CENTRAL PACIFIC FINANCIAL CORP
Form 10-K
February 27, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

x **Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the Fiscal year ended December 31, 2014

or

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

Commission file number: 001-31567

Central Pacific Financial Corp.

(Exact name of registrant as specified in its charter)

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

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

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. Yes o No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No x

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

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

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. o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer o	Accelerated Filer x

Non-Accelerated Filer o	Smaller Reporting Company o

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

As of June 30, 2014, the aggregate market value of the common stock held by non-affiliates of the registrant was approximately $374,448,000. As of February 13, 2015, the number of shares of common stock of the registrant outstanding was 34,759,845 shares.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s proxy statement for the 2015 annual meeting of shareholders are incorporated by reference into Part III 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 1

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 us or with our approval 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 position 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 business plans, use of capital resources, products or services and regulatory developments and regulatory actions; (iii) statements of future economic performance; and (iv) statements of assumptions underlying such statements. Words such as believes, plans, anticipates, expects, intends, forecasts, hopes, targeted, continue, remain, will, should, may and other similar expressions a 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:

- increase in inventory or adverse conditions in the real estate market and deterioration in the construction industry;

- adverse changes in the financial performance and/or condition of our borrowers and, as a result, increased loan delinquency rates, deterioration in asset quality and losses in our loan portfolio;

- the impact of local, national, and international economies and events (including natural disasters such as wildfires, tsunamis, storms and earthquakes) on the Company s business and operations and on tourism, the military and other major industries operating within the Hawaii market and any other markets in which the Company does business;

- deterioration or malaise in domestic economic conditions, including any further destabilization in the financial industry and deterioration of the real estate market, as well as the impact of declining levels of consumer and business confidence in the state of the economy in general and in financial institutions in particular;

- changes in estimates of future reserve requirements based upon the periodic review thereof under relevant regulatory and accounting requirements;

- the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), changes in capital standards, other regulatory reform, including but not limited to regulations promulgated by the Consumer Financial Protection Bureau (the CFPB), government-sponsored enterprise reform, and any related rules and regulations which affect our business operations and competitiveness;

- the costs and effects of legal and regulatory developments, including legal proceedings or regulatory or other governmental inquiries and proceedings and the resolution thereof, and the results of regulatory examinations or reviews;

• the effects of and changes in trade, monetary and fiscal policies and laws, including the interest rate policies of the Board of Governors of the Federal Reserve System (the FRB of the Federal Reserve);

• inflation, interest rate, securities market and monetary fluctuations;

• negative trends in our market capitalization and adverse changes in the price of the Company s common shares;

• political instability;

• acts of war or terrorism;

• changes in consumer spending, borrowings and savings habits;

• failure to maintain effective internal control over financial reporting or disclosure controls and procedures;

• technological changes and developments;

• changes in the competitive environment among financial holding companies and other financial service providers;

• the effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Public Company Accounting Oversight Board, the Financial Accounting Standards Board (FASB) and other accounting standard setters;

• our ability to attract and retain skilled employees;

• changes in our organization, compensation and benefit plans; and

- our success at managing any of the risks involved in the foregoing items.

For information with respect to factors that could cause actual results to differ from the expectations stated in the forward-looking statements, see also Risk Factors under Part I, Item 1A of this report. We urge investors to consider all of these factors carefully in evaluating the forward-looking statements contained in this Form 10-K. 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 except as required by law.

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 (the BHC Act), 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. 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. and its subsidiaries on a consolidated basis. When we refer to Central Pacific Financial Corp., CPF or to the holding company, we are referring to the parent company on a standalone basis. We refer to Central Pacific Bank herein as our bank or the bank.

Through our bank and its subsidiaries, we offer full-service commercial banking with 36 bank branches and 110 ATMs located throughout the state of Hawaii. Our administrative and main offices are located in Honolulu and we have 28 branches on the island of Oahu. We operate four branches on the island of Maui, two branches on the island of Hawaii and two branches on the island of Kauai. 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 commercial bank offering a broad range of banking products and services, including accepting time and demand deposits and originating loans. Our loans include 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 substantially on a foundation of locally generated deposits. For financial reporting purposes, we have the following three reportable segments: (1) Banking Operations, (2) Treasury and (3) All Others. For further information about our reporting segments, including information about the assets and operating results of each, see Note 25 Segment Information in the accompanying consolidated financial statements.

Our operations, like those of other financial institutions that operate in our market, are significantly influenced by economic conditions in Hawaii, 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. See Supervision and Regulation below for other information about the regulation of our holding company and bank.

Following our successful capital raises in 2011, we have accomplished a number of key performance objectives through December 31, 2014:

- In 2013, our Board of Directors and management, in consultation with our regulators, reinstated and declared quarterly cash dividends on the Company s outstanding common stock totaling $0.16 per share of common stock in 2013 ($0.08 per share in the 3rd and 4th quarters of 2013) and $0.36 per share of common stock in 2014 ($0.08 per share in the 1st and 2nd quarters of 2014 and $0.10 per share in the 3rd and 4th quarters of 2014).

- On March 28, 2014, we completed a tender offer to purchase 3,405,888 shares of common stock at a purchase price of $20.20 per share for a total cost of $68.8 million, excluding fees and expenses. On April 7, 2014, we also completed repurchase agreements with each of our two largest shareholders to privately purchase 1,391,089 shares of common stock at a purchase price of $20.20 per share from each shareholder for a total cost of $56.2 million, excluding fees and expenses.

- On May 20, 2014, our Board of Directors authorized the repurchase and retirement of up to $30.0 million of the Company s outstanding common stock. In 2014, 857,554 shares of common stock, at a cost of $16.5 million, were repurchased under this program.

- We have continued to maintain a strong capital position with tier 1 risk-based capital, total risk-based capital and leverage capital ratios as of December 31, 2014 of 16.97%, 18.24%, and 12.03%, respectively, compared to 20.27%, 21.54%, and 13.68%, respectively, as of

December 31, 2013, and 22.54%, 23.83%, and 14.32%, respectively, as of December 31, 2012. Our capital ratios continue to exceed the levels required for a well-capitalized regulatory designation.

- We reported four consecutive profitable years with net income totaling $40.5 million, $172.1 million, $47.4 million, and $36.6 million for the years ended December 31, 2014, 2013, 2012 and 2011, respectively.

- We have continued to grow our loan and lease portfolio. Loans and leases, net of deferred income/costs, totaled $2.9 billion at December 31, 2014, and increased by $301.6 million, or 11.5%, from December 31, 2013.

- We reduced our nonperforming assets by $4.8 million to $42.0 million at December 31, 2014 from $46.8 million at December 31, 2013. Our nonperforming assets at December 31, 2013 were reduced by $43.2 million from $90.0 million at December 31, 2012.

- We maintained an allowance for loan and lease losses as a percentage of total loans and leases of 2.53% at December 31, 2014, compared to 3.19% and 4.37% at December 31, 2013 and 2012, respectively. In addition, we maintained an allowance for loan and lease losses as a percentage of nonperforming assets of 176.14% at December 31, 2014, compared to 179.29% and 107.10% at December 31, 2013 and 2012, respectively.

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

In addition, the bank was notified by the FDIC on November 14, 2014 that the Compliance MOU that the bank entered into with the FDIC in October 2012 had been terminated.

We also remain focused on lowering our efficiency ratio and growing market share within our core Hawaii market. In connection with improving our efficiency ratio, we have completed several initiatives, including (i) outsourcing the data center and hardware for our core information technology system as well as our items processing function to Fiserv, which is our existing core software application provider; and (ii) implementing a staff right-sizing plan. Additionally, we have begun designing, developing, and implementing our data warehouse and customer relationship management programs.

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 loan products, including residential mortgage loans, commercial and consumer loans and lines of credit, commercial real estate loans and construction loans.

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

(1) *Residential Mortgage Lending.* Residential mortgage loans include fixed- and adjustable-rate loans primarily secured by single-family, owner-occupied residences in Hawaii and home equity lines of credit and loans. 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 $0.4 million and marketable collateral. Changes in interest rates, the economic recession and other market factors have impacted, and future changes will likely continue to impact, the marketability and value of collateral and the financial condition of our borrowers and thus the level of credit risk inherent in the portfolio. The majority of our residential mortgage loan originations are sold in the secondary market.

(2) *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 and help to reduce credit losses.

(3) *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 multi-family residential properties, industrial, warehouse, general office, retail, health care and religious dwellings. Our underwriting policy generally requires net cash flow from the property to cover the debt service while maintaining an appropriate amount of reserve and permits consideration of liquidation of the collateral as a secondary source of repayment. Financing of commercial real estate projects is subject to a high degree of credit risk. The limited supply of land at a given commercially attractive location, the long economic life of the assets, the long delivery time frames required for the development and construction of major projects and high interest rate sensitivity have given commercial real estate markets a long history of significant cyclical fluctuations and volatility.

(4) *Construction Lending.* Construction lending encompasses the financing of residential and commercial construction projects. Similar to commercial real estate lending, construction projects are subject to a high degree of credit risk given the long delivery time frames for projects.

(5) *Consumer Lending.* 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 amount many borrowers.

Beyond the lending function described above, we also offer a full range of deposit products and services including checking, savings and time deposits, cash management and electronic 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 was the fourth-largest depository institution in the state at December 31, 2014.

The banking and financial services industry in the state of Hawaii generally, and particularly in our target market areas, is highly competitive. We compete for loans, deposits and customers with other commercial banks, savings banks, securities and brokerage companies, mortgage companies, insurance companies, finance companies, credit unions and other nonbank financial service providers. Some of these competitors are much larger by total assets and capitalization, have greater access to capital markets and have achieved better results than we have during the recent economic downturn.

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.

For further discussion of factors affecting our operations see, Part II, 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 72% of our loan portfolio held for investment at December 31, 2014 consisted of real estate-related loans, including construction loans, residential mortgage loans and commercial mortgage loans. See Part II, Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations Financial Condition Loan Portfolio.

Our business activities are focused primarily in Hawaii. Consequently, our results of operations and financial condition are impacted by the general economic trends in Hawaii, particularly in the commercial and residential real estate markets. During periods of economic strength, the real estate market and the real estate industry typically perform well; during periods of economic weakness, they typically are adversely affected.

Our Subsidiaries

Central Pacific Bank is the wholly-owned principal subsidiary of Central Pacific Financial Corp. Other wholly-owned subsidiaries include: CPB Capital Trust II; CPB Statutory Trust III; CPB Capital Trust IV; and CPB Statutory Trust V. CPB Capital Trust I was dissolved in 2014.

Central Pacific Bank had two wholly-owned subsidiaries as of December 31, 2013: CPB Real Estate, Inc. and Citibank Properties, Inc. Both were real estate investment trusts that were dissolved in 2014. Central Pacific Bank had two other wholly-owned subsidiaries, CB Technology, Inc. and Central Pacific HomeLoans, Inc., that were dissolved in February 2013 and February 2012, respectively. As of December 31, 2014, Central Pacific Bank does not have any wholly-owned subsidiaries but does own 50% of Pacific Access Mortgage, LLC, Gentry HomeLoans, LLC, Haseko HomeLoans, LLC, and Island Pacific HomeLoans, LLC.

Supervision and Regulation

General

The Company and the bank are subject to significant regulation and restrictions by federal and state laws and regulatory agencies for the protection of depositors and the FDIC deposit insurance fund, borrowers, and the stability of the U.S. banking system. The following discussion of statutes and regulations is a summary and does not purport to be complete nor does it address all applicable statutes and regulations. This discussion is qualified in its entirety by reference to the statutes and regulations referred to in this discussion. We cannot predict whether or when new legislative initiatives may be proposed or enacted or new regulations or guidance may be promulgated nor the effect new laws, regulations and supervisory policies may have on community banks generally or on our financial condition and results of operations. Such developments 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.

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 BHC Act and is subject to inspection, examination and supervision by the FRB. It is also subject to Hawaii s Code of Financial Institutions and is subject to inspection, examination and supervision by the DFI.

The Company 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 (the Exchange Act), 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. In addition to the powers of the bank regulatory agencies we are subject to, the SEC and the NYSE have the ability to take enforcement actions against us.

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

Central Pacific Bank, as a Hawaii-chartered bank, is subject to primary supervision, periodic examination and regulation by the DFI and FDIC and is also subject to certain regulations promulgated by the FRB. In periodic examinations, each of these regulatory bodies assesses our financial condition, capital resources, asset quality, earnings prospects, management, liquidity and other aspects of our operations. These bodies also determine whether our management is effectively managing the bank and the holding company and whether they are in compliance with all applicable laws or regulations.

Legislative and Regulatory Developments

The implementation and impact of legislation and regulations enacted since 2008 in response to the U.S. economic downturn and financial industry instability continued in 2014, even as continued modest recovery was experienced by many institutions in the banking sector. Many institutions, including CPF, have exited Treasury investments under the Troubled Assets Relief Program (TARP) and certain provisions of the Dodd-Frank Act are effective and have been fully implemented, including the revisions in the deposit insurance assessment base for FDIC insurance and the permanent increase in coverage to $250,000; the permissibility of paying interest on business checking accounts; the removal of barriers to interstate branching and required disclosure and shareholder advisory votes on executive compensation. Implementation in 2014 of additional Dodd-Frank regulatory provisions included aspects of (i) the final new capital rules and (ii) the so called Volcker Rule restrictions on certain proprietary trading and investment activities.

In the exercise of their supervisory and examination authority, the regulatory agencies have emphasized corporate governance, stress testing, enterprise risk management and other board responsibilities; anti-money laundering compliance and enhanced high risk customer due diligence; vendor management; cyber security and fair lending and other consumer compliance obligations.

Capital Adequacy Requirements

Bank holding companies and banks are subject to various regulatory capital requirements administered by state and federal banking agencies. New capital rules described below were effective on January 1, 2014, and are being phased in over various periods (the New Capital Rules). The basic capital rule changes were fully effective on January 1, 2015, but many elements are being phased in over multiple future years. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations (see Prompt Corrective Action Provisions below), 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 risk-based capital guidelines for bank holding companies and banks require capital ratios that vary based on the perceived degree of risk associated with a banking organization s operations for both transactions reported on the balance sheet as assets, such as loans, and those recorded as off-balance sheet items, such as commitments, letters of credit and recourse arrangements. The risk-based capital ratio is determined by classifying assets and certain off-balance sheet financial instruments into weighted categories, with higher levels of capital being required for those categories perceived as representing greater risks and dividing its qualifying capital by its total risk-adjusted assets and off-balance sheet items. Bank holding companies and banks engaged in significant trading activity may also be subject to the market risk capital guidelines and be required to incorporate additional market and interest rate risk components into their risk-based capital standards. To the extent that the new rules are not fully phased in, the prior capital rules continue to apply.

Under the risk-based capital guidelines in place prior to the effectiveness of the New Capital Rules, there were three fundamental capital ratios: a total risk-based capital ratio, a Tier 1 risk-based capital ratio and a Tier 1 leverage ratio. To be deemed well capitalized, a bank must have a total risk-based capital ratio, a Tier 1 risk-based capital ratio and a Tier 1 leverage ratio of at least ten percent, six percent and five percent, respectively. Under the capital rules that applied in 2014, there was no Tier 1 leverage requirement for a holding company to be deemed well-capitalized. At December 31, 2014, the respective capital ratios of the Company and the bank exceeded the minimum percentage requirements to be deemed well-capitalized for regulatory purposes. See Management s Discussion and Analysis of Financial Condition and

Results of Operations Capital Resources. The federal banking agencies may require banks and bank holding companies subject to enforcement actions to maintain capital ratios in excess of the minimum ratios otherwise required to be deemed well capitalized, in which case institutions may no longer be deemed to be well capitalized and may therefore be subject to certain restrictions such as taking brokered deposits.

The New Capital Rules and Minimum Capital Ratios

In July 2013, the federal bank regulatory agencies adopted final regulations which revised their risk-based and leverage capital requirements for banking organizations to meet requirements of the Dodd Frank Act and to implement the Basel III international agreements reached by the Basel Committee. Although many of the rules contained in these final regulations are applicable only to large, internationally active banks, some of them will apply on a phased-in basis to all banking organizations, including the Company and the bank.

The following are among the new requirements that are phased-in beginning January 1, 2015 under the New Capital Rules:

- an increase in the minimum Tier 1 capital ratio from 4.00% to 6.00% of risk-weighted assets;

- a new category and a required 4.50% of risk-weighted assets ratio is established for common equity Tier 1 as a subset of Tier 1 capital limited to common equity;

- a minimum non-risk-based leverage ratio is set at 4.00% with no 3.00% exception for higher rated banks;

- changes in the permitted composition of Tier 1 capital to exclude trust preferred securities subject to certain grandfathering exceptions for organizations like the Company which were under $15 billion in assets as of December 31, 2009, mortgage servicing rights and certain deferred tax assets and include unrealized gains and losses on available for sale debt and equity securities unless the organization opts out of including such unrealized gains and losses, which the Company intends to do;

- the risk-weights of certain assets for purposes of calculating the risk-based capital ratios are changed for high volatility commercial real estate acquisition, development and construction loans, certain past due non-residential mortgage loans and certain mortgage-backed and other securities exposures; and

- an additional countercyclical capital buffer is required for larger and more complex institutions.

The prompt corrective action standards are changed as the new capital rule ratios become effective. Under the new standards, in order to be considered well-capitalized, the bank will be required to meet the new common equity Tier 1 ratio of 6.5%, an increased Tier 1 ratio of 8% (increased from 6%), a total capital ratio of 10% (unchanged) and a leverage ratio of 5% (unchanged).

An additional capital conservation buffer of 2.5% of risk weighted assets above the regulatory minimum capital ratios established under the new final capital rule will be phased in from 2016 to 2019 and must be met to avoid limitations on the ability of the bank to pay dividends, repurchase shares or pay discretionary bonuses. Including the capital conservation buffer of 2.5%, the new final capital rule would result in the following minimum ratios to be considered well capitalized: (i) a Tier 1 capital ratio of 8.5%, (ii) a common equity Tier 1 capital ratio of 7.0%, and (iii) a total capital ratio of 10.5%. The new capital conservation buffer requirement will be phased in beginning in January 2016 at 0.625% of risk-weighted assets and would increase each year until fully implemented in January 2019. While the new final capital rule sets higher regulatory capital standards for the Company and the bank, bank regulators may also continue their past policies of expecting banks to maintain additional capital beyond the new minimum requirements. The implementation of the new capital rules or more stringent requirements to maintain higher levels of capital or to maintain higher levels of liquid assets could adversely impact the Company s net income and return on equity, restrict the ability to pay dividends or executive bonuses and require the raising of additional capital.

Management believes that, as of December 31, 2014, the Company and the bank would meet all applicable capital requirements under the New Capital Rules on a fully phased-in basis if such requirements were currently in effect (see *Legislative and Regulatory Developments*).

Prompt Corrective Action Provisions

The Federal Deposit Insurance Act requires the federal bank regulatory agencies to take prompt corrective action with respect to a depository institution if that institution does not meet certain capital adequacy standards, including requiring the prompt submission of an acceptable capital restoration plan. Depending on the bank s capital ratios, the agencies regulations define five categories in which an insured depository institution will be placed: well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. At each successive lower capital category, an insured bank is subject to more restrictions, including restrictions on the bank s activities, operational practices or the ability to pay dividends or executive bonuses. Based upon its capital levels, a bank that is classified as well-capitalized, adequately capitalized, or undercapitalized may be treated as though it were in the next lower capital category if the appropriate federal banking agency, after notice and opportunity for hearing, determines that an unsafe or unsound condition, or an unsafe or unsound practice, warrants such treatment.

