities issued to finance the CB Bancshares acquisition.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Introduction

We are a bank holding company that, through our banking subsidiary, Central Pacific Bank, offers full service commercial banking in the state of Hawaii. In addition, we have four loan production offices serving customers in California. In 2007, we decided to exit the market in the state of Washington in order to refocus our efforts in the Hawaii and California markets.

Our products and services focus on two areas:

- Loans: We focus our lending activities on commercial, commercial mortgage and construction loans to small and medium-sized companies, business professionals and real estate developers. Our lending activities contribute to a key component of our revenues—interest income.

- Deposits: We strive to provide exceptional customer service and products that meet our customers' needs, like our Exceptional Account and Totally Free Checking and maintenance of a broad branch and ATM network in the state of Hawaii. Raising funds through our deposit accounts enables us to support our lending activities. The interest paid on such deposits has a significant impact on our interest expense, an important factor in determining our earnings. In addition, fees and service charges on deposit accounts contribute to our revenues.

Additionally, we offer wealth management products and services such as non-deposit investment products, annuities, insurance, investment management, asset custody and general consultation and planning services.

In this discussion, we have included statements that may constitute "forward-looking statements" within the meaning of the safe harbor provisions of The Private Securities Litigation Reform Act of 1995. These forward-looking statements are not historical facts but instead represent only our beliefs regarding future events, many of which, by their nature, are inherently uncertain and beyond our control. These statements relate to our future plans and objectives, among other things. By identifying these statements for you in this manner, we are alerting you to the possibility that our actual results may differ, possibly materially, from the results indicated in the forward-looking statements. Important factors that could, among others, cause our results to differ, possibly materially, from those indicated in the forward-looking statements are discussed above under "Business–Factors that May Affect Our Business" in Part I, Item 1 of this Annual Report on Form 10-K.

Executive Overview

Our operating results during the first half of 2007 were generally favorable due to a combination of factors including sequential loan and deposit growth, strong asset quality and our ability to control expenses. However, during the second half of 2007, our operating results were negatively impacted primarily by the rapid decline in the California residential construction market as the weakening of the U.S. housing sector became worse than most observers expected. Despite the deterioration of the California housing and construction markets during the second half of 2007, we were able to:

- Increase total loans and leases (excluding loans held for sale) by 7.7% over the prior year;
- Grow total assets by 3.5% over the prior year;
- Increase total deposits by 4.1% over the prior year;

- Increase total interest income by 9.2% over the prior year; and

- Enhance our risk monitoring systems and compliance processes to a sufficient level that enabled us to successfully lift the previously agreed upon Order in November 2007.

We began 2007 with the primary focus of expanding and solidifying deposit relationships in support of strong loan demand and mitigating the impact of competitive factors and interest rate driven shifts in deposit composition. Although asset quality also remained strong through the first half of 2007 with a net loan charge-off ratio of 0.23% and a nonperforming assets to loans ratio of 0.03%, during the second half of 2007 our focus quickly shifted to managing credit risk as we experienced a deterioration in our California residential construction loan portfolio. Home sales activity in California began to drop off dramatically starting in August 2007, largely due to the tightening of lending standards resulting from the nationwide increase in subprime mortgage defaults and foreclosures. This drop off, combined with overcapacity in the California real estate market, resulted in the suspension of many projects and made it increasingly difficult to move existing inventory. These factors in turn caused a noticeable slowing of absorption rates and certain of our borrowers in the California residential construction market found it increasingly difficult to repay amounts due on their outstanding balances. As a result, we experienced a significant increase in credit costs during the second half of 2007.

For further discussion of these trends and other factors affecting our business, see “Overview of Results of Operations.”

Business Environment

The majority of our operations are concentrated in the states of Hawaii and California. Accordingly, our business performance is directly affected by conditions in the banking industry, macro economic conditions and the real estate market in those states. A favorable business environment is generally characterized by expanding gross state product, low unemployment and rising personal income.

General economic conditions in Hawaii continued to moderate in 2007 after exceptional growth in 2004 and 2005 and moderate growth in 2006. Tourism remains Hawaii’s most significant economic driver, and according to the Hawaii Department of Business Economic Development & Tourism (“DBEDT”), 7.4 million visitors visited the state in 2007. This was a slight decrease of 1.2% from the number of visitor arrivals in 2006. However, increased daily visitor spending boosted total visitor spending to a record $12.2 billion, an increase of 0.9% over 2006. The Department of Labor and Industrial Relations reported that Hawaii’s seasonally adjusted unemployment rate was 3.2% in December 2007, compared to 2.0% in December 2006. Despite the increase, Hawaii’s unemployment rate remained well below the national seasonally adjusted unemployment rate of 5.0%. The DBEDT projects real personal income growth to approximate 1.8% in 2007, and remain relatively unchanged through 2008. The DBEDT also projects real gross state product growth of 2.8% in 2008. With real estate lending as a primary focus, including construction loans, residential mortgages and commercial mortgages, we are also dependent on the strength of the real estate market. Following several years of strong growth in 2004 and 2005, the Hawaii real estate market further cooled in 2007 as it did in 2006. According to the Honolulu Board of Realtors, for the full year 2007, Oahu unit sales volume dropped 10.2% for single-family homes and dropped 13.8% for condominiums. Despite the decrease in unit sales volumes, median sales prices in 2007 for single-family homes and condominiums on Oahu were $643,500 and $325,000, respectively, representing increases of 2.1% and 4.8%, respectively, over 2006 median prices. Expectations are for the Hawaii real estate market to continue to moderate with slight declines in unit sales volumes and sales prices likely in 2008.

The economy in California began to cool in the second half of 2007, primarily caused by the slowdown in the real estate market. The residential real estate market in California began to show clear signs of weakness and began rapidly deteriorating in August 2007. The Central Valley and Inland Empire areas of California have been particularly hard hit and foreclosure rates continue to rise in those areas. The decline of the real estate market generally has been significantly worsened by recent events in the sub-prime and non-prime loan markets. The California Association of

Realtors (“CAR”) reported that December 2007 unit home sales declined 33.4%, while the median price fell 16.5% from year ago levels. CAR forecasts continued declines in home prices and unit sales in 2008 as decreased affordability and the impact of tighter credit underwriting standards amid rising default rates in sub-prime and non-prime mortgages are expected to continue to impact housing growth. According to the California Department of Finance (“CDOF”), average personal income increased by 5.6% in 2007 from one year ago and projections for 2008 call for an increase of 4.8% from 2007. The CDOF also reported that California civilian workforce grew by 2.3% to 18.4 million in December 2007 from 18.0 million a year ago, while California’s seasonally adjusted unemployment rate in December 2007 increased to 6.1% from 4.8% in the prior year.

Critical Accounting Policies and Use of Estimates

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America 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

We maintain an allowance for loan and lease losses (the “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 construction market. Estimated loss rates are determined by loan category and risk profile, and an overall required Allowance is calculated. Based on our estimate of the level of Allowance required, a provision for loan and lease losses (the “Provision”) is recorded to maintain the Allowance at an appropriate level. We adjusted our Provision in the third and fourth quarters of 2007 in accordance with our risk assessment policies to account for an increase in exposure which was primarily caused by changes in the California residential construction market.

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.

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, a range of loss estimates could reasonably have been used to determine the Allowance and Provision. In addition, various regulatory agencies, as an integral part of their examination processes, periodically review our Allowance. Such agencies may require that we recognize additions to the Allowance based on their judgments about information available to them at the time of their examination. Accordingly, actual results could differ from those estimates.

Deterioration in the Hawaii real estate market or continued deterioration in the California real estate market could result in an increase in loan delinquencies, additional increases in our Allowance and Provision, as well as an increase in loan charge-offs.

Goodwill and Other Intangible Assets

In accordance with Statement of Financial Accounting Standards (“SFAS”) No. 142, “Goodwill and Other Intangible Assets” (“SFAS 142”), we review the carrying amount of goodwill for impairment on an annual basis. Additionally, we perform an impairment assessment of goodwill and other intangible assets whenever events or changes in circumstances indicate that the carrying value of goodwill and other intangible assets may not be recoverable. Significant negative industry or economic trends, disruptions to our business, unexpected significant changes or planned changes in use of the assets, divestitures and market capitalization declines may result in impairments to goodwill.

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

In the fourth quarter of 2007, we experienced a significant decline in our market capitalization and we determined that this decline was an indicator that an impairment test was required under SFAS 142. As a result of our impairment test, we determined that the goodwill associated with our Commercial Real Estate reporting segment, which includes the

California residential construction loan portfolio, was impaired and we consequently recorded a non-cash charge of $48.0 million in the fourth quarter of 2007.