Final Volcker Rule

In December 2013, the federal bank regulatory agencies adopted final rules that implement a part of the Dodd-Frank Act commonly referred to as the Volcker Rule. Under these rules and subject to certain exceptions, banking entities are restricted from engaging in activities that are considered proprietary trading and from sponsoring or investing in certain entities, including hedge or private equity funds that are considered covered funds. These rules became effective on April 1, 2014, although certain provisions are subject to delayed effectiveness under rules promulgated by the FRB. The Company and the bank held no investment positions at December 31, 2014 which were subject to the final rule. Therefore, while these new rules may require us to conduct certain internal analysis and reporting, they did not require any material changes in our operations or business.

Bank Holding Company Regulation

As contained in both federal and state banking laws and regulations, a wide range of requirements and restrictions apply to bank holding companies and their subsidiaries which:

- require regular periodic reports and such additional reports of information as the Federal Reserve may require;
- require bank holding companies to meet or exceed minimum capital requirements (see *Legislative and Regulatory Developments* and *Current Capital Adequacy Requirements*);

- require that bank holding companies serve as a source of financial and managerial strength to subsidiary banks and commit resources as necessary to support each subsidiary bank. The source-of-strength doctrine most directly affects bank holding companies where a bank holding company s subsidiary bank fails to maintain adequate capital levels. In such a situation, the subsidiary bank will be required by the bank s federal regulator to take prompt corrective action (see *Prompt Corrective Action Provisions*);

- limit dividends payable to shareholders and restrict the ability of bank holding companies to obtain dividends or other distributions from their subsidiary banks;

- require a bank holding company to terminate an activity or terminate control of or liquidate or divest certain subsidiaries, affiliates or investments if the Federal Reserve believes the activity or the control of the subsidiary or affiliate constitutes a significant risk to the financial safety, soundness or stability of any bank subsidiary;

- require the prior approval for changes in senior executive officer or directors and prohibit golden parachute payments, including change in control agreements, or new employment agreements with such payment terms, which are contingent upon termination when a bank holding company is deemed to be in troubled condition;

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

- require prior approval of acquisitions and mergers with other banks or bank holding companies and consider certain competitive, management, financial, and anti-money laundering compliance impact on the U.S.

Other Restrictions on the Company s Activities

Subject to prior notice or Federal Reserve approval, bank holding companies may generally engage in, or acquire shares of companies engaged in, activities determined by the Federal Reserve to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. Bank holding companies that elect and retain financial holding company status pursuant to the Gramm-Leach-Bliley Act of 1999 (GLBA) may engage in these nonbanking activities and broader securities, insurance, merchant banking and other activities that are determined to be financial in nature or are incidental or complementary to activities that are financial in nature without prior Federal Reserve approval. Pursuant to the GLBA and the Dodd-Frank Act, in order to elect and retain financial holding company status, a bank holding company and all depository institution subsidiaries of that bank holding company must be well capitalized and well managed, and, except in limited circumstances, depository subsidiaries must be in satisfactory compliance with the Community Reinvestment Act (CRA), which requires banks to help meet the credit needs of the communities in which they operate. Failure to sustain compliance with these requirements or correct any non-compliance within a fixed time period could lead to the required divestiture of subsidiary banks or the termination of all activities that do not conform to those permissible for a bank holding company. The Company has not elected financial holding company status and neither Company nor the bank has engaged in any activities determined by the Federal Reserve to be financial in nature or incidental or complementary to activities that are financial in nature.

Dividends

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

The bank is a legal entity that is separate and distinct from its holding company. CPF is dependent on the performance of the bank for funds which may be received as dividends from the bank for use in the operation of CPF and the ability of CPF to pay dividends to shareholders. Subject to the regulatory restrictions which currently further restrict the ability of the bank to declare and pay dividends under applicable Hawaii law, future cash dividends by the bank will depend upon management s assessment of future capital requirements, contractual restrictions and other factors. When effective, the new minimum capital rule may restrict dividends by the bank if the additional capital conservation buffer is not achieved.

Regulation of the Bank

As a Hawaii-chartered commercial bank whose deposits are insured by the FDIC, the bank is subject to regulation, supervision, and regular examination by the DFI and by the FDIC as a nonmember state bank, as the bank s primary Federal regulator. Specific federal and state laws and regulations which are applicable to banks regulate, among other things, the scope of their business, their investments, their reserves against deposits, the timing of the availability of deposited funds, their activities relating to dividends, investments, loans, the nature and amount of and collateral for certain loans, servicing and foreclosing on loans, transactions with affiliates, borrowings, capital requirements, certain check-clearing activities, branching, and mergers and acquisitions.

FDIC and DFI Enforcement Authority

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

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

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

- restrict the bank s growth geographically, by products and services, or by mergers and acquisitions, including bidding in FDIC receiverships for failed banks;

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

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

- terminate FDIC insurance, revoke the charter and/or take possession of and close and liquidate the bank or appoint the FDIC as receiver, which for a Hawaii-chartered bank would result in a revocation of its charter.

The bank received a letter from the FDIC dated November 14, 2014 advising that the Memorandum of Understanding (the Compliance MOU) previously entered into with the FDIC on October 9, 2012, relating to improvement of the bank s compliance management system (CMS) was terminated. As further described in Note 2 to the Consolidated Financial Statements under Part II, Item 8. Financial Statements and Supplementary Data, the bank and CPF were previously subject to regulatory orders with the FDIC and the FRB which were terminated on October 26, 2012 and February 12, 2013, respectively. Although we are no longer subject to any regulatory agreements with our regulators, we may in the future become subject to other agreements with our regulators which restrict our activities or may also impose increased capital ratios or other requirements on our business.

Deposit Insurance

The FDIC is an independent federal agency that insures deposits through the Deposit Insurance Fund (the DIF) up to prescribed statutory limits of federally insured banks and savings institutions and safeguards the safety and soundness of the banking and savings industries. The amount of FDIC assessments paid by each DIF member institution is based on its asset size and its relative risk of default as measured by regulatory capital ratios and other supervisory factors. The bank s FDIC insurance expense totaled $2.8 million for 2014. We are generally unable to control the amount of premiums that we are required to pay for FDIC insurance. If there are additional bank or financial institution failures or if the FDIC otherwise determines, we may be required to pay even higher FDIC premiums. Any future increases in FDIC insurance premiums may have a material and adverse effect on our earnings and could have a material adverse effect on the value of, or market for, our common stock.

Operations and Consumer Compliance Laws

The bank must comply with numerous federal and state anti-money laundering and consumer protection and privacy statutes and implementing regulations, including the USA Patriot Act of 2001, GLBA, the Bank Secrecy Act, the Foreign Account Tax Compliance Act (effective 2013), the CRA, the Fair Credit Reporting Act, as amended by the Fair and Accurate Credit Transactions Act, the Equal Credit Opportunity Act, the Truth in Lending Act, the Fair Housing Act, the Home Mortgage Disclosure Act, the Real Estate Settlement Procedures Act, the National Flood Insurance Act, the California Homeowner Bill of Rights and various federal and state privacy protection laws. Noncompliance with these laws could subject the bank to lawsuits and could also result in administrative penalties, including, fines and reimbursements. The bank and CPF are also subject to federal and state laws prohibiting unfair or fraudulent business practices, untrue or misleading advertising and unfair competition.

These laws and regulations mandate certain disclosure and reporting requirements and regulate the manner in which financial institutions must deal with customers when taking deposits, making loans, servicing, collecting, and foreclosure of loans, and providing other services. Failure to comply with these laws and regulations can subject the bank to various penalties, including but not limited to enforcement actions, injunctions, fines or criminal penalties, punitive damages to consumers, and the loss of certain contractual rights.

The bank received an Outstanding rating in the FDIC s 2012 Community Reinvestment performance evaluation that measures how financial institutions support their communities in the areas of lending, investment and service.

CFPB

The Dodd-Frank Act provided for the creation of the CFPB as an independent entity within the Federal Reserve with broad rulemaking, supervisory and enforcement authority over consumer financial products and services, including deposit products, residential mortgages, home-equity loans, credit cards, and other consumer loans. The CFPB s functions include investigating consumer complaints, conducting market research, rulemaking, supervising and examining bank consumer transactions, and enforcing rules related to consumer financial products and services. CFPB regulations and guidance apply to all financial institutions and banks with $10 billion or more in assets and are subject to examination by the CFPB. Banks with less than $10 billion in assets, including the bank, will continue to be examined for compliance by their primary federal banking agency. If we were able to grow beyond $10 billion in assets, we would be subject to enhanced CFPB examination as well as be required to perform more comprehensive stress-testing on our business and operations.

In 2014, the CFPB adopted revisions to Regulation Z which implements the Truth in Lending Act (TILA), pursuant to the Dodd-Frank Act and apply to all consumer mortgages (except home equity lines of credit, timeshare plans, reverse mortgages, or temporary loans). The revisions mandate specific underwriting criteria for home loans in order for creditors to make a reasonable, good faith determination of a consumer s ability to repay and establish certain protections from liability under this requirement for qualified mortgages meeting certain standards. In particular, it will prevent banks from making no doc and low doc home loans, as the rules require that banks determine a consumer s ability to pay based in part on verified and documented information. Because we do not originate no doc or low doc loans, this regulation did not have a significant impact on our operations.

Employees

At December 31, 2014, we employed 841 persons, 754 on a full-time basis and 87 on a part-time basis. We are not a party to any collective bargaining agreement.

Protection of Net Operating Losses

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

On November 23, 2010, our board declared a dividend of preferred share purchase rights (Rights) in respect of our common stock which were issued pursuant to a Tax Benefits Preservation Plan, dated as of November 23, 2010 (the Tax Benefits Preservation Plan), between the Company and Wells Fargo Bank, National Association, as rights agent. Each Right represents the right to purchase, upon the terms and subject to the conditions in the Tax Benefits Preservation Plan, 1/10,000th of a share of our Junior Participating Preferred Stock, Series C, no par value, for $6.00, subject to adjustment. The Tax Benefits Preservation Plan is designed to reduce the likelihood that the Company will experience an ownership change by discouraging any person from becoming a beneficial owner of 4.99% or more of our common stock (a Threshold Holder). Adoption of the Tax Benefits Preservation Plan was required by our agreements with The Carlyle Group (Carlyle) and Anchorage Capital Group, L.L.C. (Anchorage). On January 29, 2014, our Board of Directors approved an amendment to the Tax Benefits Preservation Plan to extend it for up to an additional two years (until February 18, 2016).

To further protect our tax benefits, on January 26, 2011, our board approved a proposed amendment to our restated articles of incorporation to restrict transfers of our stock if the effect of an attempted transfer would cause the transferee to become a Threshold Holder or to cause the beneficial ownership of a Threshold Holder to increase (the Protective Charter Amendment). At our annual meeting of shareholders on April 27, 2011, our shareholders approved the Protective Charter Amendment. On January 29, 2014, our Board of Directors approved an amendment to the Protective Charter Amendment to extend it for up to an additional two years (until May 2, 2016). Our shareholders approved the extension of the Protective Charter Amendment on April 25, 2014. There is no guarantee, however, that the Tax Benefits Preservation Plan or the Protective Charter Amendment will prevent the Company from experiencing an ownership change.

Available Information

Our internet website can be found at www.centralpacificbank.com. Our annual reports 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 materials are 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, Compensation Committee and Corporate Governance Committee, as well as our Corporate Governance Guidelines and Code of Business Conduct and Ethics. Within the time period required by the SEC and 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

Our business faces significant risks, including credit, market/liquidity, operational, legal/regulatory and strategic/reputation risks. The factors described below may not be the only risks we face and are not intended to serve as a comprehensive listing or be applicable only to the category of risk under which they are disclosed. The risks described below are generally applicable to more than one of the following categories of risks. Additional risks that we do not yet know of or that we currently think are immaterial may also impair our business operations. If any of the events or circumstances described in the following factors actually occurs, our business, financial condition and/or results of operations could be materially and adversely affected.

Risk Factors Related to our Business

Negative developments in the global and U.S. economies could have an adverse effect on us.

Although general economic trends and market conditions have stabilized, concerns about the ability to maintain a sustained economic recovery still remain, including lingering concerns over unemployment levels, growing U.S. government and foreign indebtedness, a large budget deficit, and the federal debt ceiling. Downgrades in U.S. and foreign debt instruments could raise borrowing costs and adversely impact the mortgage and housing markets. In general, adverse economic conditions could have one or more of the following negative impacts on us, any one of which could have a material adverse effect on our financial condition or results of operations: (i) loan delinquencies may increase; (ii) problem assets and foreclosures may increase leading to higher loan charge-offs; (iii) demand for our products and services may decline; (iv) low cost or non-interest bearing deposits may decrease; and (v) collateral for loans made by us, especially involving real estate, may decline in value, in turn reducing customers borrowing power and reducing the value of assets and collateral associated with our existing loans.

Difficult economic and market conditions have adversely affected our industry and renewed economic slowdown in Hawaii would result in additional adverse effects on us.

Unlike larger national or other regional banks that are more geographically diversified, our business and operations are closely tied to the Hawaii market. The Hawaii economy relies on tourism, real estate, government and other service-based industries. Declines in tourism, increases in energy costs, the availability of affordable air transportation, adverse weather and natural disasters, and local budget issues impact consumer and corporate spending. As a result, such events may contribute to the deterioration in Hawaii s general economic condition, which could adversely impact us and our borrowers.

The high concentration of real estate loans in our portfolio, combined with the deterioration in these sectors caused by the economic downturn, had and may continue to have a significantly more adverse impact on our operating results than many other banks across the nation. If our borrowers continue to experience financial difficulty, or if property values securing our real estate loans decline, we will incur elevated credit costs due to the composition of our loan portfolio even if market conditions improve.

Our real estate loan operations have a considerable effect on our results of operations.

The performance of our real estate loans depends on a number of factors, including the continued stabilization and eventual improvement of the real estate markets in which we operate. As we have seen in the Hawaii and California construction and real estate markets since the latter part of 2007, the strength of the real estate market and the results of our operations could be negatively affected by an economic downturn.

In addition, declines in the market for commercial property could cause some of our borrowers to suffer losses on their project, which would negatively affect our financial condition, results of operations and prospects. Declines in housing prices and the supply of existing houses for sale could cause residential developers who are our borrowers to suffer losses on their projects and encounter difficulty in repaying their loans. We cannot assure you that we will have an adequate allowance for loan and lease losses to cover future losses. If we suffer greater losses than we are projecting, our financial condition and results of operations would be adversely affected.

Our allowance for loan and lease loss methodology has resulted in credits to our provision for loan and lease losses but the credit provisions may not continue.

For four consecutive years from 2011 through 2014, we recorded a credit to the provision for loan and lease losses. Although other factors of our overall risk profile have improved in recent years and general economic trends and market conditions have stabilized, concerns over the global and U.S. economies still remain. Accordingly, it is possible that the real estate markets we participate in could deteriorate as it did from the latter part of 2007 through 2010. If this occurs, it may result in an increase in loan delinquencies, loan charge-offs, and our allowance for loan and lease losses. Even if economic conditions improve or stay the same, it is possible that we may experience material credit losses and in turn, increases to our allowance for loan and lease losses, due to any number of factors, including but not limited to, the elevated risk still inherent in our existing loan portfolio resulting from our high concentration of commercial real estate loans. If that were to occur, or if we continue to have strong growth in our loan portfolio, we may have to record a provision for loan and lease losses which would have an adverse impact on our net income.

A large percentage of our loans are collateralized by real estate and continued deterioration in the real estate market may result in additional losses and adversely affect our financial results.

Our results of operations have been, and in future periods, will continue to be significantly impacted by the economy in Hawaii, and to a lesser extent, other markets we are exposed to including California. Approximately 72% of our loan portfolio as of December 31, 2014 was comprised of loans primarily collateralized by real estate, with the significant majority of these loans concentrated in Hawaii.

Deterioration of the economic environment in Hawaii, California or other markets we are exposed to, including a decline in the real estate market and 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 we have seen in the past, material declines in the value of the real estate assets securing many of our commercial real estate loans may lead to significant credit losses in this portfolio. As a result of our particularly high concentration of real estate loans, our portfolio had been and remains particularly susceptible to significant credit losses during economic downturns and adverse changes in the real estate market.

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 may 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. Our current allowance for loan and lease losses may not be sufficient to cover future loan losses. 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 for loan and lease losses, we rely on an analysis of our loan portfolio, our experience and our evaluation of general economic conditions, as well as the requirements of any supervisory action taken by the bank s regulators and other regulatory input. If our assumptions prove to be incorrect, our current allowance for loan and lease losses may not be sufficient to cover the losses. Because of the uncertainty in the economy, volatility in the credit and real estate markets, including specifically, the deterioration in the Hawaii and California real estate markets and our high concentration of commercial real estate loans, we made significant enhancements to our allowance for loan and lease losses over the past several years and may need to make additional enhancements in the future. In addition, third parties, including our federal and state regulators, periodically evaluate the adequacy of our allowance for loan and lease losses and may communicate with us concerning the methodology or judgments that we have raised in determining the allowance for loan and lease losses. As a result of this input, we may be required to assign different grades to specific credits, increase our provision for loan and lease losses, and/or recognize further loan charge offs.

Our ability to use net operating loss carry forwards to reduce future tax payments may be limited or restricted.

We have generated significant net operating losses (NOLs) as a result of our prior losses. We generally are able to carry NOLs forward to reduce taxable income in future years. However, our ability to utilize the NOLs is subject to the rules of Section 382 of the Internal Revenue Code. Section 382 generally restricts the use of NOLs after an ownership change. An ownership change occurs if, among other things, the shareholders (or specified groups of shareholders) who own or have owned, directly or indirectly, 5% or more of a corporation s common stock or are otherwise treated as 5% shareholders under Section 382 and Treasury regulations promulgated thereunder increase their aggregate percentage ownership of that corporation s stock by more than 50 percentage points over the lowest percentage of the stock owned by these shareholders over a three-year rolling period. In the event of an ownership change, Section 382 imposes an annual limitation on the amount of taxable income a corporation may offset with NOL carry forwards. This annual limitation is generally equal to the product of the value of the corporation s stock on the date of the ownership change, multiplied by the long-term tax-exempt rate published monthly by the Internal Revenue Service. Any unused annual limitation may be carried over to later years until the applicable expiration date for the respective NOL carryforwards.

In order to reduce the likelihood that transactions in our common stock will result in an ownership change, on November 23, 2010, we adopted a Tax Benefits Preservation Plan, which provides an economic disincentive for any person or group to become an owner, for relevant tax purposes, of 4.99% or more of our common stock. On January 29, 2014, our Board of Directors approved an amendment to the Tax Benefits Preservation Plan to extend it for up to an additional two years (until February 18, 2016). To further protect our NOL carryforwards, on May 2, 2011, we filed the Protective Charter Amendment to restrict transfers of our common stock if the effect of the transfer would be to cause the transferee to become an owner, for relevant tax purposes, of 4.99% or more of our common stock (a Threshold Holder) or cause the beneficial ownership of our common stock by any Threshold Holder to increase. On January 29, 2014, our Board of Directors approved an amendment to the Protective Charter Amendment to extend it for up to an additional two years (to May 2, 2016). Our shareholders approved the extension of the Protective Charter Amendment on April 25, 2014. However, we cannot ensure that our ability to use our NOLs to offset income will not become limited in the future. As a result, we could pay taxes earlier and in larger amounts than would be the case if our NOLs were available to reduce our federal income taxes without restriction.

Our ability to maintain adequate sources of funding and liquidity and required capital levels may be negatively impacted by uncertainty in the economic environment which may, among other things, impact our ability to satisfy our obligations.

Liquidity is essential to our business. An inability to raise funds through deposits, borrowings, the sale of investments or loans, and other sources would have a substantial negative effect on our liquidity. Our access to funding sources in amounts adequate to finance our activities on terms which are acceptable to us could be impaired by factors that affect us specifically or the financial services industry or economy in general. Factors that could detrimentally impact our access to liquidity sources include concerns regarding deterioration in our financial condition, increased regulatory actions against us and a decrease in the level of our business activity as a result of a downturn in the markets in which our loans or deposits are concentrated. Our ability to borrow could also be impaired by factors that are not specific to us, such as a disruption in the financial markets or negative views and expectations about the prospects for the financial industry in light of the past turmoil faced by banking organizations and the credit markets.

The management of liquidity risk is critical to the management of our business and our ability to service our customer base. In managing our balance sheet, our primary source of funding is customer deposits. Our ability to continue to attract these deposits and other funding sources is subject to variability based upon a number of factors including volume and volatility in the securities markets, our financial condition, our credit rating and the relative interest rates that we are prepared to pay for these liabilities. The availability and level of deposits and other funding sources is highly dependent upon the perception of the liquidity and creditworthiness of the financial institution, which perception can change quickly in response to market conditions or circumstances unique to a particular company. Concerns about our past and future financial condition or concerns about our credit exposure to other persons could adversely impact our sources of liquidity, financial position, including regulatory capital ratios, results of operations and our business prospects.

If the level of deposits were to materially decrease, we would need to raise additional funds by increasing the interest that we pay on certificates of deposits or other depository accounts, seek other debt or equity financing or draw upon our available lines of credit. We rely on commercial and retail deposits, and to a lesser extent, advances from the Federal Home Loan Bank of Seattle (FHLB) and the Federal Reserve discount window, to fund our operations. Although we have historically been able to replace maturing deposits and advances as necessary, we might not be able to replace such funds in the future if, among other things, our results of operations or financial condition or the results of operations or financial condition of the FHLB or market conditions were to change.

Our line of credit with the FHLB serves as our primary outside source of liquidity. The Federal Reserve discount window also serves as an additional outside source of liquidity. Borrowings under this arrangement are through the Federal Reserve s primary facility under the borrower-in-custody program. The duration of borrowings from the Federal Reserve discount window are generally for a very short period, usually overnight. In the event that these outside sources of liquidity become unavailable to us, we will need to seek additional sources of liquidity, including selling assets. We cannot assure you that we will be able to sell assets at a level to allow us to repay borrowings or meet our liquidity needs.

We constantly monitor our activities with respect to liquidity and evaluate closely our utilization of our cash assets; however, there can be no assurance that our liquidity or the cost of funds to us may not be materially and adversely impacted as a result of economic, market, or operational considerations that we may not be able to control.

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 net interest margin could be expected to remain relatively constant during periods of rising interest rates, and to decline slightly 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;
- international disorder and instability in domestic and foreign financial markets; and
- governmental actions.

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 assets and liabilities to reduce our net interest income volatility. 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.

Governmental regulation and regulatory actions against us may further 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 funds, federal deposit insurance funds and the banking system as a whole, not security holders. These regulations affect our lending practices, capital structure, investment practices, dividend policy and growth, among other things. Congress and federal regulatory agencies continually review banking laws, regulations and policies for possible changes. 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. In addition, regulations may be adopted which increase our deposit insurance premiums and enact special assessments which could increase expenses associated with running our business and adversely affect our earnings.

There can be no assurance that such statutes and regulations, any changes thereto or to their interpretation will not adversely affect our business. In particular, these statutes and regulations, and any changes thereto, could subject us to additional costs (including legal and compliance costs), limit the types of financial services and products we may offer and/or increase the ability of non-banks to offer competing financial services and products, among other things. 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 us and the banking industry generally. We are subject to the rules and regulations of the FRBSF, the FDIC and the DFI, and may be subject to the rules and regulations promulgated by the CFPB. In addition, we are subject to the rules and regulation of the NYSE and the SEC. If we fail to comply with federal and state regulations, the regulators may limit our activities or growth, impose fines on us or in the case of our bank regulators, ultimately require our bank to cease its operations. 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;
- procedures and policies we must adopt; and
- how much cash we must set aside as reserves for deposits.

In addition, bank regulatory authorities have the authority to bring enforcement actions against banks and bank holding companies, including the bank and CPF, for unsafe or unsound practices in the conduct of their businesses or for violations of any law, rule or regulation, any condition imposed in writing by the appropriate bank regulatory agency or any written agreement with the authority. Enforcement actions against us could include a federal conservatorship or receivership for the bank, the issuance of additional orders that could be judicially enforced, the imposition of civil monetary penalties, the issuance of directives to enter into a strategic transaction, whether by merger or otherwise, with a third party, the termination of insurance of deposits, the issuance of removal and prohibition orders against institution-affiliated parties, and the enforcement of such actions through injunctions or restraining orders.

We face a risk of noncompliance and enforcement action with the Bank Secrecy Act and other anti-money laundering statutes and regulations.

The Bank Secrecy Act, the USA PATRIOT Act of 2001, and other laws and regulations require financial institutions, among other duties, to institute and maintain an effective anti-money laundering program and file suspicious activity and currency transaction reports as appropriate. The federal Financial Crimes Enforcement Network is authorized to impose significant civil money penalties for violations of those requirements and has recently engaged in coordinated enforcement efforts with the individual federal banking regulators, as well as the U.S. Department of Justice, Drug Enforcement Administration, and Internal Revenue Service. We are also subject to increased scrutiny of compliance with the rules enforced by the Office of Foreign Assets Control and compliance with the Foreign Corrupt Practices Act. If our policies, procedures and systems are deemed deficient, we would be subject to liability, including fines and regulatory actions, which may include restrictions on our ability to pay dividends and the necessity to obtain regulatory approvals to proceed with certain aspects of our business plan. Failure to maintain and implement adequate programs to combat money laundering and terrorist financing could also have serious reputational consequences for us. Any of these results could materially and adversely affect our business, financial condition and results of operations.

New regulatory capital standards impose enhanced capital adequacy requirements on us.

Increased regulatory capital requirements (and the associated compliance costs) which have been adopted by federal banking regulators impose additional capital requirements on our business. The administration of existing capital adequacy laws as well as adoption of new laws and regulations relating to capital adequacy, or more expansive or aggressive interpretations of existing laws and regulations, could have a material adverse effect on our business, liquidity, financial condition and results of operations and could substantially restrict our ability to pay dividends, repurchase any of our capital stock, or pay executive bonuses. In addition, increased regulatory capital requirements could require us to raise additional capital which would dilute our existing shareholders at the time of such capital issuance.

If we are unable to effectively manage the composition of our investment securities portfolio, which we expect will continue to comprise a significant portion of our earning assets, our net interest income and net interest margin could be adversely affected.

Our primary sources of interest income include interest on loans and leases, as well as interest earned on investment securities. Interest earned on investment securities represented 25.1% of our interest income in the year ended December 31, 2014, as compared to 25.4% of our interest income in the year ended December 31, 2013. Accordingly, effectively managing our investment securities portfolio to generate interest income while managing the composition and risks associated with that portfolio, including the mix of government agency and non-agency securities, has become increasingly important. If we are unable to effectively manage our investment securities portfolio or if the interest income generated by our investment securities portfolio declines, our net interest income and net interest margin could be adversely affected.

The soundness of other financial institutions could adversely affect us.

Our ability to engage in routine funding transactions could be adversely affected by the actions and commercial soundness of other financial institutions. Defaults by, or even rumors or questions about, one or more financial services institutions, or the financial services industry generally, have led to market-wide liquidity problems and could lead to losses or defaults by us or by other institutions. There is no assurance that any such losses would not materially and adversely affect our results of operations.

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

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 or seek to spread their deposits over several banks to maximize FDIC insurance coverage. Furthermore, technology and other changes have made it more convenient for the bank s 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 the bank s customers move money out of bank deposits in favor of alternative investments or into higher yielding deposits, or spread their accounts over several banks, we can lose a relatively inexpensive source of funds, thus increasing our funding costs.

The fiscal, monetary and regulatory policies of the federal government and its agencies could have a material adverse effect on our results of operations.

The FRB regulates the supply of money and credit in the U.S. Its policies determine in large part the cost of funds for lending and investing and the return earned on those loans and investments, both of which affect the net interest margin. It also can materially decrease the value of financial assets we hold, such as debt securities.

In an effort to stimulate the economy, the federal government and its agencies have taken various steps to keep interest rates at extremely low levels. Our net interest income and net interest margin may be negatively impacted by a prolonged low interest rate environment like we are currently experiencing as it may result in us holding lower yielding loans and securities on our balance sheet, particularly if we are unable to replace the maturing higher yielding assets with similar higher yielding assets. Changes in the slope of the yield curve, which represents the spread between short-term and long-term interest rates, could also reduce our net interest income and net interest margin. Historically, the yield curve is upward sloping, meaning short-term rates are lower than long-term rates. When the yield curve flattens, as is the case in the current interest rate environment, our net interest income and net interest margin could decrease as our cost of funds increases relative to the yield we can earn on our assets.

If we continue to see an improvement in national economic conditions or other changes occur, there is a potential that the FRB will increase interest rates. Should the FRB raise interest rates significantly and rapidly, there is potential for decreased demand for our loan products, an increase in our cost of funds, and curtailment of the current economic recovery.

Changes in FRB policies and our regulatory environment generally are beyond our control, and we are unable to predict what changes may occur or the manner in which any future changes may affect our business, financial condition and results of operation.

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

Because we are a holding company with no significant operations other than our bank, we depend upon dividends from our bank for a substantial portion of our revenues.

Hawaii law only permits the bank to pay dividends out of retained earnings as defined under Hawaii banking law (Statutory Retained Earnings), which differs from GAAP retained earnings. At December 31, 2014, the bank had Statutory Retained Earnings of $123.8 million.

Our ability to pay cash dividends to our shareholders is subject to restrictions under federal and Hawaii law, including restrictions imposed by the FRB and covenants set forth in various agreements we are a party to, including covenants set forth in our subordinated debentures.

The occurrence of fraudulent activity, breaches or failures of our information security controls or cybersecurity-related incidents could have a material adverse effect on our business, financial condition and results of operations.

As a financial institution, we are susceptible to fraudulent activity, information security breaches and cybersecurity-related incidents that may be committed against us or our clients, which may result in financial losses or increased costs to us or our clients, disclosure or misuse of our information or our client information, misappropriation of assets, privacy breaches against our clients, litigation, or damage to our reputation. Such fraudulent activity may take many forms, including check fraud, electronic fraud, wire fraud, phishing, social engineering and other dishonest acts. Information security breaches and cybersecurity-related incidents may include fraudulent or unauthorized access to systems used by us or our clients, denial or degradation of service attacks, and malware or other cyber-attacks. In recent periods, there continues to be a rise in electronic fraudulent activity, security breaches and cyber-attacks within the financial services industry, especially in the commercial banking sector due to cyber criminals targeting commercial bank accounts. Consistent with industry trends, we have also experienced an increase in attempted electronic fraudulent activity, security breaches and cybersecurity-related incidents in recent periods. Moreover, in recent periods, several large corporations, including financial institutions and retail companies, have suffered major data breaches, in some cases exposing not only confidential and proprietary corporate information, but also sensitive financial and other personal information of their customers and employees and subjecting them to potential fraudulent activity. Some of our clients may have been affected by these breaches, which increase their risks of identity theft, credit card fraud and other fraudulent activity that could involve their accounts with us.

Information pertaining to us and our clients is maintained, and transactions are executed, on the networks and systems of us, our clients and certain of our third party partners, such as our online banking or reporting systems. The secure maintenance and transmission of confidential information, as well as execution of transactions over these systems, are essential to protect us and our clients against fraud and security breaches and to maintain our clients confidence. Breaches of information security also may occur, and in infrequent cases have occurred, through intentional or unintentional acts by those having access to our systems or our clients or counterparties confidential information, including employees. In addition, increases in criminal activity levels and sophistication, advances in computer capabilities, new discoveries, vulnerabilities in thirdparty technologies (including browsers and operating systems) or other developments could result in a compromise or breach of the technology, processes and controls that we use to prevent fraudulent transactions and to protect data about us, our clients and underlying transactions, as well as the technology used by our clients to access our systems. Although we have developed, and continue to invest in, systems and processes that are designed to detect and prevent security breaches and cyber-attacks and periodically test our security, our inability to anticipate, or failure to adequately mitigate, breaches of security could result in: losses to us or our clients; our loss of business and/or clients; damage to our reputation; the incurrence of additional expenses; disruption to our business; our inability to grow our online services or other businesses; additional regulatory scrutiny or penalties; or our exposure to civil litigation and possible financial liability any of which could have a material adverse effect on our business, financial condition and results of operations.

More generally, publicized information concerning security and cyber-related problems could inhibit the use or growth of electronic or web-based applications or solutions as a means of conducting commercial transactions. Such publicity may also cause damage to our reputation as a financial institution. As a result, our business, financial condition and results of operations could be adversely affected.

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 our customers. In addition, there are a limited number of qualified persons in our local marketplace with the knowledge and experience required to effectively maintain our information technology systems and implement our technology initiatives. Failure to successfully attract and retain qualified personnel, or 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 implementing changes to our operations to improve our efficiency ratio that may adversely impact our results of operations.

We have completed or are in progress with several initiatives to improve our efficiency ratio. Several key initiatives involve changes to our technology and information systems including outsourcing the data centers and hardware for our core information technology system and items processing function to Fiserv, Inc., which is our existing core software application provider, and designing, developing, and implementing our data warehouse and customer relationship management programs. Additionally, during the third quarter of 2013, we began to implement a staff right-sizing plan which was completed in 2014. With the assistance of third-party consultants, we have completed comprehensive assessments and plans and are effectively managing and monitoring the execution of these initiatives. However, as a result of the significance of the changes, we could experience adverse effects on our operations. These adverse effects may include system transactional or reporting errors and delays, short-term reduced productivity, undesired personnel turnover, and loss of key customer relationships. If any of these effects were to occur, it could have a material adverse impact on our results of operations. Additionally, these changes could require us to change our internal and management control environment.

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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.

We are subject to various legal claims and litigation.

From time to time, customers, employees and others that we do business with, or are regulated by, as well as our shareholders, can make claims and take legal action against us. Regardless of whether these claims and legal actions 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. Even if these claims and legal actions do not result in a financial liability or reputational damage, defending these claims and actions have resulted in, and will continue to result in, increased legal and professional services costs, which adds to our noninterest expense and negatively impacts our operating results.

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 banks, 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 our 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.

The soundness of our financial condition may also affect our competitiveness. Customers may decide not to do business with the bank due to its financial condition.

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

Competition for qualified employees and personnel in the banking industry is intense and there is a limited number of qualified persons with knowledge of, and experience in, the regional banking industry, especially in the Hawaii market. The process of recruiting personnel with the combination of skills and attributes required to carry out our strategies is often lengthy. Our success depends to a significant degree upon our ability to attract and retain qualified management, loan origination, finance, administrative, marketing, and technical personnel, and upon the continued contributions of our management and personnel. In particular, our success has been and continues to be highly dependent upon the abilities of key executives, including our Chief Executive Officer, our Presidents who are our Chief Banking Officer and our Chief Operating Officer, our Chief Financial Officer, our Chief Risk Officer and certain other employees.

Our business could be adversely affected by unfavorable actions from rating agencies.

Ratings assigned by ratings agencies to us, our affiliates or our securities may impact the decision of certain customers, in particular, institutions, to do business with us. A rating downgrade or a negative rating could adversely affect our deposits and our business relationships.

We may suffer substantial losses due to our agreements to indemnify investors who invested in our Company in 2011 against a broad range of potential claims.

In our agreements with certain investors who provided us with capital in 2011 (the Private Placement), we agreed to indemnify the investors for a broad range of claims, including losses resulting from the inaccuracy or breach of representations or warranties made by us in such agreements and the breach by us to perform our covenants contained in such agreements. While these indemnities are subject to various limitations, if claims were successfully brought against us, it could potentially result in significant losses for the Company.

As a result of the recapitalization, Carlyle and Anchorage are substantial holders of our common stock.

Following the closing of our recapitalization in 2011, the two lead investors in the recapitalization, Carlyle Financial Services Harbor, L.P. (Carlyle) and ACMO CPF, L.L.C. (Anchorage) each became beneficial owners of our outstanding common stock. As of December 31, 2014, each of Carlyle and Anchorage owns approximately 23% of our common stock and each has the ability to designate a representative on our Board of Directors so long as each owns 10% or more of our outstanding common stock. Accordingly, Anchorage and Carlyle have influence over the election of directors to our board and over corporate policy, including decisions to enter into mergers or other extraordinary transactions. In addition, Carlyle and Anchorage each have certain preemptive rights to maintain their respective fully diluted percentage ownership of our common stock in the event of certain issuances of securities by us so long as each owns 10% or more of our outstanding common stock. In pursuing their economic interests, Anchorage and Carlyle may make decisions with respect to fundamental corporate transactions that may not be aligned with the interests of other shareholders.

Failure to maintain effective internal control over financial reporting or disclosure controls and procedures could adversely affect our ability to report our financial condition and results of operations accurately and on a timely basis.

A failure to maintain effective internal control over financial reporting or disclosure controls and procedures could adversely affect our ability to report our financial results accurately and on a timely basis, which could result in a loss of investor confidence in our financial reporting or adversely affect our access to sources of liquidity. Furthermore, because of the inherent limitations of any system of internal control over financial reporting, including the possibility of human error, the circumvention or overriding of controls and fraud, even effective internal controls may not prevent or detect all misstatements.

Risk Factors Related to Our Securities

The market price of our common stock could decline.

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

- failure to comply with all of the requirements of any governmental orders or agreements we may become subject to and the possibility of resulting action by the regulators;
- deterioration of asset quality;
- the incurrence of losses;

- actual or anticipated quarterly fluctuations in our operating results and financial condition;
- changes in revenue or earnings/losses estimates or publication of research reports and recommendations by financial analysts;
- failure to meet analysts revenue or earnings/losses estimates;
- speculation in the press or investment community;
- strategic actions by us or our competitors, such as acquisitions or restructurings;
- additions or departures of key personnel;

- actions by institutional shareholders;
- fluctuations in the stock price and operating results of our competitors;
- future sales of our common stock, including sales of our common stock in short sale transactions;
- general market conditions and, in particular, developments related to market conditions for the financial services industry;
- proposed or adopted regulatory changes or developments;
- breaches in our security systems and loss of customer data;
- anticipated or pending investigations, proceedings or litigation that involve or affect us; or
- domestic and international economic factors unrelated to our performance.

The stock market and, in particular, the market for financial institution stocks, have experienced significant volatility over the past few years. In addition, the trading volume in our common stock may fluctuate more than usual and cause significant price variations to occur. In addition, sales of shares by investors in the Private Placement may cause our share price to decrease. Accordingly, the common stock that you purchase may trade at a price lower than that at which they were purchased. Volatility in the market price of our common stock may prevent individual shareholders from being able to sell their shares when they want or at prices they find attractive.

A significant decline in our stock price could result in substantial losses for shareholders and could lead to costly and disruptive securities litigation.

The transferability of our common stock is limited as a result of the Tax Benefits Preservation Plan and the Protective Charter Amendment.

As described under Risk Factors Related to our Business Our ability to use net operating loss carryforwards to reduce future tax payments may be limited or restricted, we have generated significant NOLs as a result of our prior losses. In order to reduce the likelihood that transactions in our common stock would result in an ownership change, on November 23, 2010, we adopted a Tax Benefits Preservation Plan, which provides an economic disincentive for any person or group to become an owner, for relevant tax purposes, of 4.99% or more of our common stock. On January 29, 2014, our Board of Directors approved an extension of the Tax Benefits Preservation Plan by up to an additional two years (until February 18, 2016). To further protect our NOLs, we filed the Protective Charter Amendment on May 2, 2011 to restrict transfers of our stock if the effect of an attempted transfer would cause the transferee to become a Threshold Holder or cause the beneficial ownership of a Threshold Holder to increase. On January 29, 2014 our Board of Directors approved an amendment to the Protective Charter Amendment to extend it for up to an additional two years (until May 2, 2016). Our shareholders approved the extension of the Protective Charter Amendment on April 25, 2014.