Deferred Tax Assets and Tax Contingencies

We account for income taxes in accordance with SFAS 109, “Accounting for Income Taxes” and FASB Interpretation No. 48, “Accounting for Uncertainty in Income Taxes” (“FIN 48”). Deferred tax assets 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 deferred tax assets 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 deferred tax assets may not be realized, which would result in a charge to earnings.

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.

Defined Benefit Retirement Plan

Defined benefit plan obligations and related assets of our defined benefit retirement plan are presented in Note 14 to the Consolidated Financial Statements. In 2002, the defined benefit retirement plan was curtailed and all plan benefits were fixed as of that date. Plan assets, which consist primarily of marketable equity and debt securities, are typically valued using market quotations. Plan obligations and the annual pension expense are determined by independent actuaries through the use of a number of assumptions. Key assumptions in measuring the plan obligations include the discount rate and the expected long-term rate of return on plan assets. In determining the discount rate, we utilize a yield that reflects the top 50% of the universe of bonds, ranked in the order of the highest yield. Asset returns are based upon the anticipated average rate of earnings expected on the invested funds of the plans.

At December 31, 2007, we used a weighted-average discount rate of 6.5% and an expected long-term rate of return on plan assets of 8.0%, which affected the amount of pension liability recorded as of year-end 2007 and the amount of pension expense to be recorded in 2008. At December 31, 2006, a weighted-average discount rate of 5.9% and an expected long-term rate of return on plan assets of 8.0% were used in determining the pension liability recorded as of year-end 2006 and the amount of pension expense recorded in 2007. For both the discount rate and the asset return rate, a range of estimates could reasonably have been used which would affect the amount of pension expense and pension liability recorded.

An increase in the discount rate or asset return rate would reduce pension expense in 2007, while a decrease in the discount rate or asset return rate would have the opposite effect. A 0.25% change in the discount rate assumption would impact 2008 pension expense by $0.1 million and year-end 2007 pension liability by $0.7 million, while a 0.25% change in the asset return rate would impact 2008 pension expense by $0.1 million.

Overview of Results of Operations

2007 vs. 2006 Comparison

Our net income of $5.8 million in 2007 was a decrease of $73.4 million, or 92.7%, from the $79.2 million recognized in 2006. The decrease in our net income for 2007 was driven by $53.0 million in provision for loan and lease losses directly attributable to the significant and rapid deterioration in the California residential construction market which began to affect us in the second half of 2007, as well as a $48.0 million goodwill impairment charge associated with our Commercial Real Estate reporting segment, which includes the California residential construction loan portfolio. Partially offsetting the negative effects of the increase in the provision for loan and lease losses and the goodwill impairment charge was the decrease in income tax expense as there was a disproportionate recognition of our federal and state tax credits compared to our taxable income. Net income in 2007 was also impacted by $2.4 million of additional income tax expense resulting from the settlement of a tax contingency item, $2.0 million of income tax benefit related to certain income tax adjustments, a $1.1 million after tax reversal of prior year incentive compensation accruals and a $1.0 million after tax loss on an investment portfolio repositioning.

Diluted earnings per share of $0.19 for 2007 decreased by $2.38, or 92.6%, from 2006, while cash dividends declared of $0.98 per common share increased by $0.10, or 11.4%, over prior year amounts. Return on average assets of 0.10% in 2007 decreased from 1.50% in 2006 and return on average equity was 0.77% in 2007 compared to 11.16% in 2006. Our efficiency ratio, which measures operating expenses before the amortization and impairment of intangible assets and goodwill as a percentage of tax-equivalent total revenue, was 47.80% in 2007 compared to 49.67% in 2006.

2006 vs. 2005 Comparison

In 2006, our net income of $79.2 million increased by $6.7 million, or 9.3%, over the $72.5 million recognized in 2005. The increase in net income in 2006 reflected growth in net interest income and other operating income which more than offset increased operating expenses. Net income in 2006 included after-tax charges totaling $3.8 million relating to executive retirement expenses, income tax liability adjustments, an investment securities portfolio repositioning and an employee benefit-related liabilities adjustment.

Diluted earnings per share for 2006 of $2.57 increased by $0.19, or 8.0%, compared to the $2.38 earned in 2005, while cash dividends declared of $0.88 per common share increased by 20.5% over the dividends of $0.73 per share declared in 2005. Return on average assets of 1.50% in 2006 increased slightly over the 1.48% in 2005 and return on average equity remained unchanged at 11.16% in 2006. Our efficiency ratio increased slightly to 49.67% from 49.59% in 2005.

Net Interest Income

Table 1 sets forth information concerning average interest earning assets and interest-bearing liabilities and the yields and rates thereon. Table 2 presents an analysis of changes in components of net interest income between years. 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, are expressed on a taxable equivalent basis using an assumed income tax rate of 35%.

Table 1. Average Balances, Interest Income and Expense, Yields and Rates (Taxable Equivalent)

	2007			2006			2005		
	Average Balance	Average Yield/ Rate	Amount of Interest	Average Balance	Average Yield/ Rate	Amount of Interest	Average Balance	Average Yield/ Rate	Amount of Interest
				(Dollars in thousands)					
Assets									
Interest earning assets:									
Interest-bearing deposits in other banks	$ 3,358	5.08%	$ 170	$ 11,919	4.62%	$ 550	$ 13,205	2.64%	$ 349
Federal funds sold	6,065	5.04	306	2,880	4.95	143	5,956	2.87	171
Taxable investment securities (1)	733,105	4.77	34,968	799,583	4.42	35,313	807,216	4.25	34,336
Tax-exempt investment securities (1)	153,459	5.43	8,338	136,809	5.71	7,815	130,889	6.21	8,125
Loans and leases (2)	4,021,094	7.68	308,720	3,689,979	7.57	279,246	3,301,277	6.75	222,841
Federal Home Loan Bank stock	48,797	0.60	293	48,797	0.10	49	48,749	0.56	272
Total interest earning assets	4,965,878	7.10	352,795	4,689,967	6.89	323,116	4,307,292	6.18	266,094
Nonearning assets	597,106			581,677			575,933		
Total assets	$ 5,562,984			$ 5,271,644			$ 4,883,225		
Liabilities and Shareholders' Equity									
Interest-bearing liabilities:									
Interest-bearing demand deposits	$ 440,537	0.13%	$ 556	$ 426,828	0.13%	$ 566	$ 429,798	0.17%	$ 730
Savings and money market deposits	1,206,392	1.99	23,950	1,153,651	1.53	17,684	1,131,964	0.69	7,859
Time deposits under $100,000	612,793	3.83	23,450	590,335	3.08	18,156	548,043	2.00	10,953
Time deposits $100,000 and over	1,018,123	4.52	46,017	876,513	4.02	35,263	684,938	2.75	18,844
	30,640	5.28	1,616	41,401	5.31	2,197	56,757	3.27	1,858

Short-term borrowings									
Long-term debt	816,591	5.19	42,390	755,378	4.72	35,666	660,992	3.98	26,333
Total interest-bearing liabilities	4,125,076	3.34	137,979	3,844,106	2.85	109,532	3,512,492	1.90	66,577
Noninterest-bearing deposits	594,361			628,736			634,035		
Other liabilities	88,369			89,558			87,699		
Shareholders' equity	755,178			709,244			648,999		
Total liabilities and shareholders' equity	$ 5,562,984			$ 5,271,644			$ 4,883,225		
Net interest income			$ 214,816			$ 213,584			$ 199,517
Net interest margin		4.33%			4.55%			4.63%	

(1) At amortized cost.
(2) Includes nonaccrual loans.