The Tax Benefits Preservation Plan and the Protective Charter Amendment have the effect of limiting transferability of our common stock because they may make it more difficult and more expensive to acquire our common stock under the circumstances described above and, in the case of the Protective Charter Amendment, prohibit certain acquisitions of our common stock as described above. These transfer restrictions may discourage, delay or prevent a change in control of the Company and make it more difficult for a potential acquirer to consummate an acquisition of the Company. In addition, these provisions could limit the price that investors would be willing to pay in the future for our common shares and may limit a shareholder s ability to dispose of our common shares by reducing the class of potential acquirers for our common shares.

Anti-takeover provisions in our restated articles of incorporation and bylaws and applicable federal and state law may limit the ability of another party to acquire us, which could cause our stock price to decline.

Various provisions of our restated articles of incorporation and bylaws and certain other actions we have taken could delay or prevent a third-party from acquiring us, even if doing so might be beneficial to our shareholders. These include, among other things, the Tax Benefits Preservation Plan, the Protective Charter Amendment and the authorization to issue blank check preferred stock by action of the Board of Directors acting alone, thus without obtaining shareholder approval. In addition, applicable provisions of federal and state law require regulatory approval in connection with certain acquisitions of our common stock and supermajority voting provisions in connection with certain transactions. These provisions of our restated articles of incorporation and bylaws and federal and state law may prevent a merger or acquisition that would be attractive to shareholders and could limit the price investors would be willing to pay in the future for our common stock.

Resales of our common stock in the public market may cause the market price of our common stock to fall.

We issued a large number of common stock to the investors in the Private Placement. Carlyle and Anchorage (the Lead Investors) have certain registration rights with respect to the common stock held by them. The registration rights for the Lead Investors will allow them to sell their common stock without compliance with the volume and manner of sale limitations under Rule 144 promulgated under the Securities Act. The market value of our common stock could decline as a result of sales by the Lead Investors from time to time of a substantial amount of the common stock held by them.

Our common stock is equity and therefore is subordinate to our subsidiaries indebtedness and preferred stock.

Our common stock constitutes equity interests and does not constitute indebtedness. As such, common stock will rank junior to all current and future indebtedness and other non-equity claims on us with respect to assets available to satisfy claims against us, including in the event of our liquidation. We may, and the bank and our other subsidiaries may also, incur additional indebtedness from time to time and may increase our aggregate level of outstanding indebtedness. As of December 31, 2014, we had $90.0 million in face amount of trust preferred securities outstanding and accrued and unpaid dividends thereon of $0.2 million. We also had short-term borrowings of $38.0 million as of December 31, 2014. Additionally, holders of common stock are subject to the prior dividend and liquidation rights of any holders of our preferred stock that may be outstanding from time to time. The Board of Directors is authorized to cause us to issue additional classes or series of preferred stock without any action on the part of our stockholders. If we issue preferred shares in the future that have a preference over our common stock with respect to the payment of dividends or upon liquidation, or if we issue preferred shares with voting rights that dilute the voting power of the common stock, then the rights of holders of our common stock or the market price of our common stock could be adversely affected.

There is a limited trading market for our common stock and as a result, you may not be able to resell your shares at or above the price you pay for them.

Although our common stock is listed for trading on the NYSE, the volume of trading in our common shares is lower than many other companies listed on the NYSE. A public trading market with depth, liquidity and orderliness depends on the presence in the market of willing buyers and sellers of our common shares at any given time. This presence depends on the individual decisions of investors and general economic and market conditions over which we have no control.

Our common stock is not insured and you could lose the value of your entire investment.

An investment in our common stock is not a deposit and is not insured against loss by the government.

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, 2014. Last year, we submitted to the NYSE on April 25, 2014 our annual CEO certification regarding the Company s compliance with the NYSE s corporate governance listing standards. 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 April 24, 2015.

ITEM 2. PROPERTIES

We hold title to the land and building in which our Main branch office and headquarters, Hilo branch office, Kailua-Kona branch office, Pearl City branch office and certain operations offices are located. We also hold title to portions of the land our University branch office and operations center are located. The remaining lands on which the University branch office and operations center are located are leased, as are all remaining branch and support office facilities. 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 40 other properties including office space for our remaining branches. 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 as of December 31, 2014, see Note 18 to the Consolidated Financial Statements under Part II, Item 8. Financial Statements and Supplementary Data.

ITEM 3. LEGAL PROCEEDINGS

Certain claims and lawsuits have been filed or are pending against us arising in the ordinary course of business. In the opinion of management, all such matters 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. MINE SAFETY DISCLOSURES

Not applicable

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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 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, 2009 and ending December 31, 2014. The graph assumes the investment of $100 on December 31, 2009.

Indexed Total Annual Return

(as of December 31, 2014)

December 31,

Index	2009	2010	2011	2012	2013	2014
Central Pacific Financial Corp.	$ 100.00	$ 116.79	$ 49.31	$ 59.50	$ 77.31	$ 84.38
Russell 2000	100.00	126.86	121.56	141.43	196.34	205.95
S&P 600 Commercial Bank Index	100.00	118.20	118.83	136.60	207.10	214.19

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 2014 and 2013:

	Year Ended December 31,			
	2014		2013	
	High	Low	High	Low
First quarter	$ 20.52	$ 17.76	$ 16.65	$ 15.20
Second quarter	20.75	17.64	18.84	14.71
Third quarter	20.38	17.12	19.21	16.75
Fourth quarter	21.61	17.51	20.26	17.14

As of February 13, 2015, there were 2,649 shareholders of record, excluding individuals and institutions for which shares were held in the names of nominees and brokerage firms.

Dividends

The following table sets forth information on dividends declared per share of common stock for each quarterly period within 2014 and 2013:

	Year Ended December 31,	
	2014	2013
First quarter	$ 0.08	$
Second quarter	0.08	
Third quarter	0.10	0.08
Fourth quarter	0.10	0.08

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.

Under the terms of our trust preferred securities, our ability to pay dividends with respect to common stock was restricted until our obligations under our trust preferred securities were brought current. Our obligations on our outstanding trust preferred securities were brought current in the first quarter of 2013.

Additionally, our ability to pay dividends depends on our ability to obtain dividends from our bank. As a Hawaii state-chartered bank, the bank may only pay dividends to the extent it has retained earnings as defined under Hawaii banking law (Statutory Retained Earnings), which differs from GAAP retained earnings. As of December 31, 2014, the bank had Statutory Retained Earnings of $123.8 million. In 2013, in light of the Company s improved capital position and financial condition, our Board of Directors in consultation with our regulators, reinstated and declared quarterly cash dividends on the Company s outstanding common shares.

Dividends are payable at the discretion of the Board of Directors and there can be no assurance that the Board of Directors will continue to pay dividends at the same rate, or at all, in the future. Our ability to pay cash dividends to our shareholders is subject to restrictions under federal and Hawaii law, including restrictions imposed by the FRB and covenants set forth in various agreements we are a party to, including covenants set forth in our subordinated debentures.

See Part I, Item 1. Business Supervision and Regulation Regulatory Actions for a discussion on regulatory restrictions. For additional information regarding our previous election to defer payments on our trust preferred securities, see Note 14 to the Consolidated Financial Statements under Part II, Item 8. Financial Statements and Supplementary Data.

Recent Sales of Unregistered Securities

During the second quarter of 2014, we discovered that common stock that was not registered with the SEC was sold to certain participants, through their investment in our unitized common stock fund, in the Central Pacific Bank 401(k) Retirement Savings Plan (the Plan). Under terms of the Plan, participants may invest Plan contributions for an interest in the common stock fund which is primarily comprised of shares of our common stock, and to a lesser extent, cash. The unregistered shares of our common stock held in the common stock fund are purchased by our Plan trustee from the open market; hence, these purchases do not represent any additional equity dilution of our outstanding shares. We do not receive any proceeds from these transactions.

Under applicable federal securities laws, certain participants may have a right to rescind, and to require us to repurchase, their purchases of our common stock (through their investment in the common stock fund) for an amount equal to the price paid for the securities, plus interest. Generally, the federal statute of limitations applicable to such rescission rights is one year. Additionally, we may be subject to potential civil and other penalties by regulatory authorities as a result of this registration issue.

Based on our estimates, we do not believe the amount of potential liability associated with the securities subject to rescission rights is material to our financial condition or results of operations. As of December 31, 2014, we estimate that there were 2,383 shares of our common stock in the Plan that were purchased within a one-year period would potentially be subject to rescission rights. These securities continue to be reflected in stockholders equity in our balance sheet.

On June 18, 2014, we filed a new registration statement on Form S-8 to register 250,000 shares for future sales of our common stock through our common stock fund under the Plan.

Issuer Purchases of Equity Securities

In January 2008, our Board of Directors authorized the repurchase and retirement of up to 60,000 shares of the Company s common stock (the 2008 Repurchase Plan). Repurchases under the 2008 Repurchase Plan may be made from time to time on the open market or in privately negotiated transactions. A total of 55,000 shares remained available for repurchase under the 2008 Repurchase Plan at December 31, 2013. In January 2014, the 2008 Repurchase Plan and the remaining 55,000 shares were superseded by the Tender Offer and Repurchase Agreements with our Lead Investors.

On May 20, 2014, our Board of Directors authorized the repurchase and retirement of up to $30.0 million of the Company s outstanding common stock (the 2014 Repurchase Plan). Repurchases under the 2014 Repurchase Plan may be made from time to time on the open market or in privately negotiated transactions.

In 2014, 857,554 shares of common stock, at a cost of $16.5 million, were repurchased. A total of $13.5 million remained available for repurchased under the 2014 Repurchase Plan at December 31, 2014. The table below sets forth certain information concerning repurchases of our securities during the fourth quarter of 2014.

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Period	Total Number of Shares Purchased		Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Programs	Maximum Number of Shares that May Yet Be Purchased Under the Program		Dollar Value of Shares Purchased as Part of Publicly Announced Programs		Maximum Dollar Value of Shares that May Yet Be Purchased Under the Program
				Issuer Purchases of Equity Securities					
October 1-31		$				$		$	26,588,374
November 1-30	261,354		19.14				5,003,522		21,584,852
December 1-31	415,000		19.37				8,036,901		13,547,951
Total	676,354	$	19.28			$	13,040,423	$	13,547,951

In January 2015, our Board of Directors increased the authorization under the share repurchase program by an additional $25.0 million.

Information relating to compensation plans under which equity securities of the Registrant are authorized for issuance is set forth under Part III, Item 12 Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

The following table sets forth selected financial information for each of the years in the five-year period ended December 31, 2014. This information is not necessarily indicative of results of future operations and should be read in conjunction with Part II, Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations and the Consolidated Financial Statements and related Notes contained in Part II, Item 8. Financial Statements and Supplementary Data.

Selected Financial Data	2014	2013	2012	2011	2010
	Year Ended December 31, (Dollars in thousands, except per share data)				
Statement of Operation Data:					
Total interest income	$ 149,809	$ 140,278	$ 128,445	$ 136,450	$ 160,754
Total interest expense	6,391	7,169	8,734	18,629	42,101
Net interest income	143,418	133,109	119,711	117,821	118,653
Provision (credit) for loan and lease losses	(6,414)	(11,310)	(18,885)	(40,690)	159,548
Net interest income (loss) after provision for loan and lease losses	149,832	144,419	138,596	158,511	(40,895)
Other operating income	43,823	54,945	60,743	57,002	57,700
Goodwill impairment					102,689
Other operating expense (excluding goodwill impairment)	132,813	139,536	151,918	178,942	165,069
Income (loss) before income taxes	60,842	59,828	47,421	36,571	(250,953)
Income tax expense (benefit)	20,389	(112,247)			
Net income (loss)	40,453	172,075	47,421	36,571	(250,953)
Balance Sheet Data (Year-End):					
Interest-bearing deposits in other banks	$ 13,691	$ 4,256	$ 120,902	$ 180,839	$ 729,014
Investment securities (1)	1,467,305	1,660,046	1,698,593	1,493,925	705,345
Loans and leases	2,932,198	2,630,601	2,203,944	2,064,447	2,169,444
Allowance for loan and lease losses	74,040	83,820	96,413	122,093	192,854
Goodwill					
Other intangible assets	29,697	32,783	37,499	41,986	44,639
Total assets	4,852,987	4,741,198	4,370,368	4,132,865	3,938,051
Core deposits (2)	3,306,133	3,093,279	3,006,657	2,786,215	2,796,144
Total deposits	4,110,300	3,936,173	3,680,772	3,443,528	3,132,947
Long-term debt	92,785	92,799	108,281	158,298	459,803
Total shareholders equity	568,041	660,113	504,822	456,440	66,052
Per Share Data (3):					
Basic earnings (loss) per share	$ 1.08	$ 4.10	$ 1.14	$ 3.36	$ (171.13)
Diluted earnings (loss) per share	1.07	4.07	1.13	3.31	(171.13)
Cash dividends declared	0.36	0.16			
Book value	16.12	15.68	12.06	10.93	(42.18)
Diluted weighted average shares outstanding (in thousands)	37,937	42,317	42,084	36,342	1,516
Financial Ratios:					
Return (loss) on average assets	0.85%	3.73%	1.13%	0.90%	(5.74)%
Return (loss) on average shareholders equity	6.80	27.70	9.81	9.83	(140.73)
Net income (loss) to average tangible shareholders equity	6.93	28.34	10.17	10.41	(193.24)
Average shareholders equity to average assets	12.50	13.47	11.49	9.17	4.08
Efficiency ratio (4)	70.93	74.20	84.19	102.36	151.83
Net interest margin (5)	3.32	3.19	3.10	3.09	2.91
Net loan charge-offs to average loans and leases	0.12	0.05	0.32	1.42	6.33
Nonaccrual loans to total loans and leases (6)	1.33	1.58	3.60	6.49	11.31
Allowance for loan and lease losses to total loans and leases	2.53	3.19	4.37	5.91	8.89
Allowance for loan and lease losses to nonaccrual loans (6)	189.42	201.55	121.53	91.17	78.62
Dividend payout ratio	33.64	3.93	N/A	N/A	N/A

(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) On February 2, 2011, we effected a 1 for 20 reverse stock split on our outstanding common stock.

(4) The efficiency ratio is a non-GAAP financial measure which should be read and used in conjunction with the Company s GAAP financial information. Comparison of our efficiency ratio with those of other companies may not be possible because other companies may calculate the efficiency ratio differently. Our efficiency ratio is derived by dividing other operating expense by net operating revenue (net interest income plus other operating income). See Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations Table 7. Reconciliation to Efficiency Ratio.

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

(6) Nonaccrual loans include nonaccrual loans held for sale.

Five Year Performance Comparison

The significant items affecting the comparability of the five years performance include:

Provision for loan and lease losses

- Credit to the provision for loan and lease losses of $6.4 million, $11.3 million, $18.9 million and $40.7 million in 2014, 2013, 2012 and 2011, respectively, compared to a charge of $159.5 million in 2010.

Other operating income

- Net gains on sales of residential mortgage loans of $5.5 million, $10.0 million, $17.1 million, $8.1 million and $8.5 million in 2014, 2013, 2012, 2011 and 2010, respectively;

- Net gains on sales of foreclosed assets of $1.0 million, $8.6 million, $5.0 million, $6.8 million and $0.7 million in 2014, 2013, 2012, 2011 and 2010, respectively;

- Gain on early extinguishment of debt of $1.0 million in 2013, compared to a loss on early extinguishment of debt of $6.2 million and $5.7 million in 2011 and 2010, respectively; and

- Gain on ineffective portion of derivative of $0.1 million and $1.0 million in 2013 and 2011, respectively, compared to a loss on ineffective portion of derivative of $0.1 million in 2012.

Other operating expense

- Share-based compensation expense of $6.1 million, $6.4 million, $4.6 million, $2.6 million and $0.4 million recognized in 2014, 2013, 2012, 2011 and 2010, respectively;

- FDIC insurance premiums of $2.8 million, $2.7 million, $4.9 million, $6.8 million and $12.6 million in 2014, 2013, 2012, 2011 and 2010, respectively;

- Foreclosed asset expense of $1.7 million, $1.0 million, $6.9 million, $11.4 million and $9.6 million in 2014, 2013, 2012, 2011 and 2010, respectively;

- Severance, early retirement, and retention benefits of $0.9 million and $3.0 million in 2014 and 2013, respectively;

- Branch consolidation and relocation costs of $1.3 million in 2014;

- Charge for the provision for repurchased residential mortgage loans of $0.5 million, $5.0 million and $6.1 million in 2014, 2011 and 2010, respectively, compared to a credit to the provision for repurchased residential mortgage loans of $0.1 million and $2.0 million in 2013 and 2012, respectively;

- Credit to the reserve for unfunded loan commitments of $0.4 million, $3.5 million, $1.7 million, and $1.1 million in 2014, 2013, 2012 and 2010, respectively, compared to a charge of $1.6 million in 2011;

- Contributions to the Central Pacific Bank Foundation of $0.7 million, $0.8 million and $8.5 million in 2013, 2012, and 2011, respectively;

- Write down of assets of $2.6 million, $4.6 million and $1.5 million in 2012, 2011 and 2010, respectively;

- Goodwill impairment charge of $102.7 million in 2010; and

- Gain on sale of property of $7.7 million in 2010.

Income tax expense (benefit)

- Income tax expense of $20.4 million in 2014, compared to income tax benefit of $112.2 million in 2013. We did not record income tax expense in 2012, 2011 and 2010.

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.

Our products and services consist primarily of the following:

- *Loans*: Our loans consist of commercial, commercial mortgage, construction loans, and leases to small and medium-sized companies, business professionals, and real estate developers, as well and residential mortgage and consumer loans to local homebuyers and individuals. 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 Value Plus Checking, as well as our Exceptional Checking & Savings and Super Savings accounts. We also maintain a broad branch and ATM network in the state of Hawaii. 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 Part 1. Forward-Looking Statements and Factors that Could Affect Future Results and Part I, Item 1A. Risk Factors Factors that May Affect our Business.

Executive Overview

We continued to make significant progress toward a full recovery of our Company in 2014. After three years of net losses in 2008 to 2010, we recorded our fourth consecutive profitable year in 2014. During fiscal 2014, we reported net income of $40.5 million, compared to net income of $172.1 million and $47.4 million in fiscal 2013 and 2012, respectively. Net income in 2013 included a non-cash income tax benefit of $119.8

million recorded in the first quarter of 2013 related to the reversal of a significant portion of a valuation allowance that was established against the Company s net DTA during the third quarter of 2009. We also saw continued improvement in our asset quality as we reduced our nonperforming assets by $4.8 million to $42.0 million at December 31, 2014 from $46.8 million at December 31, 2013.

As a result of the continued improvement in our credit risk profile, we were able to reduce our allowance for loan and lease losses (the Allowance), which resulted in a positive impact to earnings. Our total credit costs during fiscal 2014, which include the provision for loan and lease losses (the Provision), write-downs of loans classified as held for sale, foreclosed asset expense, gains on sales of foreclosed assets, and the change in the reserve for unfunded loan commitments, totaled a credit of $6.0 million, compared to a credit of $22.4 million in 2013.

With the improving market conditions in Hawaii, together with our efforts to increase market share, we realized strong loan growth of $301.6 million, or 11.5%, as well as an increase of $212.9 million, or 6.9% in our core deposit base in 2014. Our capital position remained strong, supported by four years of profitability and the improvements in our asset quality. As a result of our stable financial performance, all three of the regulatory enforcement actions the bank and CPF were previously subject to have been terminated.

Basis of Presentation

Management s discussion and analysis of financial condition and results of operations should be read in conjunction with the accompanying consolidated financial statements under Part II, Item 8. Financial Statements and Supplementary Data.