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Table 2. Analysis of Changes in Net Interest Income (Taxable Equivalent)

	2007 Compared to 2006 Increase (Decrease) Due to Change In:			2006 Compared to 2005 Increase (Decrease) Due to Change In:		
	Volume	Rate	Net Change	Volume	Rate	Net Change
	(Dollars in thousands)					
Interest earning assets						
Interest-bearing deposits in other banks	$ (396)	$ 16	$ (380)	$ (34)	$ 235	$ 201
Federal funds sold	158	5	163	(88)	60	(28)
Taxable investment securities	(2,938)	2,593	(345)	(324)	1,301	977
Tax-exempt investment securities	951	(428)	523	368	(678)	(310)
Loans and leases	25,065	4,409	29,474	26,237	30,168	56,405
Federal Home Loan Bank stock	-	244	244	-	(223)	(223)
Total interest earning assets	22,840	6,839	29,679	26,159	30,863	57,022
Interest-bearing liabilities						
Interest-bearing demand deposits	18	(28)	(10)	(5)	(159)	(164)
Savings and money market deposits	807	5,459	6,266	150	9,675	9,825
Time deposits under $100,000	692	4,602	5,294	909	5,468	6,377
Time deposits $100,000 and over	5,693	5,061	10,754	5,038	12,207	17,245
Short-term borrowings	(571)	(10)	(581)	(502)	841	339
Long-term debt	2,889	3,835	6,724	3,757	5,576	9,333
Total interest-bearing liabilities	9,528	18,919	28,447	9,347	33,608	42,955
Net interest income	$ 13,312	$ (12,080)	$ 1,232	$ 16,812	$ (2,745)	$ 14,067

Net interest income is our primary source of earnings and is derived primarily from the difference between the interest we earn on loans and investments versus the interest we pay on deposits and borrowings. Net interest income expressed on a taxable-equivalent basis, totaled $214.8 million in 2007, increasing by $1.2 million, or 0.6%, over net interest income of $213.6 million in 2006, which increased by $14.1 million, or 7.1%, over net interest income of $199.5 million recognized in 2005. The increase in net interest income in 2007 was driven in large part by the increase in average interest earning assets, offset by increases in funding costs as average rates increased during the period.

Interest Income

Our primary sources of interest income include interest on loans and leases, which represented 87.5%, 86.4% and 83.7% of interest income in 2007, 2006 and 2005, respectively, as well as interest earned on investment securities, which represented 12.3%, 13.3% and 16.0% of interest income in 2007, 2006 and 2005, respectively. Interest income expressed on a taxable-equivalent basis of $352.8 million in 2007 increased by $29.7 million, or 9.2%, over the $323.1 million earned in 2006, which increased by $57.0 million, or 21.4%, from $266.1 million in 2005.

As depicted in Table 2, the increase in interest income in 2007 is due primarily to the increase in average loan and lease balances, and to a lesser extent, the increase in average yields thereon. Average interest earning assets of $5.0

billion in 2007 increased by $275.9 million, or 5.9%, over 2006 due largely to an increase of $331.1 million, or 9.0%, in average loans and leases as loan demand remained relatively strong through most of 2007. The average yield on interest earning assets of 7.10% in 2007 increased by 21 basis points over the 2006 average yield of 6.89%, with loan and lease yields increasing by only 11 basis points as variable rate loans began to reprice downward in mid-2007.

Comparing 2006 results to those of 2005, the increase in interest income can be attributed to the $388.7 million, or 11.8%, increase in average loans and leases combined with the 71 basis point increase in average yield over 2005. Loan and lease growth in 2006 was reflective of strong demand in our construction and residential lending portfolios. Average yields on loans and leases increased by 82 basis points in 2006, reflective of the general level of market interest rates at that time.

Interest Expense

Interest expense expressed on a taxable-equivalent basis of $138.0 million in 2007 increased by $28.4 million, or 26.0%, compared to $109.5 million in 2006, which increased by $43.0 million, or 64.5%, compared to $66.6 million in 2005.

In 2007, average interest-bearing liabilities increased by $281.0 million, or 7.3%, to $4.1 billion, including increases of $230.5 million in average interest-bearing deposits and $61.2 million in average long-term debt, while average short-term borrowings decrease by $10.8 million. The average rate on interest-bearing liabilities increased by 49 basis points due primarily to a 52 basis-point increase in rates paid on interest-bearing deposits. Competitive pricing in the Hawaii market, coupled with the migration in customer accounts from demand and savings and money market accounts to time deposits, resulted in the higher funding costs in 2007.

In 2006, increases in average interest-bearing liabilities and the average rates paid thereon were the drivers of the increase in interest expense. Average interest-bearing liabilities of $3.8 billion increased by $331.6 million, or 9.4%, including increases of $252.6 million in average interest-bearing deposits and $94.4 million in average long-term debt. The average rate on interest-bearing liabilities increased by 95 basis points due primarily to a 98 basis-point increase in rates paid on interest-bearing deposits. Competitive pricing in the Hawaii market, coupled with promotional rates offered in connection with our Exceptional Account campaigns, resulted in the higher funding costs in 2006, particularly for savings and money market deposits and time deposits of $100,000 and over.

Net Interest Margin

Our net interest margin was 4.33%, 4.55% and 4.63% in 2007, 2006 and 2005, respectively. The decline in net interest margin in both 2007 and 2006 can be attributed to the differences in timing of rate movements in our interest earning assets and interest-bearing liabilities. In both 2007 and 2006, increases in average yields on interest earning assets fell short of increases in average rates on interest-bearing liabilities. This mismatched timing of rate movements resulted from delayed deposit repricings in the Hawaii market.

Based on our expectations for stabilized to slightly declining loan levels and interest rate movements in 2008, we anticipate declines in asset yields and moderate decreases in deposit rates. Accordingly, we anticipate further compression of our net interest margin for the coming year. Our ability to generate continued growth in loans, which typically bring higher yields than other interest earning assets, our ability to fund that asset growth with relatively low-cost core deposits and competitive pricing factors will directly impact our anticipated future net interest margins and net interest income.

Other Operating Income

Table 3 sets forth components of other operating income and the total as a percentage of average assets for the periods indicated.

Table 3. Components of Other Operating Income

	Year Ended December 31, 2007	2006	2005
	(Dollars in thousands)		
Service charges on deposit accounts	$ 14,167	$ 14,408	$ 11,782
Other service charges and fees	13,178	12,188	11,234
Income from bank-owned life insurance	5,821	3,989	2,205
Gains on sales of loans	5,389	4,863	4,913
Income from fiduciary activities	3,566	2,915	2,431
Loan placement fees	1,079	1,767	1,780
Fees on foreign exchange	721	765	787
Equity in earnings of unconsolidated subsidiaries	703	576	767
Investment securities gains (losses)	(1,715)	(1,510)	1,550
Other	2,895	3,195	3,553

Total other operating income	$ 45,804	$ 43,156	$ 41,002
Total other operating income as a percentage of average assets	0.82%	0.82%	0.84%

Total other operating income of $45.8 million in 2007 increased by $2.6 million, or 6.1%, over the $43.2 million earned in 2006, which increased by $2.2 million, or 5.3%, over the $41.0 million earned in 2005.

In 2007, income from bank-owned life insurance increased by $1.8 million, or 45.9%, due to an additional $25.0 million purchase of life insurance policies and certain death benefits received during the period. Other service charges and fees increased by $1.0 million, or 8.1%, over prior year amounts primarily due to increases in investment service fees of 21.6% and charge card fees of 10.0% from 2006. Income from our trust services has shown continued growth in the past few years as income from fiduciary activities increased by $0.7 million, or 22.3%, from the prior year. These increases were partially offset by a decrease in loan placement fees of $0.7 million, or 38.9%.

In 2006, service charges on deposit accounts increased by $2.6 million, or 22.3%, over 2005's revenue due primarily to higher non-sufficient funds fees, and income from bank-owned life insurance increased by $1.8 million, or 80.9%, due to additional purchases of insurance during the year.

In 2007, we recognized $1.7 million in losses from investment securities compared to $1.5 million of losses in 2006 and $1.6 million of gains in 2005. The losses in 2007 and 2006 were attributable to the repositioning of our investment portfolio in each of those years as we sought to reduce net interest income volatility.

Other Operating Expense

Table 4 sets forth components of other operating expense and the total as a percentage of average assets for the periods indicated.

Table 4. Components of Other Operating Expense

	Year Ended December 31, 2007	2006	2005
	(Dollars in thousands)		
Salaries and employee benefits	$ 62,562	$ 73,211	$ 64,963
Net occupancy	10,408	9,218	9,666
Legal and professional services	9,137	8,575	8,014
Equipment	5,228	4,864	4,873
Communication expense	4,266	4,642	4,174
Computer software expense	3,360	2,818	2,798
Amortization of core deposit premium	3,148	3,897	6,266
Advertising expense	2,582	2,569	2,347
Amortization of mortgage servicing rights	1,844	2,223	1,844
Other	26,021	20,146	19,827
Total other operating expense (excluding goodwill impairment)	128,556	132,163	124,772
Goodwill impairment	48,000	-	-
Total other operating expense	$ 176,556	$ 132,163	$ 124,772
Total other operating expense as a percentage of average assets	3.17%	2.51%	2.56%

Total other operating expense of $176.6 million in 2007 increased by $44.4 million, or 33.6%, from total operating expense of $132.2 million in 2006, which increased by $7.4 million, or 5.9%, compared to 2005. Excluding the aforementioned goodwill impairment charge of $48.0 million, total other operating expense as a percentage of average assets was 2.31% in 2007.