Business Environment

While there remains continued uncertainty in the global macroeconomic environment, the U.S. economy has continued to stabilize following the economic downturn caused by disruptions in the financial system beginning in 2007.

Despite this stabilization, underutilization of labor forces, a slow recovery in the housing sector, low level of inflation as a result of declining commodity prices and weak global trade have added to the uncertainty surrounding a sustained economic recovery. In addition, downgrades of ratings of foreign debt instruments could raise borrowing costs and adversely impact the mortgage and housing markets.

The majority of our operations are concentrated in the state of Hawaii. As a result, our performance is significantly influenced by conditions in the banking industry, macroeconomic conditions and the real estate markets in Hawaii. A favorable business environment is generally characterized by expanding gross state product, low unemployment and rising personal income; while an unfavorable business environment is characterized by the reverse.

Hawaii s general economic conditions continued to improve in 2014. Tourism continues to be Hawaii s center of strength and its most significant economic driver. Hawaii s strong visitor industry broke records for arrivals and visitor spending for the third consecutive year in 2014. According to the Hawaii Tourism Authority (HTA), 8.3 million total visitors arrived in the state in 2014. This was an increase of 1.3% from the previous high of 8.2 million visitor arrivals in 2013. The HTA also reported that total spending by visitors increased to $14.7 billion in 2014, an increase of $334.5 million, or 2.3%, from the previous high of $14.4 billion in 2013. According to the Hawaii Department of Business Economic Development & Tourism (DBEDT), total visitor arrivals and visitor spending are expected to gain 1.9% and 3.6% in 2015, respectively.

Hawaii s labor market conditions continued to improve in 2014. The Department of Labor and Industrial Relations reported that Hawaii s seasonally adjusted annual unemployment rate improved to 4.0% in December 2014, compared to 4.7% in December 2013. In addition, Hawaii s unemployment rate in December 2014 of 4.0%, which is among the lowest in the nation, remained below the national seasonally adjusted unemployment rate of 5.6%. DBEDT projects Hawaii s seasonally adjusted annual unemployment rate to remain stable at 4.1% in 2015.

Both real personal income and real gross state product grew by approximately 2.6% in 2014. DBEDT projects real personal income and real gross state product to grow by 2.5% and 2.8%, respectively, in 2015. Based on the recent developments in the national and global economy, the performance of Hawaii s tourism industry, the labor market conditions in the state, and growth of personal income and tax revenues, DBEDT expects Hawaii s economy will continue positive growth in 2015.

Historically, real estate lending has been a primary focus for us, including residential mortgage, commercial mortgage and construction loans. As a result, we are dependent on the strength of Hawaii s real estate market. Home sales in Hawaii and all around the country slowed in 2014. According to the Honolulu Board of Realtors, Oahu unit sales volume decreased by 0.8% for single-family homes and decreased 1.3% for condominiums in 2014 from 2013, due primarily to low inventory of properties on the market. Real estate prices on Oahu, however, continued its moderate appreciation and set new records in 2014. The median resale price in 2014 for single-family homes on Oahu was $675,000, representing an increase of 3.8% from the median resale price of $650,000 in 2013. The median resale price for condominiums on Oahu was $350,000, representing an increase of 5.4% from the median resale price of $332,000 in 2013. We believe the Hawaii real estate market will show improvements in 2015, however, there can be no assurance that this will occur.

As we have seen in the past, our operating results are significantly impacted by: (i) the economy in Hawaii, and to a significantly lesser extent, California, and (ii) the composition of our loan portfolio. Loan demand, deposit growth, Provision, asset quality, noninterest income and noninterest expense are all affected by changes in economic conditions. If the residential and commercial real estate markets we have exposure to deteriorate as they did in 2008 through 2010, our results of operations would be negatively impacted. See Overview of Results of Operations Concentrations of Credit Risk for a further discussion on how a deteriorating real estate market, combined with the elevated concentration risk within our portfolio, could have a significant negative impact on our asset quality and credit losses.

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

Allowance for Loan and Lease Losses

The Allowance is management s estimate of credit losses inherent in our loan and lease portfolio at the balance sheet date. We maintain our Allowance at an amount we expect to be sufficient to absorb probable losses inherent in our loan and lease portfolio. At December 31, 2014, we had an Allowance of $74.0 million, compared to $83.8 million at December 31, 2013.

The Company s approach to developing the Allowance has three basic elements. These elements include specific reserves for individually impaired loans, a general allowance for loans other than those analyzed as individually impaired, and an unallocated reserve. These three methods are explained below.

Specific Reserve

Individually impaired loans in all loan categories are evaluated using one of three valuation methods as prescribed under Accounting Standards Codification (ASC) 310-10, *Fair Value of Collateral, Observable Market Price, or Cash Flow*. A loan is generally evaluated for impairment on an individual basis if it meets one or more of the following characteristics: risk-rated as substandard, doubtful or loss, loans on nonaccrual status, troubled debt restructures, or any loan deemed prudent by management to so analyze. If the valuation of the impaired loan is less than the recorded investment in the loan, the deficiency will be charged off against the Allowance or, alternatively, a specific reserve will be established and included in the overall Allowance balance. As of December 31, 2014, this specific reserve represented $1.5 million of the total Allowance, compared to $0.3 million at December 31, 2013.

General Allowance

In determining the general allowance component of the Allowance, the Company utilizes a comprehensive approach to segment the loan portfolio into homogenous groups. Six criteria divide the Company s loan portfolio into 128 homogenous subsectors. First, loans are divided by general geographic region (U.S. Mainland and Hawaii). Second, loans are subdivided according to FDIC classification (Construction, Commercial Mortgage, Commercial, Financial and Agricultural, Leases, Residential Mortgage, Consumer). Third, loans within the Construction category are further subdivided by collateral type (Commercial and Residential). Fourth, loans within the Residential Mortgage category are further subdivided by ownership type (Investor-owned and Owner-occupied). Fifth, loans are subdivided by state or for some, by county (All Hawaii, Hawaii Island, Kauai, Maui, Oahu, Other Hawaii, All U.S. Mainland, Los Angeles/Orange County CA, Riverside/San Bernardino CA, Sacramento/Placer/El Dorado/Yolo CA, San Diego CA, Washington/Oregon, Other U.S. Mainland). Finally, loans are further subdivided by risk rating (Pass, Special Mention, Substandard, and Doubtful).

For the purpose of determining general allowance loss factors, loss experience is derived from charge-offs and recoveries. A charge-off occurs when the Company makes the determination that an amount of debt is deemed to be uncollectible. Loans are also charged off when it is probable that a loss has been incurred and it is possible to make a reasonable estimate of the loss. Charge-offs are classified into subsectors according to the underlying loan s primary geography, loan category, collateral type (if applicable), investment type (if applicable), state/county, and the risk rating of the loan one year prior to the charge-off. A recovery occurs when a loan that is classified as a bad debt was either partially or fully charged off and has been subsequently recovered. Recoveries are classified according to the subsector of the earliest associated charge-off of the loan within a selected look-back period. The cumulative charge-offs are determined by summing all subsector-specific charge-offs that occurred within the selected look-back period and the cumulative recoveries are determined by summing the subsector-specific recoveries for each subsector. Subsector losses are measured by subtracting each subsector s cumulative recoveries from their respective cumulative charge-offs. Subsector losses are then divided by the subsector loan balance averaged over the look-back period to determine each subsector s historical loss rate.

From 2010 through 2013, the calculation of subsector loss factors involved a look-back period of eight quarters (for loans secured by real estate by FDIC classifications) or four quarters (for all other loans). The Company s then rapidly evolving loss experience necessitated the use of shorter loss analysis periods in order to ensure that loss rates would be adequately responsive to changes in loss experience. During that period, the Company considered recent loss data to be more relevant to the current period under analysis. The look-back period was also consistent with commentary provided by our primary banking regulator following our 2010 Safety and Soundness Examination.

As economic conditions continued to improve and stabilize through 2014, the Company experienced improving credit quality trends that contributed to consistent reductions to the Allowance. Given the diminishing loss rates, in the first quarter of 2014 the look-back period for loans secured by real estate was extended from 8 quarters to 17 quarters, with the intention of extending the look-back period each quarter thereafter to a total of 24 quarters or six years to incorporate broader loss experience through a more complete economic cycle. This would also reduce the Company s reliance on proxy loss rates by capturing more of the Company s own historical loss experience in the extended look-back period. The longer look-back period is appropriate in light of the Company s limited loss experience throughout the recent economic recovery and stabilization. Additionally, as economic conditions have stabilized through 2014, lower loss rate volatility has diminished the need for shorter loss analysis periods that are more responsive to shifts in loss experience. The enhanced methodology does not incorporate data before 2010 due to the anomalous loss activity during that time period that may cause pre-2010 internal loss data to be an inappropriate representation of the current inherent risk in the Company s loan portfolio. In our revised approach, the losses during the six year look-back period will be weighted to place more emphasis on recent loss experience. Also in late 2013, the Company received guidance from its primary banking regulator supporting the use of extended loss analysis periods. The Supervisory Examiner recommended a periodic reassessment of the look-back period and suggested that a look-back period beyond eight quarters may be more reasonable given the then current economic conditions and portfolio performance.

Application of Proxies

The Company applies external proxies for minimum loss rates in those loan categories with no associated loss experience during the prescribed look-back period, including criticized credits. The Company believes the use of external proxies is a prudent approach versus using a zero loss factor for those loan categories that do not have loss experience in the look-back period. The external proxies used are based on four select credit loss rates tracked by Moody s Investor Service.

The following table describes the Moody s loss rate that is applied as a proxy to each loan category when no associated loss experience is registered in a subsector of the loan category over the relevant look-back period.

Loan Segment	**Proxy- Moody s Loss Rate**
Commercial, Financial and Agricultural	Maximum of Last 5 Yrs Annual Corporate Bond Loss Rate
Construction	Cumulative 2-Yr U.S. CMBS Loss Rate
Commercial Mortgage	Cumulative 2-Yr U.S. CMBS Loss Rate
Residential Mortgage	Cumulative 2-Yr U.S. RMBS/HEL Loss Rate
Consumer	1-Yr U.S. ABS excl. HEL Loss Rate
Leases	Maximum of Last 5 Yrs Annual Corporate Bond Loss Rate

In those loan categories described in the table above, specific loss rate proxies are applied based on the equivalence of respective risk ratings between the proxy rate and the loan subsector. Based on the conformity of risk characterizations, B-rated proxy rates are matched to substandard loan segments (risk rating 6), Ba-rated proxy rates are matched to special mention loan segments (risk rating 5), and Aaa, Aa, A and Baa-rated proxy rates are matched to risk ratings strong quality, above average quality, average quality, and acceptable quality, respectively (risk ratings 1, 2, 3 and 4).

For pass rated loan segments with no associated loss experience during the respective prescribed look-back periods, the proxy loss rate is determined by weighting each proxy loss rate (ratings Aaa, Aa, A and Baa) by the loan balance in each equivalent risk rating (strong, above average, average and acceptable quality, respectively).

In assessing the appropriateness of Moody s proxy rates, the Company conducted a comprehensive review of other potential sources of proxy loss data, evaluated the qualitative and quantitative factors influencing the relevance and reliability of proxy data, and performed a correlation analysis to determine the co-dependency of historical loss ratios with Moody s loss rates. The analysis compared historical loss ratios in each loan category to the associated Moody s loss rates over ten years.

An analysis of the correlation between historical loss ratios and Moody s loss rates revealed that the two metrics demonstrated a directionally consistent loss relationship in nearly every rating group and exhibited average to strong correlation across all rating groups in almost every segment. Given the results of the correlation analysis, the Company deemed application of these proxy loss rates to be reasonable and supportable.

Qualitative Adjustments

Our Allowance methodology uses qualitative adjustments for economic/market conditions and Company-specific conditions. The Company-specific condition factor is applied on a category basis and the economic/market conditions factor is applied on a regional/geographic basis. Two key indicators, personal income and unemployment, comprise the economic/market adjustment factor.

Personal income is analyzed by comparing average quarter-to-quarter percentage change trends reported by the U.S. Bureau of Economic Analysis. Specifically, the rolling four quarter average percentage change in personal income is calculated and compared to a baseline historical factor, calculated as the average quarter-to-quarter percentage change over the prior ten years. The difference between the current average change and the historical average change is utilized as the personal income component of the economic/market adjustment factor.

The second component of the economic/market factor, unemployment, is derived by comparing the current quarter unemployment rate, reported by the U.S. Bureau of Labor Statistics, to its ten year historical average. A constant scaling factor is applied to the difference between the current rate and the historical average in order to smooth significant period-to-period fluctuations. The result is utilized as the unemployment component of the economic factor. The personal income factor and unemployment factor are added together to determine each region s total economic/market adjustment factor.

The general allowance also incorporates qualitative adjustment factors that capture company-specific conditions for which national/regional statistics are not available, or for which significant localized market specific events have not yet been captured within regional statistics or the Company s historical loss experience. Since we cannot predict with certainty the amount of loan and lease charge-offs that will be incurred and because the eventual level of loan and lease charge-offs are impacted by numerous conditions beyond our control, we use our historical loss experience adjusted for current conditions to determine both our Allowance and Provision. In addition, various regulatory agencies, as an integral part of their examination processes, periodically review our Allowance. The determination of the Allowance requires us to make estimates of losses that are highly uncertain and involves a high degree of judgment. Accordingly, actual results could differ from those estimates. Changes in the estimate of the Allowance and related Provision could materially affect our operating results.

The sum of each subsector s historical loss rate plus a region-specific economic/market qualitative adjustment and category-specific other qualitative adjustment, as discussed in the above *Application of Proxies* section, is then multiplied by the subsector s period-ending loan balance to determine each subsector s general allowance provision. The sum of the 128 subsector general allowance provisions represents the general allowance provision of the entire portfolio. As of December 31, 2014, this general allowance represented $68.5 million of the total Allowance, compared to $77.5 million at December 31, 2013.

Unallocated Reserve

The Company maintains an unallocated Allowance amount to provide for other credit losses inherent in our loan and lease portfolio that may not have been contemplated in the credit loss factors. The unallocated reserve is a measure to address judgmental estimates that are inevitably imprecise and it reflects an adjustment to the Allowance that is not attributable to specific categories of the loan portfolio. The unallocated reserve is distinct from and not captured in the Company s qualitative adjustments in the general component of the Allowance. These qualitative adjustments only capture direct and specific risks to our portfolio, whereas the unallocated reserve is intended to capture broader national and global economic risks that could potentially have a ripple effect on our loan portfolio.

As of December 31, 2014 and 2013, an unallocated estimate of $4.0 million and $6.0 million, respectively, was based on the Company s recognition of domestic (U.S. mainland) and international events that pose heightened volatility in the isolated Hawaiian market. Examples of such stressors are acts of terrorism, pandemic events, energy price volatility and Federal budget changes. Any of these in isolation or combination could have significant effects on the two key drivers of the Hawaiian economy: tourism and Federal spending.

Although the Company does not have direct exposure to the economic and political crises occurring internationally, the ripple effect of continuous uncertainty surrounding ultimate resolution, along with quantifiable measures once achieved, may result in increased risk to the Company from the standpoint of consequences to its customer base and impacts on the Hawaii tourism market.

In the second quarter of 2014, the Company adopted an enhancement which limits the unallocated component of the Allowance as a percentage of the then current general component of the Allowance, rounded upward to the nearest $500,000. This is derived by taking the historical average of the percentage of the unallocated component to the general component over the maximum look-back period prescribed in our methodology. The unallocated amount may be maintained at higher levels during times of economic stress conditions on a local or global basis.

Reserve for Unfunded Loan Commitments

Our process for determining the reserve for unfunded loan commitments is consistent with our process for determining the Allowance and is adjusted for estimated loan funding probabilities. The reserve for unfunded loan commitments is 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. As of December 31, 2014 and December 31, 2013, our reserve for unfunded loan commitments totaled $1.7 million and $2.1 million, respectively.

Loans Held for Sale

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

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

The fair value of loans classified as held for sale are generally based upon quoted prices for similar assets in active markets, acceptance of firm offer letters with agreed upon purchase prices, discounted cash flow models that take into account market observable assumptions, or independent appraisals of the underlying collateral securing the loans. We report the fair values of the non-residential mortgage loans classified as held for sale net of applicable selling costs on our consolidated balance sheets. At December 31, 2014 and 2013, all of our loans held for sale were Hawaii residential mortgage loans.

Reserve for Residential Mortgage Loan Repurchase Losses

We sell residential mortgage loans on a whole-loan basis to government-sponsored entities (GSEs or Agencies) Fannie Mae and Freddie Mac and also to non-agency investors. These loan sales occur under industry standard contractual provisions that include various representations and warranties, which typically cover ownership of the loan, compliance with loan criteria set forth in the applicable agreement, validity of the lien securing the loan and other similar matters. We may be required to repurchase certain loans sold with identified defects, indemnify the investor, or reimburse the investor for any credit losses incurred. We establish mortgage repurchase reserves related to various representations and warranties that reflect management s estimate for which we have a repurchase obligationThe reserves are established by a charge to other operating expense in our consolidated statements of income. At December 31, 2014 and 2013, this reserve totaled $2.7 million and $2.9 million, respectively, and is included in other liabilities on our consolidated balance sheets.

The repurchase reserve is applicable to loans we originated and sold with representations and warranties, which is representative of the entire sold portfolio. Originations for agency and non-agency investors for vintages 2005 through 2014 were approximately $4.6 billion and $4.2 billion, respectively. Representations and warranties relating to borrower fraud generally are enforceable for the life of the loan, whereas early payment default clauses generally expire after 90 days, depending on the sales contract. We estimate that outstanding loans sold that have early payment default clauses as of December 31, 2014 total approximately $65.3 million.

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

Loans repurchased during the year ended December 31, 2014 totaled approximately $1.2 million. In 2012, additional reserves were established as an unallocated component in recognition of the emergence of make-whole demands. The establishment of an unallocated component considers anticipated future losses and our lack of historical experience with the make-whole demands. Repurchase activity by vintage and investor type are depicted in Table 1 below.

Table 1. Repurchase Demands, Appeals, Repurchased and Pending Resolution

	Government Sponsored Entities				Non-GSE Investors			
Vintage	**Repurchase Demands**	**Appeals Granted**	**Repurchased**	**Pending Resolution**	**Repurchase Demands**	**Appeals Granted**	**Repurchased**	**Pending Resolution**
Year ended December 31, 2014 [1]								
2005 and prior	2		2		2		1	1
2006	1		1		2	1		1
2007					1		1	
2008	5	3	2					
2009	1			1	1		1	
2010								
2011								
2012								
2013	1	1						
2014					1	1		
Total	10	4	5	1	7	2	3	2
Year ended December 31, 2013 [2]								
2005 and prior	2	1		1				
2006	3	2		1				
2007	6	1	5					
2008	15	6	6	3				
2009	2	1	1					
2010	1	1						
2011	5	5						
2012	3	2	1		2		1	1
2013								
Total	37	19	13	5	2		1	1

[1] Based on repurchase requests received between January 1, 2014 and December 31, 2014.

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

The reserve for residential mortgage loan repurchase losses of $2.7 million at December 31, 2014 represents our best estimate of the probable loss that we may incur due to the representations and warranties in our loan sales contracts with investors. This represents a decrease of $0.3 million from December 31, 2013. The table below shows changes in the repurchase losses liability.

Table 2. Changes in the Reserve for Residential Mortgage Loan Repurchase Losses

	Year Ended December 31, 2014		2013	
	(Dollars in thousands)			
Balance, beginning of period	$	2,949	$	3,552
Change in estimate		467		(130)
Utilizations		(731)		(473)
Balance, end of period	$	2,685	$	2,949

Our capacity to estimate repurchase losses is improving as we record additional experience. Repurchase losses depend upon economic factors and other external conditions that may change over the life of the underlying loans. Additionally, lack of access to the servicing records of loans sold on a service released basis adds difficulty to the estimation process, thus requiring considerable management judgment. To the extent that future investor repurchase demand and appeals success differ from past experience, we could have increased demands and increased loss severities on repurchases, causing future additions to the repurchase reserve.

Other Intangible Assets

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

Our core deposit premium is being amortized over 14 years which approximates the estimated life of the purchased deposits. The carrying value of our core deposit premium is periodically evaluated to estimate the remaining periods of benefit. If these periods of benefit are determined to be less than the remaining amortizable life, an adjustment to reflect such shorter life will be made.

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

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

The fair value of our mortgage servicing rights is validated by first ensuring the completeness and accuracy of the loan data used in the valuation analysis. Reconciliation is performed by comparing the loan data from our loan system to a valuation report prepared by a third party. Additionally, the critical assumptions which come from the third party are reviewed by management. This review may include comparing actual assumptions to forecast or evaluating the reasonableness of market assumptions by reviewing them in relation to the values and trends of assumptions used by peer banks. The validation process also includes reviewing key metrics such as the fair value as a percentage of the total unpaid principal balance of the mortgages serviced, and the resulting percentage as a multiple of the net servicing fee. These key metrics are tracked to ensure the trends are reasonable, and are periodically compared to peer banks.

Prepayment speeds may be affected by economic factors such as home price appreciation, market interest rates, the availability of other credit products to our borrowers and customer payment patterns. Prepayment speeds include the impact of all borrower prepayments, including full payoffs, additional principal payments and the impact of loans paid off due to foreclosure liquidations. As market interest rates decline, prepayment speeds will generally increase as customers refinance existing mortgages under more favorable interest rate terms. As prepayment speeds increase, anticipated cash flows will generally decline resulting in a potential reduction, or impairment, to the fair value of the capitalized mortgage servicing rights. Alternatively, an increase in market interest rates may cause a decrease in prepayment speeds and therefore an increase in fair value of mortgage servicing rights.

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

During the second quarter of 2012, we evaluated the recoverability of the intangible assets on our customer relationships and non-compete agreements related to the acquisition of Pacific Islands Financial Management. Upon completion of this review, we determined that the intangible assets related to our customer relationships and non-compete agreements were both fully impaired, and thus, we recorded impairment charges to other operating expense totaling $0.9 million during the second quarter of 2012.

Deferred Tax Assets and Tax Contingencies

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

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

Defined Benefit Retirement Plan

Defined benefit plan obligations and related assets of our defined benefit retirement plan are presented in Note 16 to the Consolidated Financial Statements under Part II, Item 8. Financial Statements and Supplementary Data. 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, 2014, we used a weighted-average discount rate of 4.0% and an expected long-term rate of return on plan assets of 7.0%, which affected the amount of pension liability recorded as of year-end 2014 and the amount of pension expense to be recorded in 2015. At December 31, 2013, we used a weighted-average discount rate of 4.7% and an expected long-term rate of return on plan assets of 7.5% in determining the pension liability recorded as of year-end 2013 and the amount of pension expense recorded in 2014. 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 2014, while a decrease in the discount rate or asset return rate would have had the opposite effect. A 0.25% change in the discount rate assumption would impact 2015 pension expense by less than $0.1 million and year-end 2014 pension liability by $1.0 million, while a 0.25% change in the asset return rate would impact 2015 pension expense by less than $0.1 million.

Overview of Results of Operations

2014 vs. 2013 Comparison

In 2014, we recognized net income of $40.5 million, or $1.07 per diluted common share, compared to net income of $172.1 million, or $4.07 per diluted common share, in 2013. Net income in 2013 included a non-cash income tax benefit of $119.8 million recorded in the first quarter of 2013 related to the reversal of a significant portion of a valuation allowance that was established against the Company s net DTA during the third quarter of 2009. Excluding this income tax benefit, net income for 2013 was $52.3 million, or $1.24 per diluted common share.

Total credit costs, which include the Provision, write-downs of loans classified as held for sale, foreclosed asset expense, gains on sales of foreclosed assets, and the change in the reserve for unfunded loan commitments, amounted to a credit of $6.0 million in 2014, compared to a credit of $22.4 million in 2013.

The decrease in net income from 2013 to 2014 was due primarily to an income tax benefit of $112.2 million recorded in 2013, which included the aforementioned reversal of a significant portion of a valuation allowance on our net DTA, compared to income tax expense of $20.4 million recorded in 2014. In addition, we recorded a credit to the Provision of $11.3 million in 2013, compared to a credit to the Provision of $6.4 million in 2014, and we also experienced a decrease in other operating income of $11.1 million from 2013 to 2014. The decrease in other operating income was due primarily to lower net gains on sales of foreclosed assets of $7.6 million and lower net gains on sales of residential mortgage loans of $4.4 million.

Offsetting these decreases was an increase in net interest income of $10.3 million and a decrease in other operating expense of $6.7 million. The increase in net interest income was due primarily to an increase in interest-earnings assets from 2013 to 2014, combined with an increase in yields earned on the assets. The decrease in other operating expense was due primarily to lower salaries and employee benefits of $8.4 million and lower amortization of intangible assets of $2.1 million, partially offset by higher computer software expense of $1.7 million.

Our net income on average assets and average shareholders equity for 2014 was 0.85% and 6.80%, respectively, compared to 3.73% and 27.70%, respectively, in 2013.

2013 vs. 2012 Comparison

In 2013, we recognized net income of $172.1 million, or $4.07 per diluted common share, compared to net income of $47.4 million, or $1.13 per diluted common share, in 2012. Net income in 2013 included a non-cash income tax benefit of $119.8 million recorded in the first quarter of 2013 related to the reversal of a significant portion of a valuation allowance that was established against the Company s net DTA during the third quarter of 2009. Excluding this income tax benefit, net income for 2013 was $52.3 million, or $1.24 per diluted common share.

Total credit costs, which include the Provision, write-downs of loans classified as held for sale, foreclosed asset expense, gains on sales of foreclosed assets, and the change in the reserve for unfunded loan commitments, amounted to a credit of $22.4 million in 2013, compared to a credit of $16.1 million in 2012. Our operating results in 2013 were positively impacted by an income tax benefit for 2013 of $112.2 million, an increase in net interest income of $13.4 million, and a decrease in other operating expense of $12.4 million, offset by a lower credit to the provision for loan and lease losses of $7.6 million and lower other operating income of $5.8 million. Our net income on average assets and average shareholders equity for 2013 was 3.73% and 27.70%, respectively, compared to 1.13% and 9.81%, respectively, in 2012.

Net Interest Income

The following table sets forth information concerning average interest earning assets and interest-bearing liabilities and the yields and rates thereon. Net interest income, when expressed as a percentage of average interest earning assets, is referred to as net interest margin. Interest income, which includes loan fees and resultant yield information, is expressed on a taxable equivalent basis using an assumed income tax rate of 35%. Table 4 presents an analysis of changes in components of net interest income between years. For each category of interest earning assets and interest-bearing liabilities, information is provided on changes attributable to: (i) changes in volume (change in volume of the asset multiplied by the prior year s rate) and (ii) changes in rates (change in rate multiplied by the current year s volume).

Table 3. Average Balances, Interest Income and Expense, Yields and Rates (Taxable Equivalent)

	2014 Average Balance	2014 Average Yield/ Rate	2014 Amount of Interest	2013 Average Balance	2013 Average Yield/ Rate	2013 Amount of Interest	2012 Average Balance	2012 Average Yield/ Rate	2012 Amount of Interest
				(Dollars in thousands)					
Assets									
Interest earning assets:									
Interest-bearing deposits in other banks	$ 13,207	0.25%	$ 33	$ 81,249	0.25%	$ 203	$ 114,438	0.25%	$ 285
Taxable investment securities (1)	1,344,821	2.50	33,597	1,534,136	2.05	31,521	1,521,164	1.89	28,819
Tax-exempt investment securities (1)	178,275	3.45	6,148	177,510	3.51	6,232	83,663	4.25	3,557
Loans and leases, including loans held for sale (2)	2,798,826	4.01	112,137	2,394,955	4.36	104,479	2,130,758	4.55	97,029
Federal Home Loan Bank stock	45,185	0.10	46	47,202	0.05	24	48,654		
Total interest earning assets	4,380,314	3.47	151,961	4,235,052	3.36	142,459	3,898,677	3.33	129,690
Nonearning assets	379,502			375,770			308,978		
Total assets	$ 4,759,816			$ 4,610,822			$ 4,207,655		
Liabilities and Equity									
Interest-bearing liabilities:									
Interest-bearing demand deposits	$ 764,504	0.05%	$ 373	$ 708,658	0.05%	$ 349	$ 615,960	0.05%	$ 339
Savings and money market deposits	1,227,049	0.07	901	1,191,919	0.07	894	1,163,963	0.09	1,006
Time deposits under $100,000	254,572	0.42	1,069	285,042	0.46	1,301	326,288	0.59	1,937
Time deposits $100,000 and over	804,863	0.17	1,384	769,672	0.19	1,500	652,339	0.27	1,751
Short-term borrowings	31,732	0.29	92	1,988	0.32	6	11	0.67	
Long-term debt	92,790	2.77	2,572	104,373	2.99	3,119	109,791	3.37	3,701
Total interest-bearing liabilities	3,175,510	0.20	6,391	3,061,652	0.23	7,169	2,868,352	0.30	8,734
Noninterest-bearing deposits	938,078			849,371			773,768		
Other liabilities	51,003			73,040			72,131		
Total liabilities	4,164,591			3,984,063			3,714,251		
Shareholders equity	595,210			621,282			483,435		
Non-controlling interests	15			5,477			9,969		
Total equity	595,225			626,759			493,404		
Total liabilities and equity	$ 4,759,816			$ 4,610,822			$ 4,207,655		
Net interest income			$ 145,570			$ 135,290			$ 120,956
Net interest margin		3.32%			3.19%			3.10%	

(1) At amortized cost.

(2) Includes nonaccrual loans.

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Table 4. Analysis of Changes in Net Interest Income (Taxable Equivalent)

	2014 Compared to 2013 Increase (Decrease) Due to Change In: Volume	Rate	Net Change	2013 Compared to 2012 Increase (Decrease) Due to Change In: Volume	Rate	Net Change
	(Dollars in thousands)					
Interest earning assets						
Interest-bearing deposits in other banks	$ (170)	$	$ (170)	$ (82)	$	$ (82)
Taxable investment securities	(3,881)	5,957	2,076	245	2,457	2,702
Tax-exempt investment securities	27	(111)	(84)	3,988	(1,313)	2,675
Loans and leases, including loans held for sale	17,609	(9,951)	7,658	12,031	(4,581)	7,450
Federal Home Loan Bank stock	(1)	23	22		24	24
Total interest earning assets	13,584	(4,082)	9,502	16,182	(3,413)	12,769
Interest-bearing liabilities						
Interest-bearing demand deposits	28	(4)	24	46	(36)	10
Savings and money market deposits	25	(18)	7	25	(137)	(112)
Time deposits under $100,000	(140)	(92)	(232)	(243)	(393)	(636)
Time deposits $100,000 and over	67	(183)	(116)	317	(568)	(251)
Short-term borrowings	95	(9)	86	13	(7)	6
Long-term debt	(346)	(201)	(547)	(183)	(399)	(582)
Total interest-bearing liabilities	(271)	(507)	(778)	(25)	(1,540)	(1,565)
Net interest income	$ 13,855	$ (3,575)	$ 10,280	$ 16,207	$ (1,873)	$ 14,334

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 $145.6 million in 2014, increasing by $10.3 million, or 7.6%, from $135.3 million in 2013, which increased by $14.3 million, or 11.9%, from net interest income of $121.0 million recognized in 2012. The increase in net interest income for 2014 was primarily the result of a significant increase in average loans and leases as we continued to redeploy our excess liquidity into higher yielding assets. Also contributing to the increase was the 45 basis points (bp) increase in average yields earned on our taxable investment securities. Offsetting these increases was a decline in average yields earned on our loans and leases portfolio of 35 bp.

Average rates earned on our interest-earning assets increased by 11 bp in the year ended December 31, 2014, from the year ended December 31, 2013. Average rates paid on our interest-bearing liabilities in the year ended December 31, 2014 declined by 3 bp, compared to the same period in 2013. The improvement in average yields earned on our interest earning assets in 2014 was directly attributable to the 45 bp increase in average yields earned on our taxable investment securities, an increase in our higher yielding loans and leases portfolio, and the corresponding decreases in our lower yielding interest-bearing deposits in other banks and taxable investment securities portfolio.

In the second quarter of 2014, $162.3 million in available-for-sale securities were sold as part of a balance sheet optimization strategy designed to improve our interest rate risk profile. Investment securities sold had a weighted average life of 5.7 years, average yield of 2.68%, and resulted in a gain of $0.2 million.

In the fourth quarter of 2013, we executed a bond swap where we sold $271.5 million in lower-yielding available-for-sale agency debentures and agency mortgage-backed securities with an average net yield of 1.87% and a weighted average life of 2.9 years and reinvested the majority of the proceeds in $242.5 million of higher-yielding agency mortgage-backed securities, non-agency commercial mortgage-backed securities, and corporate bond securities with an average yield of 3.21% and a weighted average life of 7.4 years. The new securities were classified in the available-for-sale portfolio and a net gain of $0.5 million was realized on the transaction. This transaction contributed to the significant increase in average yields earned on our taxable investment securities.

Interest Income

Our primary sources of interest income include interest on loans and leases, which represented 73.8%, 73.3%, and 74.8% of interest income in 2014, 2013 and 2012, respectively, as well as interest earned on investment securities, which represented 26.2%, 26.5%, and 25.0% of interest income, respectively. Interest income expressed on a taxable-equivalent basis of $152.0 million in 2014 increased by $9.5 million, or 6.7%, from the $142.5 million earned in 2013, which decreased by $12.8 million, or 9.8%, from the $129.7 million earned in 2012.

As depicted in Table 4, the increase in interest income in 2014 from the prior year was primarily due to a significant increase in average loans and leases balances and the increase in average taxable investment securities yields, partially offset by a decrease in average loan yields and the decrease in average taxable investment securities balances. The $403.9 million increase in average loans and leases contributed to an increase of $17.6 million in current year interest income. In addition, the 45 bp increase in average taxable investment securities yields in 2014 contributed to $6.0 million in higher interest income for the current year. These increases were partially offset by the 35 bp decrease in average loan yields in 2014 which contributed to $10.0 million in lower interest income for 2014. The $189.3 million decrease in average taxable investment securities contributed to a decrease of $3.9 million in current year interest income.

The increase in interest income in 2013 from 2012 was primarily due to a significant increase in average loans and leases and investment securities balances and the increase in average taxable investment securities yields, partially offset by a decrease in average loan yields and the decrease in average tax-exempt investment securities yields. The $264.2 million increase in average loans and leases contributed to an increase of $12.0 million of interest income and the $93.8 million increase in average tax-exempt investment securities contributed to an increase of $4.0 million of interest income. In addition, the 16 bp increase in average taxable investment securities yields in 2013 contributed to an increase of $2.5 million of interest income. These increases were partially offset by the 19 bp decrease in average loan yields in 2013 which contributed to $4.6 million in lower interest income for 2013. The 74 bp decrease in average tax-exempt investment securities yields in 2013 contributed to $1.3 million of the reduction in interest income.

Interest Expense

In 2014, interest expense was $6.4 million which represented a decrease of $0.8 million, or 10.9%, compared to interest expense of $7.2 million in 2013, which decreased by $1.6 million, or 17.9%, compared to $8.7 million in 2012.

Declines in average rates paid on interest-bearing liabilities were reflective of the FRB s notably low interest rate policy that existed throughout 2014, 2013 and 2012 and contributed to the overall reduction in interest expense during the periods. In 2014, the average rate paid on interest-bearing liabilities decreased by 3 bp to 0.20%, compared to 0.23% in 2013. Decreases in the average rates paid on long-term debt of 22 bp, time deposits $100,000 and over of 2 bp, and time deposits under $100,000 of 4 bp, were the primary drivers of the overall decrease in interest expense. Decreases in the average balances of long-term debt of $11.6 million and time deposits under $100,000 of $30.5 million also contributed to the reduction of interest expense in 2014.

In 2013, the average rate paid on interest-bearing liabilities decreased by 7 bp to 0.23%, compared to 0.30% in 2012. Decreases in the average rates paid on time deposits $100,000 and over of 8 bp, long-term borrowings of 38 bp, time deposits under $100,000 of 13 bp, and savings and money market deposits of 2 bp, were the primary drivers of the overall decrease in interest expense. Decreases in the average balances of time deposits under $100,000 of $41.2 million and long-term borrowings of $5.4 million also contributed to the reduction of interest expense in 2013.

Net Interest Margin

Our net interest margin was 3.32%, 3.19% and 3.10% in 2014, 2013 and 2012, respectively. The improvement in our net interest margin in 2014 reflected the $403.9 million increase in average loans and leases contributing an increase of $17.6 million in the current year interest income. In addition, reinvestment in higher yielding taxable investment securities resulted in a 45 bp increase in average taxable yields, contributing $6.0 million in higher interest income in 2014. These increases were partially offset by the 35bp decrease in average loan yields, which contributed to the $10.0 million in lower interest income for 2014.

Improvement in our net interest margin in 2013 reflected the continued slowing of premium amortization on our mortgage backed securities and reinvestment of cash flow into higher yielding loans and leases and investment securities. Slowing of premium amortization in 2013 was attributed to reduced prepayment speeds on mortgage-backed securities. Reduced prepayment on mortgage backed securities were a result of an increase in intermediate-term yields of approximately 100 bps in 2013. As a result of slower premium amortization, the net interest margin was positively impacted by 5 bps in 2013.

The historically low interest rate environment that we continue to operate in is the result of the target Fed Funds rate of 0% to 0.25% initially set by the Federal Reserve in the fourth quarter of 2008 and other economic policies implemented by the FRB, which continued through year end 2014. We continue to expect the target Fed Funds rate to remain low throughout 2015, as longer-term inflation expectations have remained stable. We expect the yield curve to begin to steepen in late 2015 on continued job growth and increases in household spending. Thus we expect our net interest margin to remain relatively unchanged through 2015 and expand modestly with the economic recovery.

Other Operating Income

The following table sets forth components of other operating income and the total as a percentage of average assets for the periods indicated.

Table 5. Components of Other Operating Income

	Year Ended December 31, 2014	2013	2012
	(Dollars in thousands)		
Other service charges and fees	$ 11,754	$ 12,490	$ 11,083
Service charges on deposit accounts	8,113	7,041	8,367
Loan servicing fees	5,798	6,057	6,486
Net gain on sales of residential loans	5,545	9,986	17,095
Income from fiduciary activities	3,552	2,855	2,599
Income from bank-owned life insurance	2,922	2,333	2,899
Net gain on sales of foreclosed assets	971	8,584	4,999
Equity in earnings of unconsolidated subsidiaries	480	790	574
Fees on foreign exchange	464	508	551
Loan placement fees	437	570	690
Investment securities gains	240	482	789

Other		3,547		3,249		4,611
Total other operating income	$	43,823	$	54,945	$	60,743
Total other operating income as a percentage of average assets		0.92%		1.19%		1.44%

Total other operating income of $43.8 million in 2014 decreased by $11.1 million, or 20.2%, from the $54.9 million earned in 2013, which decreased by $5.8 million, or 9.5%, from the $60.7 million earned in 2012.

The decrease in other operating income in 2014 from 2013 was due to lower net gains on sales of foreclosed assets and net gains on sales of residential mortgage loans of $7.6 million and $4.4 million, respectively, and a gain on the early extinguishment of trust preferred debt of $1.0 million (included in other) recorded in 2013. Offsetting these decreases in 2014 were higher income recovered on nonaccrual loans previously written off of $1.4 million (included in other) and service charges on deposit accounts of $1.1 million.