Excluding the effects of the goodwill impairment charge recognized in 2007, other operating expenses in 2007 decreased from the prior year primarily due to the reduction of salaries and employee benefits of $10.6 million, or 14.5%, from the prior year. The decrease in salaries and employee benefits can be attributed to a reduction in certain bonus and incentive compensation accruals, as well as the recognition of $2.2 million in executive retirement expenses in 2006. The decrease in salaries and employee benefits was partially offset by the an increase in other expenses of $5.9 million, or 29.2%, as we increased our reserve for unfunded commitments by approximately $4.0 million in 2007 to cover credit risks primarily associated with our California residential construction loan portfolio.

Salaries and employee benefits of $73.2 million in 2006 increased by $8.2 million, or 12.7%, over 2005. Primary drivers for the increase in salaries and employee benefits include the recognition of $2.3 million in stock option expense as a result of the implementation of SFAS 123R and the recognition of the aforementioned executive retirement expenses totaling $2.2 million. Amortization of core deposit premium totaled $3.9 million in 2006, compared to $6.3 million in 2005. The decrease in amortization expense from 2005 to 2006 was reflective of a third-party valuation of the core deposit premium that was finalized in 2005 and resulted in a revision of the amortization period from 10 years to 15 years.

A key measure of operating efficiency tracked by management is the efficiency ratio, which measures operating expense before the amortization and impairment of intangible assets and goodwill as a percentage of total tax-equivalent revenue (tax-equivalent net interest income and other operating income, excluding investment securities gains and losses). Our efficiency ratio was 47.80% in 2007, compared to 49.67% in 2006 and 49.59% in 2005. For 2008, we anticipate our efficiency ratio will remain relatively consistent with that of 2007 as we plan to continue to closely monitor our operating expenses.

Income Taxes

Income tax expense totaled $22.3 million in 2007, decreasing from $41.3 million in 2006 and $36.5 million in 2005. The effective tax rate was 79.4% in 2007, 34.3% in 2006 and 33.5% in 2005. The increase in the 2007 effective tax rate was directly attributable to the goodwill impairment charge recognized in 2007 as none of the charge was deductible for income tax purposes. Income tax expense in 2007 includes the effects of the settlement of a tax contingency item resulting in additional income tax expense of $2.4 million and the recording of certain income tax true-up adjustments resulting in an income tax benefit of $2.0 million, while income tax expense in 2006 includes a $1.2 million adjustment to our income tax liability relating to our accounting for the net income tax benefits from tax credits earned. We recorded net reductions in taxes of approximately $2.8 million, $3.6 million and $2.1 million in 2007, 2006 and 2005, respectively, attributable to high-technology and energy tax credits. The state's high-technology tax credit program offers tax credits for investments in high-technology companies at diminishing levels over a 5-year period.

Financial Condition

Total assets of $5.7 billion at December 31, 2007 increased by $193.2 million, or 3.5%, over the $5.5 billion at year-end 2006. Investment securities totaled $881.3 million, a decrease of $17.1 million, or 1.9%, and loans and leases totaled $4.1 billion, an increase of $295.7 million, or 7.7%, over year-end 2006. Total deposits of $4.0 billion increased by $158.2 million, or 4.1%, and shareholders' equity of $674.4 million decreased by $63.7 million, or 8.6%, during the year.

Loan Portfolio

We focus our lending activities on commercial, commercial mortgage and construction loans to small and middle-market companies, business professionals and real estate developers. Our strategy for generating new loans relies upon teams of highly qualified commercial real estate and commercial banking officers organized by geographical and industry lines who are responsible for client prospecting and business development. We have established four loan production offices in California staffed by experienced lenders with established client relationships.

To manage credit risk (i.e., the inability of borrowers to repay their loan obligations), management analyzes the borrower's financial condition, repayment source, collateral and other factors that could impact credit quality, such as national and local economic conditions and industry conditions related to respective borrowers.

Loans and leases totaled $4.1 billion at December 31, 2007, increasing by $295.7 million, or 7.7%, over the $3.8 billion at year-end 2006, which increased by $293.3 million, or 8.3%, over the $3.6 billion held at year-end 2005. Despite the slowdown in the last half of 2007, we experienced overall growth in most of our various loan portfolios, led by a 15.3% increase in residential mortgage lending, a 7.3% increase in construction lending, a 7.0% increase in consumer lending and a 6.8% increase in commercial real estate mortgages. These increases were partially offset by a slowdown in our commercial, financial and agricultural lending, which decreased by 4.8% from 2006 levels. During 2007, approximately $182.6 million, or 65.1%, of total loan growth was derived from our Hawaii lending activities, while approximately $114.2 million, or 34.3%, of total loan growth was generated in California and the remaining $1.9 million in loan growth, or 0.6%, from Washington. While new loans have grown over the past year, we note that much of that growth occurred in California and we have significantly increased our provision for loan and lease losses during that same time period as a result of concerns regarding the quality of our loan portfolio in the California market. It is unlikely, given the current market conditions, that this loan growth will continue in the near future.

Table 5 sets forth information regarding outstanding loans by category as of the dates indicated. Increases in 2004 loan amounts were primarily attributable to the merger with CBBI.

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Table 5. Loans by Categories

	December 31, 2007	2006	2005	2004	2003
	(Dollars in thousands)				
Commercial, financial and agricultural	$ 384,983	$ 404,259	$ 579,070	$ 554,021	$ 283,560
Real estate:					
Construction	1,222,214	1,139,585	677,383	361,340	140,505
Mortgage:					
- residential	1,034,474	897,216	793,719	710,855	391,367
- commercial	1,237,563	1,158,755	1,269,232	1,239,242	558,974
Consumer	209,168	195,448	187,951	198,573	68,748
Leases	53,303	50,741	45,394	35,799	-
Total loans and leases	4,141,705	3,846,004	3,552,749	3,099,830	1,443,154
Allowance for loan and lease losses	(92,049)	(52,280)	(52,936)	(50,703)	(24,774)
Net loans	$ 4,049,656	$ 3,793,724	$ 3,499,813	$ 3,049,127	$ 1,418,380

Table 6 sets forth the geographic distribution of our loan portfolio and related allowance for loan and lease losses as of December 31, 2007.

Table 6. Geographic Distribution

	Hawaii	California	Washington	Total
	(Dollars in thousands)			
Commercial, financial and agricultural	$ 362,807	$ 22,176	$ -	$ 384,983
Real estate:				
Construction	511,334	625,097	85,783	1,222,214
Mortgage:				
- residential	962,847	21,922	49,705	1,034,474
- commercial	839,015	382,826	15,722	1,237,563
Consumer	209,168	-	-	209,168
Leases	53,303	-	-	53,303
Total loans and leases	2,938,474	1,052,021	151,210	4,141,705
Allowance for loan and lease losses	(26,973)	(61,358)	(3,718)	(92,049)
Net loans and leases	$ 2,911,501	$ 990,663	$ 147,492	$ 4,049,656

Commercial, Financial and Agricultural

Loans in this category consist primarily of term loans and lines of credit to small and middle-market businesses and professionals located in the state of Hawaii. The borrower's business is typically regarded as the principal source of repayment, although our underwriting policy and practice generally requires additional sources of collateral, including real estate and other business assets, as well as personal guarantees where possible to mitigate risk. Risks of credit losses are greater in this loan category relative to secured loans, such as commercial and residential mortgages, where a greater percentage of the loan amount is usually covered by collateral. Nonetheless, any collateral or personal guarantees obtained on commercial loans can mitigate the increased risk and help to reduce credit losses.

Our approach to commercial lending involves teams of lending and cash management personnel who focus on marketing loans, deposits and other bank services to new and existing commercial clients. We have also been successful in hiring experienced personnel with established networks of business contacts to support commercial sales efforts. Sustained long-term growth in this loan category will be dependent upon local economic conditions, interest rate levels, competitive market conditions and other external factors.

Real Estate—Construction

Construction loans offered include both residential and commercial development projects. Each construction project is evaluated for economic viability and maximum loan-to-value ratios of 80% on commercial projects and 85% on residential projects are generally required. A construction loan poses higher credit risks than typical secured loans. In addition to the financial strength of the borrower, construction loans have the added element of completion risk, which is the risk that the project will not be completed on time and within budget, resulting in additional costs that could affect the economic viability of the project. Careful consideration of the ability and reputation of the developer and close monitoring of a project during the construction phase by construction lending specialists is required to mitigate the higher level of risk in construction lending.