In 2013, we recorded lower net gains on sales of residential mortgage loans, rental income on foreclosed properties (included in other), and service charges on deposit accounts of $7.1 million, $3.7 million, and $1.3 million, respectively. Offsetting these decreases in 2013 were higher net gains on sales of foreclosed assets of $3.6 million, a gain on the early extinguishment of trust preferred debt of $1.0 million (included in other), and higher other service charges and fees of $1.0 million.

Other Operating Expense

The following table sets forth components of other operating expense and the total as a percentage of average assets for the periods indicated.

Table 6. Components of Other Operating Expense

	Year Ended December 31, 2014	2013 (Dollars in thousands)	2012
Salaries and employee benefits	$ 67,941	$ 76,294	$ 69,344
Net occupancy	15,252	14,323	13,920
Legal and professional services	7,806	8,094	13,824
Computer software expense	6,327	4,579	3,961
Amortization and impairment of other intangible assets	5,332	7,418	10,179
Communication expense	3,635	3,523	3,428
Equipment	3,582	3,676	3,966
Advertising expense	2,342	2,666	3,516
Foreclosed asset expense	1,710	1,036	6,887
Write down of assets			2,586
Other	18,886	17,927	20,307
Total other operating expense	$ 132,813	$ 139,536	$ 151,918
Total other operating expense as a percentage of average assets	2.79%	3.03%	3.61%

Total other operating expense of $132.8 million in 2014 decreased by $6.7 million, or 4.8%, from total operating expense of $139.5 million in 2013, which decreased by $12.4 million, or 8.2%, compared to 2012.

The decrease in total other operating expense in 2014, compared to 2013, was the result of lower salaries and employee benefits and amortization and impairment of intangible assets of $8.4 million and $2.1 million, respectively, and a premium paid in 2013 on the repurchase of preferred stock of two subsidiaries of $1.9 million (included in other). Offsetting these decreases were lower credits to reserves for unfunded loan commitments (included in other) of $3.1 million, higher computer software expense of $1.7 million, and branch consolidation and relocation costs incurred in 2014 of $1.3 million (included in other).

The decrease in total other operating expense in 2013, compared to 2012, was the result of lower credit-related charges of $10.2 million, lower legal and professional services of $5.7 million, lower amortization and impairment of other intangible assets of $2.8 million, lower FDIC insurance expense of $2.1 million (included in other), and lower accruals for the settlement of legal proceedings against the Company of $1.8 million (included in other), partially offset by higher salaries and employee benefits of $7.0 million, the aforementioned premium paid on the repurchase of preferred stock of two subsidiaries of $1.9 million (included in other), and lower credit to the reserve for repurchased residential mortgage loan losses of $1.9 million (included in other).

A key measure of operating efficiency tracked by management is the efficiency ratio, which is calculated by dividing other operating expense by total revenue. Management believes that the efficiency ratio provides useful supplemental information that is important to a proper understanding of the company s core business results by investors. Our efficiency ratio should not be viewed as a substitute for results determined in accordance with GAAP, nor is it necessarily comparable to the efficiency ratio presented by other companies. Our efficiency ratio decreased to 70.93% in 2014, compared to 74.20% in 2013 and 84.19% in 2012. The decrease in our efficiency ratio was primarily driven by the aforementioned decrease in other operating expenses and increase in net interest income.

The following table sets forth a reconciliation to our efficiency ratio for each of the dates indicated:

Table 7. Reconciliation to Efficiency Ratio

	Year Ended December 31,				
(Dollars in thousands)	**2014**	**2013**	**2012**	**2011**	**2010**
Efficiency Ratio					
Total operating expenses	$ 132,813	$ 139,536	$ 151,918	$ 178,942	$ 267,758
Net interest income	$ 143,418	$ 133,109	$ 119,711	$ 117,821	$ 118,653
Total other operating income	43,823	54,945	60,743	57,002	57,700
Total revenue	$ 187,241	$ 188,054	$ 180,454	$ 174,823	$ 176,353
Efficiency ratio	70.93%	74.20%	84.19%	102.36%	151.83%

Income Taxes

In the first quarter of 2013, the Company reversed a significant portion of the valuation allowance that was established against our net DTA during the third quarter of 2009. The valuation allowance was established during 2009 due to uncertainty at the time regarding our ability to generate sufficient future taxable income to fully realize the benefit of our net DTA. The quarter ended March 31, 2013 marked our ninth consecutive quarter of profitability. Based on this earnings performance trend, improvements in our financial condition, asset quality and capital ratios, and the expectation of continued profitability, the Company determined that it was more likely than not that a significant portion of our net DTA would be realized. The net impact of reversing the valuation allowance and recording the provision for income tax expense was a net income tax benefit of $119.8 million in the first quarter of 2013.

In the second, third and fourth quarters of 2013, the Company recorded income tax expense of $1.9 million, $2.2 million, and $3.4 million, respectively, and ended 2013 with a net income tax benefit of $112.2 million. In 2014, the Company recorded net income tax expense of $20.4 million.

In 2013, we decreased our valuation allowance against our net DTAs by $140.8 million, or 95.5%, to $6.7 million at December 31, 2013 from $147.5 million at December 31, 2012. Of the total decrease to the valuation allowance, $132.1 million was recognized as a non-cash credit to income tax expense, while $8.7 million was charged against accumulated other comprehensive income (loss) (AOCI).

As of December 31, 2014, the remaining valuation allowance on our net DTA totaled $2.8 million which related to our California state income taxes as we do not expect to generate sufficient income in California to utilize the DTA. Net of this valuation allowance, the Company s net DTA totaled $104.4 million as of December 31, 2014, compared to a net DTA of $137.2 million as of December 31, 2013, and is included in other assets on our consolidated balance sheets.

Our effective tax rate was 33.5% in 2014 compared to -187.6% in 2013 and 0% in 2012. Because we recognized a full valuation allowance against our net DTAs in 2012, we did not record any income tax expense or benefit in that period.

Financial Condition

Total assets of $4.9 billion at December 31, 2014 increased by $111.8 million, or 2.4%, from the $4.7 billion at year-end 2013, and total liabilities of $4.3 billion at December 31, 2014 increased by $203.9 million, or 5.0%, from the prior year. The increase in total assets in 2014 was due primarily to our deposit growth and deployment of these proceeds into higher yielding assets.

Loan Portfolio

Our lending activities are focused on commercial loans, commercial mortgages, construction loans, and leases to small and medium-sized companies, business professionals, and real estate developers, as well as residential mortgages and consumer loans to local homebuyers and individuals. Our strategy for generating commercial loans has traditionally relied upon teams of commercial real estate and commercial banking officers organized by geographical and industry lines who are responsible for client prospecting and business development.

To manage credit risk (i.e., the ability 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. The general underwriting guidelines require analysis and documentation to include among other things, overall credit worthiness of borrower, guarantor support, use of funds, loan term, minimum equity, loan-to-value standards, repayment terms, sources of repayment, covenants, pricing, collateral, insurance, and documentation standards. All loan requests considered by us should be for a clearly defined legitimate purpose with a determinable primary source, as well as alternate sources of repayment. All loans should be supported by appropriate documentation including, current financial statements, credit reports, collateral information, asset verification, tax returns, title reports, and appraisals (where appropriate).

We score consumer and small business loans using an underwriting matrix (Scorecard) developed based on the results of an analysis from a reputable national credit scoring company commissioned by our Bank. The Scorecard uses the attributes that were determined to most highly correlate with probability of repayment. Those attributes include (i) credit score, (ii) age of oldest account, (iii) credit limit amount, and (iv) debt-to-income ratio.

Loans and leases totaled $2.9 billion at December 31, 2014, increasing by $301.6 million, or 11.5%, from the $2.6 billion at year-end 2013, which increased by $426.7 million, or 19.4%, from the $2.2 billion held at year-end 2012. The increase in our loan portfolio in 2014 was representative of our continued effort to deploy excess liquidity into higher yielding assets. The increase in loans and leases was primarily due to net increases in the residential mortgage, commercial, financial and agricultural, consumer, and construction and development loan portfolios totaling $145.8 million, or 12.8%, $65.0 million, or 16.3%, $54.5 million, or 17.5%, and $38.9 million, or 51.5%, respectively. In addition, we transferred the collateral in six portfolio loans with a carrying value of $2.8 million to other real estate and recorded charge-offs of loans and leases of $9.9 million.

The following table sets forth information regarding outstanding loans by category as of the dates indicated.

Table 8. Loans by Categories

	December 31, 2014	2013	2012	2011	2010
	(Dollars in thousands)				
Commercial, financial and agricultural	$ 463,763	$ 398,716	$ 246,218	$ 180,704	$ 207,980
Real estate:					
Construction	114,554	75,616	96,194	161,063	313,785
Mortgage:					
- residential	1,282,324	1,136,573	966,065	844,737	690,092
- commercial	703,273	702,767	741,580	751,431	816,475
Consumer	365,144	310,688	143,383	108,810	112,949
Leases	3,140	6,241	10,504	17,702	28,163
Total loans and leases	2,932,198	2,630,601	2,203,944	2,064,447	2,169,444
Allowance for loan and lease losses	(74,040)	(83,820)	(96,413)	(122,093)	(192,854)
Net loans	$ 2,858,158	$ 2,546,781	$ 2,107,531	$ 1,942,354	$ 1,976,590

The following table sets forth the geographic distribution of our loan portfolio and related Allowance as of December 31, 2014.

Table 9. Geographic Distribution

	Hawaii	U.S. Mainland	Total
		(Dollars in thousands)	
Commercial, financial and agricultural	$ 287,254	$ 176,509	$ 463,763
Real estate:			
Construction	111,010	3,544	114,554
Mortgage:			
- residential	1,282,324		1,282,324
- commercial	587,322	115,951	703,273
Consumer	254,259	110,885	365,144
Leases	3,140		3,140
Total loans and leases	2,525,309	406,889	2,932,198
Allowance for loan and lease losses	(62,685)	(11,355)	(74,040)
Net loans and leases	$ 2,462,624	$ 395,534	$ 2,858,158

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. 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 could be greater in this loan category relative to secured loans 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 historical approach to commercial lending involves teams of lending and cash management personnel who focus on relationship development including loans, deposits and other bank services to new and existing commercial clients.

Real Estate Construction

Construction loans include both residential and commercial development projects. Each construction project is evaluated for economic viability. Construction loans pose 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 and market risk at the time construction is complete.

Due to the heightened risk of construction lending and declining real estate value, we reduced our exposure to this sector and decreased our construction loan portfolio by $152.7 million in 2011, $64.9 million in 2012, and $20.6 million in 2013. In 2014, as real estate values have shown stability, the portfolio increased by $38.9 million.

Interest Reserves

Our policies require interest reserves for construction loans, including loans to build commercial buildings, residential developments (both large tract projects and individual houses), and multi-family projects.

The outstanding principal balance of loans with interest reserves was $66.5 million at December 31, 2014, compared to $27.4 million in the prior year, while remaining interest reserves was $3.2 million, or 4.9% of the outstanding principal balance of loans with interest reserves at December 31, 2014, compared to $2.4 million, or 8.7% of the outstanding principal balance of loans with interest reserves at December 31, 2013.

Interest reserves allow the Company to advance funds to borrowers to make scheduled payments during the construction period. These advances typically are capitalized and added to the borrower s outstanding loan balance, although we have the right to demand payment under certain circumstances. Our policy is to determine if interest reserve amounts are appropriately included in each project s construction budget and are adequate to cover the expected duration of the construction period.

The amount, terms, and conditions of the interest reserve are established when a loan is originated, although we generally have the option to demand payment if the credit profile of the borrower changes. We evaluate the viability and appropriateness of the construction project based on the project s complexity and feasibility, the timeline, as well as the creditworthiness of the borrowers, sponsors and/or guarantors, and the value of the collateral.

In the event that unfavorable circumstances alter the original project schedule (e.g., cost overruns, project delays, etc.), our policy is to evaluate whether or not it is appropriate to maintain interest capitalization or demand payment of interest in cash and will work with the borrower to explore various restructuring options, which may include obtaining additional equity and/or requiring additional collateral. We may also require borrowers to directly pay scheduled interest payments.

Our process for determining that construction projects are moving as planned are detailed in our lending policies and guidelines. Prior to approving a loan, the Company and borrower generally agree on a construction budget, a pro forma monthly disbursement schedule, and sales/leaseback assumptions. As each project progresses, the projections are measured against actual disbursements and sales/lease results to determine if the project is on schedule and performing as planned.

The specific monitoring requirements for each loan vary depending on the size and complexity of the project and the experience and financial strength of the borrower, sponsor and/or guarantor. At a minimum, to ensure that loan proceeds are properly disbursed and to assess whether it is appropriate to capitalize interest or demand cash payment of interest, our monitoring process generally includes:

- Physical inspection of the project to ensure work has progressed to the stage for which payment is being requested;

- Verification that the work completed is in conformance with plans and specifications and items for which disbursement is requested are within budget; and

- Determination that there continues to be satisfactory project progress.

In certain rare circumstances, we may decide to extend, renew, and/or restructure the terms of a construction loan. Reasons for the restructure can range from cost overruns to project delays and the restructuring can result in additional funds being advanced or an extension of the maturity date of the loan. Prior to the loan being restructured, our policy is to perform a detailed analysis to ensure that the economics of the project remain feasible and that the risks to the Company are within acceptable lending guidelines.

Real Estate Mortgage

The following table sets forth information with respect to the composition of the Real Estate Mortgage loan portfolio as of the dates indicated.

Table 10. Mortgage Loan Portfolio Composition

	December 31,									
	2014		2013		2012		2011		2010	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in thousands)									
Residential										
HELOC	$ 228,319	11.5%	$ 175,612	9.6%	$ 154,195	9.0%	$ 131,980	8.3%	$ 142,445	9.5%
Closed-ended loans	1,054,005	53.1	960,961	52.2	811,870	47.6	712,757	44.6	547,647	36.3
Total	1,282,324	64.6	1,136,573	61.8	966,065	56.6	844,737	52.9	690,092	45.8
Commercial	703,273	35.4	702,767	38.2	741,580	43.4	751,431	47.1	816,475	54.2
Total	$ 1,985,597	100.0%	$ 1,839,340	100.0%	$ 1,707,645	100.0%	$ 1,596,168	100.0%	$ 1,506,567	100.0%

Residential

Residential mortgage loans include fixed- and adjustable-rate loans primarily secured by single-family owner-occupied residences in Hawaii and home equity lines of credit and loans. Our home equity lines of credit, which typically carry floating interest rates, accounted for approximately 18% of our residential mortgage portfolio. Maximum loan-to-value ratios of 80% are typically required for fixed- and adjustable-rate loans secured by single-family owner-occupied residences, although higher levels are permitted with accompanying mortgage insurance. We emphasize residential mortgage loans for owner-occupied primary residences. First mortgage loans secured by residential properties generally carry a moderate level of credit risk. With an average loan size of approximately $0.4 million, marketable collateral and a Hawaii residential real estate market that has been relatively stable, credit losses on residential mortgages had been minimal during the past several years. However, economic conditions including unemployment levels, future changes in interest rates and other market factors can impact the marketability and value of collateral and thus the level of credit risk inherent in the portfolio.

Residential mortgage loan balances as of December 31, 2014 totaled $1.3 billion, increasing by $145.8 million, or 12.8%, from the $1.1 billion held at year-end 2013, which increased by $170.5 million, or 17.6%, from the $966.1 million held at year-end 2012. The increase in residential mortgage loan balances was due primarily to the reinvestment of cash flow into higher yielding assets.

Residential mortgage loans held for sale at December 31, 2014 totaled $9.7 million, a decrease of $2.7 million, or 21.7%, from the December 31, 2013 balance of $12.4 million, which decreased by $25.9 million, or 67.7%, from the December 31, 2012 balance of $38.3 million. In 2014, 2013 and 2012, we did not securitize any residential mortgage loans.

Home equity lines of credit (HELOCs) are underwritten according to a policy and guidelines reviewed and approved by the Board of Directors annually. All HELOCs originated since early 2011 have a ten year draw period followed by a 20 year repayment period during which the principal balance will be fully amortized. As of December 31, 2014, 70% of the HELOCS in the portfolio are fully amortizing and the remaining 30% have a balloon payment due at maturity. All HELOCs today are underwritten using a qualifying payment which assumes the line is fully drawn and is amortizing as if was in the repayment period. Underwriting criteria include a minimum FICO score, maximum debt-to-income ratio (DTI), and maximum combined loan-to-value ratio (CLTV). During 2014, the weighted average FICO score for newly originated lines exceeded 760 and the weighted average CLTV was less than 60%. Any underwriting exceptions are recorded and tracked. As of December 31, 2014, more than 30% of all lines in the portfolio were secured by 1st lien mortgages at origination. All HELOCs are monitored based on default, delinquency, end of draw period, and maturity.

Commercial

Real estate mortgage loans secured by commercial properties continue to represent a sizable portion 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.

Consumer Loans

The following table sets forth the major components of our consumer loan portfolio as of the dates indicated.

Table 11. Consumer Loan Portfolio Composition

	December 31,									
	2014		2013		2012		2011		2010	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in thousands)									
Automobile	$ 150,559	41.2%	$ 149,780	48.2%	$ 70,219	48.9%	$ 64,343	59.1%	$ 66,955	59.2%
Other revolving credit plans	67,099	18.4	61,835	19.9	35,074	24.5	34,505	31.7	34,396	30.5
Student loans	57,776	15.8	15,971	5.1						
Other	89,710	24.6	83,102	26.8	38,090	26.6	9,962	9.2	11,598	10.3
Total	$ 365,144	100.0%	$ 310,688	100.0%	$ 143,383	100.0%	$ 108,810	100.0%	$ 112,949	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. Our policy is to 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 $365.1 million at December 31, 2014, increasing by $54.5 million, or 17.5%, from 2013 s year-end balance of $310.7 million, which increased by $167.3 million, or 116.7%, compared to the $143.4 million held at year-end 2012. At December 31, 2014, automobile loans, primarily indirect dealer loans, comprised 41.2% of consumer loans outstanding.

Total automobile loans of $150.6 million at year-end 2014 increased by $0.8 million, or 0.5%, from 2013 s year-end balance of $149.8 million, which increased by $79.6 million, or 113.3%, from $70.2 million at year-end 2012. In 2014, we purchased participation interest in auto loans totaling $11.2 million, which included a $0.3 million premium over the $10.9 million outstanding balance. In 2013, we purchased participation interest in auto loans totaling $67.7 million, which included a $2.8 million premium over the $64.9 million outstanding balance.

In 2014 and 2013, we purchased participation interests in student loans (included in other) totaling $51.5 million and $17.4 million, respectively, which represented the outstanding balance at the time of purchase. We did not have any participation interests in student loans at December 31, 2012.

In addition, we issued solar photovoltaic loans (included in other) which totaled $17.7 million at December 31, 2014, compared to $17.9 million at December 31, 2013 and less than $0.1 million at December 31, 2012.

Concentrations of Credit Risk

As of December 31, 2014, approximately $2.1 billion, or 71.6% of loans outstanding were real estate related, including construction loans, residential mortgage loans and commercial mortgage loans.

The majority of our loans are made to companies and individuals with headquarters in, or residing in, the states of Hawaii and California. Consistent with our focus of being a Hawaii-based bank, 86% of our loan portfolio was concentrated in the Hawaii market while 14% was concentrated in the U.S. Mainland as of December 31, 2014.

Our foreign credit exposure as of December 31, 2014 was minimal and did not exceed 1% of total assets.