The increase in our construction loan portfolio in each of the five years presented above is representative of our historic focus on this segment, a real estate market that had been strong until recently and increased development activity in all of our markets. However, construction loans exhibited higher levels of risk in 2007 with some borrowers abandoning their construction plans and defaulting on their loans due to a range of factors including declining real estate values. There has been significant deterioration in the construction loan market, particularly in California, presenting a negative outlook in 2008 for current projects and fewer new construction projects than in previous years. Furthermore, construction loans tend to be larger in amount and shorter in term than conventional commercial or mortgage loans; thus a higher level of volatility in balances from year to year is expected. We anticipate future decreases in our California real estate construction loan portfolio as we may look to minimize our exposure in this market by possibly packaging and selling some of our construction loans.

Real Estate—Mortgage

Table 7 sets forth information with respect to the composition of the Real Estate—Mortgage loan portfolio as of the dates indicated.

Table 7. Mortgage Loan Portfolio Composition

	December 31,									
	2007		2006		2005		2004		2003	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in thousands)									
Residential:										
1-4 units	$ 841,095	37.0%	$ 703,172	34.2%	$ 638,720	31.0%	$ 590,851	30.3%	$ 295,525	31.1%
5 or more units	193,379	8.5	194,044	9.4	154,999	7.5	120,004	6.2	95,842	10.1
Commercial, industrial and other	1,237,563	54.5	1,158,755	56.4	1,269,232	61.5	1,239,242	63.5	558,974	58.8
Total	$ 2,272,037	100.0%	$ 2,055,971	100.0%	$ 2,062,951	100.0%	$ 1,950,097	100.0%	$ 950,341	100.0%

Residential

Residential mortgage loans include both fixed- and adjustable-rate loans primarily secured by single-family owner-occupied residences. Maximum loan-to-value ratios of 80% are typically required, although higher levels are permitted with accompanying mortgage insurance. We emphasize residential mortgage loans for owner-occupied primary residences and do not actively seek loans on high-end residences, vacation homes and investment properties. First mortgage loans secured by residential properties generally carry a moderate level of credit risk. With an average loan size of approximately $248,000, readily marketable collateral and a residential real estate market that has been relatively stable until recently, credit losses on residential mortgages have been minimal during the past several years. However, future changes in interest rates and other market factors can impact the marketability of collateral and thus the level of credit risk inherent in the portfolio. As with all loans, managing credit risk in the residential mortgage market entails strong underwriting standards and diligent monitoring and handling of problems as they arise.

Residential mortgage loan balances as of December 31, 2007 totaled $1.0 billion, increasing by $137.3 million, or 15.3%, over the $897.2 million at year-end 2006, which increased by $103.5 million, or 13.0%, over the $793.7 million held at year-end 2005. Several factors have lead to an increase in mortgage origination activity in 2007 including our establishment of strategic alliances with real estate brokers and developers that provide additional mortgage origination opportunities and decreased competition as several national lenders have recently exited the Hawaii market.

Substantially all salable fixed-rate mortgages are sold in the secondary market. Mortgage loans held for sale at December 31, 2007 totaled $32.2 million, an increase of $5.5 million, or 20.6%, over the December 31, 2006 balance of $26.7 million, which decreased by $33.9 million, or 55.9%, over the December 31, 2005 balance of $60.5 million. The increase in loans held for sale as of December 31, 2007 is reflective of the increase in origination activity experienced during 2007.

The projected cooling of the Hawaii residential real estate market in 2008 is expected to have a stabilizing effect on origination activity, while market rates will dictate the level of refinancing activity in 2008.

Commercial

Real estate mortgage loans secured by commercial properties continues to represent the single largest component of our loan portfolio. Our policy with respect to commercial mortgages is that loans be made for sound purposes, have a definite source and/or plan of repayment established at inception, and be backed up by reliable secondary sources of repayment and satisfactory collateral with good marketability. Loans secured by commercial property carry a greater risk than loans secured by residential property due to operating income risk. Operating income risk is the risk that the borrower will be unable to generate sufficient cash flow from the operation of the property. The commercial real estate market and interest rate conditions through economic cycles will impact risk levels. To mitigate the risks inherent in commercial mortgage lending, we strive to use dedicated, experienced commercial mortgage lenders to underwrite, monitor and service commercial mortgage loans. Nevertheless, commercial mortgage lending generated by our California loan production offices exposes us to certain new risks, including the risk of economic downturn in the California market and a reliance on a relatively small staff positioned in the California market.

The 2007 increase in our commercial mortgage loan portfolio of $78.8 million, or 6.8%, over the prior year was primarily attributed to unanticipated payoffs in 2006 resulting from the sales of underlying collateral. The commercial real estate market has not experienced quite the level of slowdown as evidenced in the U.S. residential real estate market, however, there can be no assurances that a slowdown will not affect this sector. We expect our loan origination activity to decline in 2008 as a result of changes in market conditions, our applying an increasingly calculated approach to our commercial mortgage lending activities and anticipated payoffs from our existing portfolio.

Consumer Loans

Table 8 sets forth the major components of our consumer loan portfolio as of the dates indicated.

Table 8. Consumer Loan Portfolio Composition

	December 31,									
	2007		2006		2005		2004		2003	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in thousands)									
Automobile	$ 158,390	75.7%	$ 148,485	76.0%	$ 141,132	75.0%	$ 146,101	73.6%	$ 32,773	47.7%
Credit cards and other revolving credit plans	29,259	14.0	29,932	15.3	31,308	16.7	35,245	17.7	25,769	37.5
Other	21,519	10.3	17,031	8.7	15,511	8.3	17,227	8.7	10,206	14.8
Total	$ 209,168	100.0%	$ 195,448	100.0%	$ 187,951	100.0%	$ 198,573	100.0%	$ 68,748	100.0%

For consumer loans, credit risk is managed on a pooled basis. Considerations include an evaluation of the quality, character and inherent risks in the loan portfolio, current and projected economic conditions and past loan loss experience. Consumer loans represent a moderate credit risk. Loans in this category are generally either unsecured or secured by personal assets such as automobiles. The average loan size is generally small and risk is diversified among many borrowers. We utilize credit-scoring systems for most of our consumer loans, which offer the ability to modify credit exposure based on our risk tolerance and loss experience.

Consumer loans totaled $209.2 million at December 31, 2007, increasing by $13.7 million, or 7.0%, from 2006's year-end balance of $195.4 million, which increased by $7.5 million, or 4.0%, compared to the $188.0 million held at year-end 2005. The increase in 2007 was reflective of the purchase of a $10.5 million automobile loan portfolio in 2007. Automobile loans, primarily indirect dealer loans, comprised 75.7% of consumer loans outstanding. Total automobile loans of $158.4 million at year-end 2007 increased by $9.9 million, or 6.7%, from 2006's year-end balance of $148.5 million, which increased by $7.4 million, or 5.2%, over the $141.1 million at year-end 2005. We have not focused significant resources on consumer lending in recent years as several large competitors have dominated the Hawaii market. With the exception of indirect dealer loans, consumer loans are generally offered as an accommodation to existing customers. We expect consumer lending to remain a relatively small segment of our lending business.

Concentrations of Credit Risk

As of December 31, 2007, approximately 84% of loans outstanding were real estate related loans, including construction loans, residential mortgage loans and commercial mortgage loans. The real estate market tends to closely follow broader economic trends and while during periods of economic strength, the real estate market and the real estate industry typically perform well, during periods of economic weakness, they often slow down. In 2007, market interest rates and other economic conditions had a significant and immediate impact on the real estate industry. Accordingly, as we have seen during the second half of 2007, the concentration of lending in the real estate industry led to adverse portfolio performance, namely delinquencies and loan charge-offs. Our loan portfolio will continue to be adversely affected should the real estate market continue to suffer a downturn.

Most of our loans are made to companies and individuals with headquarters in or residing in the states of Hawaii, California and Washington. Consistent with our focus of being a Hawaii-based bank, 65% of our 2007 loan growth stemmed from our lending activities within the state of Hawaii. Loans originated by our mainland loan production offices accounted for approximately 35% of total loan growth in 2007. At December 31, 2007, 71% of our loan portfolio was concentrated in the Hawaii market, while 25% was concentrated in California and the remaining 4% in Washington. As a result of the uncertain market conditions in the California real estate market, we anticipate that substantially all of our loan growth will come from the Hawaii market in 2008.

To ensure that risks associated with industry concentration or geographic concentration are properly managed, we employ highly qualified lenders with established client relationships, similar lending philosophies and demonstrated expertise in their respective markets. Our foreign credit exposure as of December 31, 2007 did not exceed 1% of total assets.

Maturities and Sensitivities of Loans to Changes in Interest Rates

Table 9 sets forth the maturity distribution of the loan portfolio at December 31, 2007. Table 10 sets forth the sensitivity of amounts due after one year to changes in interest rates. Both tables exclude real estate loans (other than construction loans) and consumer loans.

Table 9. Maturity Distribution of Commercial and Construction Loans

	Maturing One year or less	Over one through five years	Over five years	Total
	(Dollars in thousands)			
Commercial, financial and agricultural	$ 147,239	$ 146,356	$ 91,388	$ 384,983
Real estate - construction	896,209	304,221	21,784	1,222,214
Total	$ 1,043,448	$ 450,577	$ 113,172	$ 1,607,197

At year-end 2007, 64.9% of our commercial and construction loans had maturities of one year or less, increasing from the prior year's proportion of 55.5%. Meanwhile, loans in the one-through-five-years category decreased from 35.6% at year-end 2006 to 28.0% at year-end 2007, and loans in the greater-than-five-years category decreased from 8.9% to 7.1%. The shift in maturities reflects our increased focus on construction lending, which generally entails shorter terms than traditional commercial loans.

Table 10. Maturity Distribution of Fixed and Variable Rate Loans

	Maturing Over one through five years	Over five years	Total
	(Dollars in thousands)		
With fixed interest rates	$ 56,397	$ 15,281	$ 71,678
With variable interest rates	394,180	97,891	492,071
Total	$ 450,577	$ 113,172	$ 563,749

Of the loans with maturities in excess of one year at year-end 2007, 12.7% had fixed interest rates, while 87.3% had variable rates, which compares to 13.4% and 86.6%, respectively, at year-end 2006. The higher proportion of variable-rate loans is also characteristic of, and consistent with, the higher proportion of construction loans.

In January 2008, we entered into a derivative transaction to hedge cashflows received from a portion of our then existing variable rate loan portfolio for a period of five years. During this time, we will receive payments equal to a fixed interest rate of 6.25% from the counterparty on a notional amount of $400 million and, in return, we will pay to the counterparty a floating rate, namely our prime rate, on the same notional amount.

Provision and Allowance for Loan and Lease Losses

As described above in "Critical Accounting Policies and Use of Estimates," the Provision is determined by management's ongoing evaluation of the loan portfolio and our assessment of the ability of the Allowance to cover inherent losses. Our methodology for determining the adequacy of the Allowance and the Provision takes into account many factors, including the level and trend of nonperforming and potential problem loans, net charge-off experience, current repayment by borrowers, fair value of collateral securing specific loans, changes in lending and underwriting standards and general economic factors, nationally and in the markets we serve.

The Allowance consists of two components: allocated and unallocated. To calculate the allocated component, we combine specific reserves required for individual loans (including impaired loans), reserves required for pooled graded loans and loan concentrations, and reserves required for homogeneous loans (e.g., consumer loans and residential mortgage loans). We use a loan grading system whereby loans are segregated by risk. Certain graded commercial and commercial real estate loans are analyzed on an individual basis. Other graded loans are analyzed on an aggregate basis based on loss experience for the specific loan type; risks inherent in concentrations by geographic location, collateral or property type; and recent changes in loan grade and delinquencies. The determination of an allocated Allowance for homogeneous loans is done on an aggregate level based upon various factors including historical loss experience, delinquency trends and economic conditions. The unallocated component of the Allowance incorporates our judgment of the determination of the risks inherent in the loan portfolio, economic uncertainties and imprecision in the estimation process.

Table 11 sets forth certain information with respect to the Allowance as of the dates or for the periods indicated.

Table 11. Allowance for Loan and Lease Losses

	Year Ended December 31,				
	2007	2006	2005	2004	2003
	(Dollars in thousands)				
Average amount of loans outstanding	$ 4,021,094	$ 3,689,979	$ 3,301,277	$ 1,986,872	$ 1,374,251
Allowance for loan and lease losses:					
Balance at beginning of year	$ 52,280	$ 52,936	$ 50,703	$ 24,774	$ 24,197
Charge-offs:					
Commercial, financial and agricultural	5,836	2,103	2,049	467	460
Real estate - construction	6,433	-	-	-	-
Real estate - mortgage - residential	379	-	74	225	15
Real estate - mortgage - commercial	-	-	-	-	882
Consumer	3,544	4,148	4,057	2,239	487
Leases	-	19	28	-	-
Total	16,192	6,270	6,208	2,931	1,844
Recoveries:					
Commercial, financial and agricultural	876	2,134	1,633	661	256
Real estate - construction	7	-	-	-	159
Real estate - mortgage - residential	232	92	621	346	118

Real estate - mortgage - commercial	12	13	544	39	1,075
Consumer	1,831	2,017	1,715	708	113
Leases	2	8	11	-	-
Total	2,960	4,264	4,524	1,754	1,721
Net loans charged off	13,232	2,006	1,684	1,177	123
Provision charged to operations	53,001	1,350	3,917	2,083	700
Allowance acquired in merger	-	-	-	25,023	-
Balance at end of year	$ 92,049	$ 52,280	$ 52,936	$ 50,703	$ 24,774
Ratios:					
Allowance for loan and lease losses to loans and leases outstanding at end of year	2.22%	1.36%	1.49%	1.64%	1.72%
Net loans charged off during year to average loans and leases outstanding during year	0.33%	0.05%	0.05%	0.06%	0.01%

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In the second half of 2007, the California residential construction market began to experience rapid and significant deterioration. Drop off in home sale activity in California coupled with significant discounts offered by several national homebuilders to move unsold inventory contributed heavily to slowing absorption rates and declining collateral values. During the fourth quarter of 2007, these problems were compounded by diminishing guarantor liquidity for some of our borrowers in this market.

The aforementioned market conditions that began to unfold in August of 2007 required us to downgrade 30 loans to, and within, our criticized risk rating categories. The outstanding principal balance of these loans aggregated $246.0 million and was comprised of thirteen residential construction loans totaling $108.1 million; seven land acquisition and development loans totaling $46.3 million and ten land loans for mixed use development of $91.6 million. Of these loans, one loan for $4.7 million was originated during the first half of 2007, fourteen loans totaling $120.0 million were originated in 2006 and fifteen loans totaling $121.3 million were originated in 2005. The majority of these loans were earmarked for development projects located in the Inland Empire and Central Valley regions of California, areas that have been particularly hard hit by the real estate slowdown in California.
In addition to the downgrade of these loans, our credit policies and procedures also required us to increase the loan loss factors assigned to outstanding balances with direct exposure to the California residential market and increase the amount of specific reserves established for nine California residential construction loans to seven borrowers with an outstanding principal balance of $74.3 million.

The downgrade of the aforementioned loans, the increase in our California residential construction loan loss factor and the increase to our specific reserves described above resulted in an increase of $49.4 million to our Provision in the second half of 2007. Accordingly, our Provision increased to $53.0 million in 2007, compared to $1.4 million in 2006 and $3.9 million in 2005. We believe this increase was necessary to maintain the adequacy of the Allowance given the current credit risk inherent in our loan portfolio and the current risk composition of our outstanding balances. We continue to monitor our exposure to the California residential real estate market. Further deterioration in this market or any other market that we serve, may require us to increase our Allowance, increase our Provision and may result in increased net charge-offs. We have reorganized our operations and retained outside real estate professionals to assist us with collections and work out plans for some of our California loans. Our plans may include potential loan restructures, note sales and/or asset sales.

Net loan charge-offs of $13.2 million in 2007 increased by $11.2 million over the net loans charge-offs of $2.0 million in 2006, which increased from $1.7 million in 2005. The increase in charge-offs recognized in 2007 was driven primarily by an increase in charge-offs in our real estate-construction portfolio due to the aforementioned deterioration in the California residential construction market and our commercial, financial and agricultural portfolio. The majority of commercial, financial and agricultural loan charge-offs were isolated to two borrowers totaling $4.9 million. Recoveries of $3.0 million in 2007 came primarily from consumer loans, which totaled $1.8 million, and commercial loans, which totaled $0.9 million.

The Allowance as a percentage of loans was 2.22% at year-end 2007, compared to 1.36% at year-end 2006 and 1.49% at year-end 2005. The increase in the Allowance in 2007 was again attributed to our exposure in the California residential construction market. General economic conditions do not always affect all borrowers in the same way or to the same extent, and there remains the risk that other borrowers in other sectors of the economy will experience problems resulting in increased delinquencies and charge-offs. Additionally, the local and national economies remain susceptible to global, national and local events which could adversely affect borrowers' ability to repay their loans, collateral values, the level of nonperforming loans, net charge-offs, Provision and net income in the future.

Table 12 sets forth the allocation of the Allowance by loan category as of the dates indicated. Our practice is to make specific allocations on impaired loans and general allocations to each loan category based on management's risk assessment and estimated loss rate. The unallocated portion of the Allowance is maintained to provide for additional credit risk which may exist but not be adequately accounted for in the specific and unspecified allocations due to the amount of judgment involved in the determination of the Allowance, the absence of perfect knowledge of all credit risks and the amount of uncertainty in predicting the strength of the economy and the sustainability of that strength.

Table 12. Allocation of Allowance for Loan and Lease Losses

	December 31,									
	2007		2006		2005		2004		2003	
	Allowance for loan and lease losses	Percent of loans in each category to total loans	Allowance for loan and lease losses	Percent of loans in each category to total loans	Allowance for loan and lease losses	Percent of loans in each category to total loans	Allowance for loan and lease losses	Percent of loans in each category to total loans	Allowance for loan and lease losses	Percent of loans in each category to total loans
	(Dollars in thousands)									
Commercial, financial and agricultural	$ 5,100	9.3%	$ 8,100	10.6%	$ 16,000	16.3%	$ 17,400	17.9%	$ 5,200	19.7%
Real estate:										
Construction	60,800	29.5	19,400	29.6	8,400	19.1	3,400	11.7	1,700	9.8
Mortgage:										
Residential	6,600	25.0	5,600	23.3	2,800	22.3	2,100	22.9	1,400	27.1
Commercial	10,500	29.8	9,600	30.1	16,600	35.7	15,200	39.9	13,900	38.6
Consumer	4,300	5.1	4,100	5.1	3,700	5.3	3,500	7.6	500	4.8
Leases	700	1.3	500	1.3	200	1.3	-	-	-	-
Unallocated	4,049	-	4,980	-	5,236	-	9,103	-	2,074	-
Total	$ 92,049	100.0%	$ 52,280	100.0%	$ 52,936	100.0%	$ 50,703	100.0%	$ 24,774	100.0%

The methodology applied in determining the level of Allowance and the allocation among loan categories in 2007 was consistent with that applied in 2006, although estimated loss rates were changed based on the averaging of historical loss experience and our assessment of inherent risks based on a consideration of the multitude of conditions and circumstances that affect the overall quality of the loan portfolio.

Allowance allocated to commercial loans at year-end 2007 totaled $5.1 million, or 1.3%, of total commercial loans, compared to $8.1 million, or 2.0%, of total commercial loans as of year-end 2006. The decrease in the allocated Allowance reflects the decrease in commercial loans outstanding and the relatively low net charge-offs experienced in the past several years.

Allowance allocated to construction loans totaled $60.8 million, or 5.0%, of construction loans at year-end 2007, compared to $19.4 million, or 1.7%, of construction loans outstanding at year-end 2006. The increase in the amount of Allowance allocated to construction loans is a direct result of the aforementioned market conditions in California. At year-end 2007, the Allowance allocated to our construction loan portfolio in California was approximately $55.5 million, or 8.8%, of our total California construction loan portfolio. Construction loans in general have a higher level of inherent risk as compared to other types of loans.

The allocated Allowance for residential mortgage loans was $6.6 million, or 0.6%, of related loans at year-end 2007, compared to $5.6 million, or 0.6%, at year-end 2006. The increase in the allocated Allowance reflects the increase in balances during the period.

Commercial mortgage loans were allocated an Allowance of $10.5 million, or 0.8%, of those loans at year-end 2007, increasing from $9.6 million, or 0.8%, of commercial mortgage loans at year-end 2006. The increase in allocated Allowance reflects the increase in balances during the year and the absence of commercial mortgage charge-offs during the past four years.

The allocated Allowance for consumer loans at year-end 2007 was $4.3 million, or 2.1%, of consumer loans, compared to $4.1 million, or 2.1%, of related loans a year ago.

We also allocated Allowance for leases of $0.7 million, or 1.3%, of total leases compared to $0.5 million, or 1.0%, of total leases as of year-end 2006. While we have not had extensive experience in our lease portfolio, which was acquired in 2004 primarily in conjunction with the CB Bancshares merger, we believe, based on our analysis of the lease portfolio, that there are inherent credit risks that we have recognized in our Allowance.

The unallocated portion of the Allowance decreased to $4.0 million as of year-end 2007, compared to $5.0 million in 2006, as more known and perceived risks attributable to particular market segments and geographical risk considerations have been incorporated into the determination of the allocated Allowance.

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

Table 13 sets forth nonperforming assets, accruing loans delinquent for 90 days or more and restructured loans still accruing interest at the dates indicated.

Table 13. Nonperforming Assets, Past Due and Restructured Loans

	December 31,				
	2007	2006	2005	2004	2003
	(Dollars in thousands)				
Nonaccrual loans					
Commercial, financial & agricultural	$ 231	$ 3,934	$ 2,333	$ 3,713	$ 517
Real estate:					
Construction	61,017	-	-	126	1,500
Mortgage:					
- residential	-	5,024	5,995	1,529	-
- commercial	293	-	4,223	4,922	1,580
Consumer	-	-	-	-	-
Total nonaccrual loans	61,541	8,958	12,551	10,290	3,597
Other real estate	-	-	-	580	-
Total nonperforming assets	61,541	8,958	12,551	10,870	3,597
Accruing loans delinquent for 90 days or more					
Commercial, financial & agricultural	18	88	99	23	80
Mortgage:					
- residential	-	364	297	49	541
- commercial	586	-	7,081	-	29
Consumer	273	457	427	321	19
Leases	26	-	2	-	-
Total accruing loans delinquent for 90 days or more	903	909	7,906	393	669
Restructured loans still accruing interest					
Commercial, financial & agricultural	-	-	285	273	-
Real estate:					
Mortgage:					
- commercial	-	-	418	428	-
Total restructured loans still accruing interest	-	-	703	701	-
Total nonperforming assets, accruing loans delinquent for 90 days or more and restructured loans still accruing interest	$ 62,444	$ 9,867	$ 21,160	$ 11,964	$ 4,266
Total nonperforming assets as a percentage of loans and other real estate	1.48%	0.23%	0.35%	0.35%	0.25%
Total nonperforming assets and accruing loans delinquent for 90 days or more as a percentage of loans and other real estate	1.51%	0.25%	0.57%	0.36%	0.29%
Total nonperforming assets, accruing loans delinquent for					

90 days or more and restructured loans still accruing interest as a percentage of loans and other real estate	1.51%	0.25%	0.59%	0.38%	0.29%

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Nonperforming assets, which includes nonaccrual loans and leases, foreclosed real estate and other nonperforming investments totaled $61.5 million at year-end 2007 compared to $9.0 million at year-end 2006 and $12.6 million at year-end 2005. Nonaccrual loans at December 31, 2007 includes one loan for $5.4 million which was classified as held for sale at December 31, 2007. The increase in nonperforming assets from year-end 2006 was primarily a result of nine residential construction loans totaling $61.0 million being placed on nonaccrual status during the second half of 2007. Four of these loans totaling $22.3 million were located in the Central Valley of California, two loans totaling $13.0 million were located in the Inland Empire area of California, one loan totaling $13.7 million was located in Contra Costa county in California, one loan totaling $8.7 million was located in the greater Los Angeles area of California and one loan totaling $3.3 million was located in the state of Washington. The increase in nonperforming assets was partially offset by the payoff of a $4.8 million nonaccrual residential mortgage loan and the charge-off of $2.9 million in commercial loans from a single borrower. Nonaccrual loans at December 31, 2006 included $3.5 million in commercial loans to a construction contractor and a $4.8 million residential mortgage loan that was subsequently paid off in 2007. In 2008, six loans to two borrowers in the California residential construction market were downgraded, resulting in approximately $35.7 million of additional nonaccrual loans in January 2008. We believe our loss exposure on nonaccrual loans has been adequately provided for in our Allowance as of December 31, 2007.

Accruing loans delinquent for 90 days or more at year-end 2007 totaled $0.9 million and remained relatively unchanged from the prior year. The accruing loans delinquent for 90 days or more at year-end 2007 represented small loans primarily less than $100,000 each in various stages of collection. Accounting policies related to nonperforming assets are discussed in Note 1 to the Consolidated Financial Statements.

Investment Portfolio

Table 14 sets forth the amounts and distribution of investment securities held as of the dates indicated.

Table 14. Distribution of Investment Securities

	December 31,					
	2007		2006		2005	
	Held to maturity (at amortized cost)	Available for sale (at fair value)	Held to maturity (at amortized cost)	Available for sale (at fair value)	Held to maturity (at amortized cost)	Available for sale (at fair value)
	(Dollars in thousands)					
U.S. Treasury and other U.S. government agencies	$ 26,844	$ 80,102	$ 26,811	$ 98,000	$ 26,779	$ 118,059
U.S. Government sponsored entities mortgage-backed securities	9,637	483,427	13,125	450,938	17,283	509,996
States and political subdivisions	9,643	148,138	15,259	145,682	27,781	123,534
Privately-issued mortgage-backed securities	-	122,733	-	137,718	-	101,239
Other	-	730	10,009	816	-	614
Total	$ 46,124	$ 835,130	$ 65,204	$ 833,154	$ 71,843	$ 853,442

Investment securities totaled $881.3 million at December 31, 2007, decreasing by $17.1 million, or 1.9%, from the $898.4 million held at December 31, 2006, which decreased by $26.9 million, or 2.9%, over the $925.3 million at year-end 2005. The decrease in 2007 reflects the utilization of cash flows from the investment securities portfolio to fund loan growth in excess of deposit growth, as well as to fund the repurchase of the Company's common stock.

Similar to 2006, in the fourth quarter of 2007, we repositioned our investment portfolio to reduce our net interest income volatility, as well as increasing our prospective earnings and net interest margin. We sold $119.0 million in available-for-sale investment securities with an average yield of 3.98% and a weighted average life of 1.3 years and reinvested the proceeds in a similar amount of new investment securities with an average yield of 5.43% and a weighted average life of 4.2 years. An after-tax loss of $1.0 million was recognized on the investment sale. In future periods we may continue to reposition our investment portfolio to reduce our net interest income volatility.

Maturity Distribution of Investment Portfolio

Table 15 sets forth the maturity distribution of the investment portfolio and weighted average yields by investment type and maturity grouping at December 31, 2007.

Table 15. Maturity Distribution of Investment Portfolio

Portfolio Type and Maturity Grouping		Carrying value	Weighted average yield (1)
		(Dollar in thousands)	
Held-to-maturity portfolio:			
U.S. Treasury and other U.S. Government agencies:			
Within one year	$	26,844	3.48%
After one but within five years		-	-
After five but within ten years		-	-
After ten years		-	-
Total U.S. Treasury and other U.S. Government agencies		26,844	3.48
U.S. Government sponsored entities mortgage-backed securities:			
Within one year		43	6.66
After one but within five years		686	6.89
After five but within ten years		8,768	3.91
After ten years		140	7.16
Total U.S. Government sponsored entities mortgage-backed securities		9,637	4.18
States and political subdivisions:			
Within one year		2,841	6.00
After one but within five years		1,984	6.38
After five but within ten years		1,449	7.04
After ten years		3,369	7.35
Total States and political subdivisions		9,643	6.70
Total held-to-maturity portfolio	$	46,124	4.30%
Available-for-sale portfolio:			
U.S. Treasury and other U.S. Government agencies:			
Within one year	$	-	-%
After one but within five years		70,015	4.88
After five but within ten years		10,087	5.30
After ten years		-	-
Total U.S. Treasury and other U.S. Government agencies		80,102	4.93
U.S. Government sponsored entities mortgage-backed securities:			
Within one year		13	3.76
After one but within five years		14,817	4.52
After five but within ten years		63,974	3.79
After ten years		404,623	5.22
Total U.S. Government sponsored entities mortgage-backed securities		483,427	5.01
States and political subdivisions:			
Within one year		3,902	6.92
After one but within five years		11,977	5.57
After five but within ten years		73,223	5.80

After ten years		59,036	5.90
Total States and political subdivisions		148,138	5.85
Other:			
Within one year		-	-
After one but within five years		-	-
After five but within ten years		-	-
After ten years		123,463	5.48
Total Other		123,463	5.48
Total available-for-sale portfolio	$	835,130	5.22%
Total investment securities	$	881,254	5.17%

(1) Weighted average yields are computed on an annual basis, and yields on tax-exempt obligations are computed on a taxable-equivalent basis using an assumed tax rate of 35%.

During 2007, the weighted average yield of the investment portfolio increased by 36 basis points to 5.17%. The increase in yield reflects the increase in market interest rates during the past year as well as the effects of the prior year investment portfolio repositioning.

Deposits

Our ability to raise low-cost funds is a principal contributor to our profitability and the primary source of funding is deposits in the state of Hawaii. In this competitive market, we strive to distinguish ourselves by providing quality customer service in our branch offices and establishing long-term relationships with businesses and their principals. Our focus has been to develop a large, stable base of core deposits, which are comprised of noninterest-bearing demand, interest-bearing demand and savings deposits and time deposits under $100,000. Time deposits in amounts of $100,000 and greater are generally considered to be more price-sensitive than relationship-based and are thus given less focus in our marketing and sales efforts.

Despite operating in a very competitive market, we were able to grow total deposits to $4.0 billion at December 31, 2007, an increase of $158.2 million, or 4.1%, over the 2006 year-end balance of $3.8 billion, which increased by $202.2 million, or 5.6%, over the year-end 2005 balance of $3.6 billion. Noninterest-bearing demand deposits of $665.0 million at year-end 2007 increased by $4.0 million, or 0.6%, from 2006's year-end balance of $661.0 million, which decreased by $70.0 million, or 9.6%, from the $731.0 million held at year-end 2005. Interest-bearing deposits at December 31, 2007 of $3.3 billion increased by $154.2 million, or 4.8%, over the $3.2 billion held at year-end 2006, which increased by $272.2 million, or 9.3%, compared to year-end 2005. Time deposits increased in 2007 as depositors sought the higher returns offered on our time deposit products. The majority of the increase in time deposits came from individual accounts with balances of $100,000 or more, which increased by $185.8 million, or 18.9%, in 2007.

During 2007, we again focused most of our marketing resources on our flagship Exceptional Checking and Exceptional Money Market Savings accounts, whose combined balances of $930.3 million at year-end 2007 increased by $49.7 million, or 5.6%, during the year. We also introduced two new deposit products called Remote Deposit Central ® and Choice Checking. Remote Deposit Central ® is a remote deposit service for business customers that allows them to deposit checks from the comfort of their office or home office. Our Choice Checking account is a checking account that allows customers to earn a time deposit like interest rate if certain requirements are met including direct deposits into the account, using a check card to pay for daily purchases and making payments online. Notwithstanding the efforts of our Exceptional campaigns and introduction of new deposit products, total core deposits (noninterest-bearing demand, interest-bearing demand and savings and time deposits under $100,000) decreased by $27.6 million, or 0.1%, during 2007, and the ratio of core deposits to total deposits declined to 70.8% at year-end 2007 from 74.4% at year-end 2006 and 77.3% at year-end 2005. The decrease in core deposit composition over the past two years coupled with the increase in time deposits reflects customers' reallocation of idle funds into higher-yielding alternative investment products. We expect to continue our deposit growth strategy in 2008, focusing primarily on core deposits, through competitive pricing and more aggressive marketing and customer calling campaigns.

Table 16 sets forth information regarding the average deposits and the average rates paid for certain deposit categories for each of the years indicated. Average balances are computed using daily average balances. The average rates paid on all categories of deposits increased in 2007 due to increases in market interest rates in the Hawaii deposit market. The average rate on time deposits, which are most sensitive to changes in market rates, increased by 62 basis points in 2007, while savings and money market deposit rates increased by 46 basis points. The average rate paid on all deposits in 2007 increased to 2.43% from 1.95% in 2006 and 1.12% in 2005. The increases in average rates paid in 2007 and 2006 were attributable to strong competition for core deposits from other Hawaii financial institutions as well as from internet-based and other financial services companies located outside of Hawaii.

We expect deposit rates to decrease in 2008 in response to recent rate cuts by the U.S. Federal Reserve. The magnitude of rate movements in our deposit base will depend in large part on competitive pricing considerations and the level of deposit growth needed to support our lending activities.

Table 16. Average Balances and Average Rates on Deposits

Year Ended December 31,