Maturities and Sensitivities of Loans to Changes in Interest Rates

At December 31, 2014, commercial, financial and agricultural loans were 25.8% fixed rate and 74.2% variable rate. Real estate construction loans were 19.0% fixed rate and 81.0% variable rate. Residential mortgage loans, which include home equity lines and loans, were 70.0% fixed rate and 30.0% variable rate. Commercial mortgage loans were 35.1% fixed rate and 64.9% variable rate. Consumer loans were 70.9% fixed rate and 29.1% variable rate.

Commercial loans and commercial mortgage loans with variable interest rates are underwritten at the current market rate of interest. For commercial loans and commercial real estate loans with a fixed rate period that are not fully amortizing, the loans are underwritten at the current market rate of interest. At the expiration of the fixed rate period and/or maturity, the projected loan balance at that time is underwritten at an interest rate based on the current interest rate plus two percent per annum (2.0%).

Qualifying payments for our variable rate residential mortgage loans with initial fixed rate periods of five years or less are calculated using the greater of the note rate plus 2% per annum or the fully indexed rate. Payments for our variable rate loans with a fixed-rate period of greater than five years are calculated using the greater of the note rate or the fully indexed rate. The qualifying payment for our HELOCs is based on the fully indexed rate plus the required principal payment due during repayment assuming the line was fully drawn. Our consumer lines of credit use a qualifying payment factor that exceeds the actual fully indexed interest rate.

Table 12 sets forth the maturity distribution and sensitivities of the loan portfolio to changes in interest rates at December 31, 2014. Maturities are based on contractual maturity dates and do not factor in principal amortization. This differs from the assumptions used in Table 22. Interest Rate Sensitivity.

Table 12. Maturity Distribution and Sensitivities of Loans to Changes in Interest Rates

	One year or less	Maturing Over one through five years (Dollars in thousands)	Over five years	Total
Commercial, financial and agricultural				
With fixed interest rates	$ 328	$ 53,414	$ 65,997	$ 119,739
With variable interest rates	2,180	151,196	190,648	344,024
	2,508	204,610	256,645	463,763
Real estate:				
Construction				
With fixed interest rates		14,730	6,999	21,729
With variable interest rates		68,928	23,897	92,825
		83,658	30,896	114,554
Mortgage - residential				
With fixed interest rates	141	12,772	885,336	898,249
With variable interest rates	450	33,824	349,801	384,075
	591	46,596	1,235,137	1,282,324
Mortgage - commercial				
With fixed interest rates	1,302	72,565	173,121	246,988
With variable interest rates	2,424	66,237	387,624	456,285
	3,726	138,802	560,745	703,273
Consumer				
With fixed interest rates	37	115,046	143,826	258,909
With variable interest rates	25,280	44,245	36,710	106,235
	25,317	159,291	180,536	365,144
Leases				
With fixed interest rates	197	2,943		3,140
With variable interest rates				
	197	2,943		3,140
Total	$ 32,339	$ 635,900	$ 2,263,959	$ 2,932,198
All loans				
With fixed interest rates	$ 2,005	$ 271,470	$ 1,275,279	$ 1,548,754
With variable interest rates	30,334	364,430	988,680	1,383,444
Total	$ 32,339	$ 635,900	$ 2,263,959	$ 2,932,198

Provision and Allowance for Loan and Lease Losses

As described above under 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 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 Company maintains its Allowance at an appropriate level as of a given balance sheet date to absorb management s best estimate of probable credit losses inherent in its loan portfolios that will likely be realized over various loss emergence periods. These periods are based upon management s comprehensive analysis of the risk profiles particular to the respective loan portfolios. Analysis of Allowance appropriateness is performed quarterly to coincide with financial disclosure to the public and to the regulatory agencies and is governed by a Board-approved policy and methodology.

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 and are adjusted for qualitative factors including migration and volatility risks. We also use third party inputs as proxies (as described above under Application of Proxies) for certain segments of loans for which we do not have sufficient historical loss data. 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.

When segmenting the Company s loan portfolio, we consider the guidance contained in ASC 310-10-55-16 through 310-10-55-18 by grouping loans that contain similar risk characteristics into various loan categories. The loan categories used are consistent with the internal reports evaluated by the Company s management and Board of Directors to monitor risk and performance within the various segments of its loan portfolio.

Loans are segmented by market (Hawaii and Mainland) and FDIC classifications, then, further segmented by geography, risk rating, and other relevant risk characteristics. The granular segmentation is performed to better account for differences in risk profiles within FDIC classifications attributable to localized market specific or other geographic factors, as based on management s analysis of the correlation of certain risk characteristics and assessment of their predictive value in terms of probable losses. Loans secured by real estate are further segmented by state, MSA, or county, as appropriate, to account for geographical impacts to historical loss rates. Commercial and Industrial loans are further segmented by product type to account for higher risk associated with unsecured lines to borrowers where source of repayment is real estate related and syndicated national credits. Unsecured lines with real estate related source of repayment have historically had higher delinquency and loss rates. Also, syndicated national credits are considered higher risk as it is a new product to the Bank and the loan size is typically larger.

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

Table 13. Allowance for Loan and Lease Losses

	Year Ended December 31, 2014	2013	2012	2011	2010
	(Dollars in thousands)				
Average amount of loans outstanding	$ 2,798,826	$ 2,394,955	$ 2,130,758	$ 2,121,544	$ 2,716,090
Allowance for loan and lease losses:					
Balance at beginning of year	$ 83,820	$ 96,413	$ 122,093	$ 192,854	$ 205,279
Charge-offs:					
Commercial, financial and agricultural	5,046	2,812	3,779	2,401	7,550
Real estate:					
Construction		358	8,435	31,371	126,829
Mortgage - residential	139	1,083	1,664	4,347	10,801
Mortgage - commercial	1,041	6,768	2,033	1,298	51,521
Consumer	3,703	1,595	1,490	2,116	3,242
Leases	8		28	10	19
Total	9,937	12,616	17,429	41,543	199,962
Recoveries:					
Commercial, financial and agricultural	2,326	1,387	1,614	1,805	2,421
Real estate:					
Construction	2,040	3,596	6,622	6,518	13,902
Mortgage - residential	992	1,107	876	1,033	847
Mortgage - commercial	53	4,240	488	1,034	9,472
Consumer	1,152	657	1,029	1,082	1,259
Leases	8	346	5		88
Total	6,571	11,333	10,634	11,472	27,989
Net loans charged off	3,366	1,283	6,795	30,071	171,973
Provision (credit) charged to operations	(6,414)	(11,310)	(18,885)	(40,690)	159,548
Balance at end of year	$ 74,040	$ 83,820	$ 96,413	$ 122,093	$ 192,854
Ratios:					
Allowance for loan and lease losses to loans and leases outstanding at end of year	2.53%	3.19%	4.37%	5.91%	8.89%
Net loans charged off during year to average loans and leases outstanding during year	0.12%	0.05%	0.32%	1.42%	6.33%

Our Allowance at December 31, 2014 totaled $74.0 million, which represented a decrease of $9.8 million, or 11.7%, from year-end 2013. When expressed as a percentage of total loans and leases, our Allowance decreased to 2.53% at December 31, 2014, from 3.19% at year-end 2013. The decrease in our Allowance during 2014 was a result of a credit to the Provision of $6.4 million recognized during the year and $3.4 million in net loan charge-offs during the year. The decrease in our Allowance as a percentage of total loans and leases from year-end 2013 to year-end 2014 is consistent with our improved credit risk profile as evidenced by a decrease in our nonperforming assets and is consistent with our belief that stabilization in our loan portfolio, the overall economy and the commercial real estate markets both in Hawaii and on the U.S. Mainland is continuing.

Our Allowance as a percentage of our nonperforming assets decreased from 179.29% at December 31, 2013 to 176.14% at December 31, 2014. Our Allowance as a percentage of our nonaccrual loans decreased from 201.55% at December 31, 2013 to 189.42% at December 31, 2014.

This trend was consistent with the improving credit quality as represented by non-performing assets of $42.0 million, $46.8 million, and $90.0 million at December 31, 2014, 2013 and 2012, respectively. Net charge-offs for the years ended December 31, 2014, 2013 and 2012 were $3.4 million, $1.3 million and $6.8 million, respectively.

The general component of the Allowance is applicable to performing loans and leases and comprised 92.5%, 92.4% and 90.7% of the total Allowance at December 31, 2014, 2013 and 2012, respectively. The amounts of the general reserves were $68.5 million, $77.5 million and $87.4 million at December 31, 2014, 2013 and 2012, respectively.

The specific component of the Allowance evaluates for impairment and provisions for those loans that meet one or more of the following characteristics: classified as substandard, doubtful or loss, nonaccrual loans, troubled debt restructures, or any loans deemed prudent by management to analyze. The specific reserves comprised 2.1%, 0.4% and 3.1% of the total Allowance at December 31, 2014, 2013 and 2012, respectively. The amounts of the specific reserves were $1.5 million, $0.3 million and $3.0 million at December 31, 2014, 2013 and 2012, respectively.

In 2010, the general reserve factors were adjusted to calculate the Allowance for our commercial mortgage portfolios both in Hawaii and on the U.S. Mainland, as well our residential mortgage loan portfolio, including the owner occupied, investor, and home equity segments. Our decision to increase the general reserves established for these loan categories were made after considering various quantitative and qualitative factors. These considerations included, but were not limited to, our recent loss history, a revised assessment of projected national and local economic and market conditions, the potential negative impact that the weak commercial and residential real estate markets may have on these portfolios, and input from our regulators.

The historical loss experience used to determine the Allowance was developed based on management s contention that baseline loss factors should be reflective of variations in risk profile across the risk rating spectrum, and that the consideration of more recent loss data is more relevant to the current period under the analysis and will provide the Bank with a more transparent, clearly defined, and consistent methods of predicting the probable loss. Upon until 2013, the cumulative net losses were traced back two years for the FDIC classifications involving real estate collateral to account for prolonged loss recognition and ultimate disposition periods associated with loans secured by real estate and traced back one year for the other FDIC classifications. The look back period for assignment of loss factors by risk rating is one year from initial loss recognition across all FDIC classifications, including those with two year cumulative look-back periods. The cumulative net losses are divided by the average outstanding balance over the same period.

While no material enhancements were made to the methodology from 2011 to 2013, the Company reevaluated its Allowance methodology and incorporated a number of enhancements in the first quarter of 2014. The enhancements focused on emphasizing the Bank s actual loss experience to generate provisions that are more reflective of current portfolio conditions and loss exposures and de-emphasizing the use of external proxies as the Bank experiences extended periods of normalized operations. This is accomplished by including additional historical loss data in the determination of loss rates and select qualitative adjustments, serving to establish a prudent, more transparent and consistently derived Allowance provision.

From 2010 through 2013, the Company had utilized an eight and four quarter look-back for the purposes of determining cumulative net losses. During this time, the Company believed that the eight and four quarter look-back periods were appropriate given the prevailing credit quality and loss rate conditions. The Company s then rapidly evolving loss experience necessitated the use of shorter loss analysis periods in order to ensure that loss rates would be adequately responsive to changes in loss experience. During that period, the Company considered recent loss data to be more relevant to the current period then under analysis. The look-back period was also consistent with commentary provided by our primary banking regulator following our 2010 Safety and Soundness Examination.

As economic conditions continued to improve and stabilize through 2014, the Company experienced improving credit quality trends that contributed to consistent reductions to the Allowance. Given the diminishing loss rates, in the first quarter of 2014 the look-back period for loans secured by real estate was extended from 8 quarters to 17 quarters, with the intention of extending the look-back period each quarter thereafter to a total of 24 quarters or six years to incorporate broader loss experience through a more complete economic cycle. This would also reduce the Company s reliance on proxy loss rates by capturing more of the Company s own historical loss experience in the extended look-back period. The longer look-back period is appropriate in light of the Company s limited loss experience throughout the recent economic recovery and stabilization. Additionally, as economic conditions have stabilized through 2014, lower loss rate volatility has diminished the need for shorter loss analysis periods that are more responsive to shifts in loss experience. The enhanced methodology does not incorporate data before 2010 due to the anomalous loss activity during that time period that may cause pre-2010 internal loss data to be an inappropriate representation of the current inherent risk in the Company s loan portfolio. In our revised approach, the losses during the six year look-back period will be weighted to place more emphasis on recent loss experience. In late 2013, the Company received guidance from its primary banking regulator supporting the use of extended loss analysis periods. The Supervisory Examiner recommended a periodic reassessment of the look-back period and suggested that a look-back period beyond eight quarters may be more reasonable given the then current economic conditions and portfolio performance.

In recognizing that current and relevant environmental (economic, market or other) conditions that can affect repayment may not yet be fully reflected in historical loss experience, qualitative assessments are conducted to factor in current loan portfolio and market intelligence. These adjustments, which are added to (or subtracted from) the loss ratio, consider the nature of the bank s primary markets and are reasonable, consistently determined and appropriately documented. These qualitative adjustments for 2012 through 2014 include the following:

<u>2012</u>

- In the second quarter 2012, adjustment factors were added to the Pass and Special Mention rated Commercial Mortgage segments in consideration of the refinance risk associated with loans maturing over the next two years. Adjustment factors were not added to Substandard rated loans due to the enhanced level of monitoring devoted to these credits, with impairment analysis performed as indicated.

- In the second quarter 2012, an adjustment factor was added in recognition of the delegation of increased credit authority to Line Division Management and changes in the underwriting and approval process for small business lending. This change involved moving from a judgmental underwriting process for all loans to a score-based approval process below a certain loan size threshold, and a streamlined judgmental process augmented by relationship officer involvement above a certain loan size threshold.

<u>2013</u>

- In the first quarter of 2013, an adjustment factor was added to the Pass rated residential mortgage segments in consideration of emerging concentration risk. In addition, benchmark loss rates were applied to loans generated via recent preapproved and invitation to apply promotions in the Direct Consumer segment until historical loss data had been accumulated. Also, weighted adjustment factors were applied to the syndicated loan portfolio based on Moody s proxy default rates to account for increased risk associated with recent entrance into this sector and risk exposure attributed to the size of individual credits.

- In the second quarter of 2013, an adjustment factor was subtracted from the Pass rated residential mortgage segments in consideration of the continued disparity between actual calculated historical loss rates and those provided by our primary regulator in 2010.

- In the third quarter of 2013, we purchased the first student loan pool. The expected loss rates were applied to the student loans in the Direct Consumer segment until historical loss data has been accumulated for this loan segment.

<u>2014</u>

- In the first quarter of 2014, the refinance risk qualitative adjustment factors for commercial mortgages were discontinued as the extension of the historical loss look-back period is deemed to capture a majority of the segment s refinance risk through the incorporation of more comprehensive economic data.

- In the first quarter of 2014, the previous methodology for Pass rated residential mortgage subsectors based on guidance from our primary regulator in 2010 was discontinued in order to better reflect the bank s current exposure and actual loss experience. The Company deems the bank s actual loss experience to be more reflective of current portfolio conditions.

- In the first quarter of 2014, in consideration of portfolio concentration risk, benchmark adjustment factors were added to the Pass and Special Mention rated subsectors of segments with loan balances comprising greater than 20% of the total loan portfolio. The benchmark adjustment factors consider segment-specific annual loss rates over the economic cycle in order to determine a loss rate that adequately captures concentration risk. In the first quarter of 2014, the benchmark adjustment factors affected the Pass rated residential mortgage and commercial mortgage segments.

- In the second quarter of 2014, the Company adopted an incremental enhancement to its existing methodology for determining the unallocated component of the reserve. This enhancement is based upon the relationship between the unallocated component of the Allowance and then current general component (FAS 5) of the Allowance, rounded upward to the nearest $500,000.

- In the fourth quarter of 2014, the Company determined that it was appropriate to separate U.S. mainland commercial mortgages from Hawaii commercial mortgages for purposes of calculating concentration risk. In making this assessment, the Company considered the regulatory guidance and concluded that the U.S. mainland commercial mortgages were no longer not sufficiently similar in credit performance to the credit performance of the Hawaii commercial mortgages such that they would necessarily perform like a single large exposure. This is supported by a correlation analysis conducted by the Company. In light of the statistical evidence demonstrating the reduced dependency between the credit performance of the two segments, the Company concluded that the U.S. mainland commercial mortgage segment should not be included with the Hawaii commercial mortgage segment for the determination of portfolio concentration.

- In the fourth quarter of 2014, the Company adopted a time based graduated scale to reduce reliance on benchmark data by substituting our emerging actual experience in the Pre-approved Consumer Loans and Student Loans portfolios of the Consumer Loan Segment.

- In the fourth quarter of 2014, the Company replaced a Moody s proxy loss rate designed to compensate for the large size of the individual loans and lack of experience with a qualitative factor based on the Company s emerging experience in the syndicated loan portfolio. The portfolio has begun to season and within the one year look-back period, we experienced a loss. The Company considers it prudent to augment the emerging experience of this portfolio with qualitative factors that are intended to compensate for lack of sufficient historical experience.

The following table 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.

Table 14. Allocation of Allowance for Loan and Lease Losses

	December 31,									
	2014		2013		2012		2011		2010	
	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	$ 8,954	15.8%	$ 13,196	15.2%	$ 4,987	11.2%	$ 6,110	8.7%	$ 13,426	9.6%
Real estate:										
Construction	14,969	3.9	2,774	2.9	4,510	4.3	28,630	7.8	76,556	14.5
Mortgage:										
Residential	17,927	43.7	25,272	43.2	27,836	43.8	30,732	40.9	29,059	31.8
Commercial	20,869	24.0	29,947	26.7	50,574	33.7	49,733	36.4	67,079	37.6
Consumer	7,314	12.5	6,576	11.8	2,421	6.5	2,335	5.3	3,155	5.2
Leases	7	0.1	55	0.2	85	0.5	553	0.9	1,579	1.3
Unallocated	4,000		6,000		6,000		4,000		2,000	
Total	$ 74,040	100.0%	$ 83,820	100.0%	$ 96,413	100.0%	$ 122,093	100.0%	$ 192,854	100.0%

The Allowance allocated to commercial loans at year-end 2014 totaled $9.0 million, compared to $13.2 million at year-end 2013, representing 1.9% and 3.3% of total commercial loans, respectively. The decreases in the ending Allowance amount and the Allowance as a percentage of commercial loans were primarily due to improvement in the Moody s proxy loss rates utilized.

The Allowance allocated to construction loans totaled $15.0 million, or 13.1%, of construction loans at year-end 2014, compared to $2.8 million, or 3.7%, of construction loans outstanding at year-end 2013. The increases in the ending Allowance amount and the Allowance as a percentage of construction loans were primarily due to the significant increase in the construction loan portfolio as of year-end 2014.

The Allowance allocated to our residential mortgage loans decreased to $17.9 million, or 14.0%, of total residential mortgage loans at December 31, 2014, compared to $25.3 million, or 2.2%, of related loans at year-end 2013. The decrease in the ending Allowance amount was primarily due to the decrease in nonaccrual residential mortgage loans as of year-end 2014.

Commercial mortgage loans were allocated an Allowance of $20.9 million, or 3.0%, of those loans at December 31, 2014, compared to $29.9 million, or 4.3%, of commercial mortgage loans at year-end 2013. The decreases in the ending Allowance amount and the Allowance as a percentage of commercial mortgage loans were primarily due to the decreases in the commercial mortgage loan portfolio and nonaccrual commercial loans as of year-end 2014.

The allocated Allowance for consumer loans at December 31, 2014 increased to $7.3 million from $6.6 million in the prior year, representing 2.0% of total consumer loans in 2014, compared to 2.1% in 2013. The increase in the ending Allowance amount was primarily due to an increase in the consumer loan portfolio as of year-end 2014.

We also allocated an Allowance for leases of $7 thousand, or 0.2%, of total leases, compared to $55 thousand, or 0.9%, of total leases as of year-end 2013.

The unallocated portion of the Allowance of $4.0 million at December 31, 2014 decreased from $6.0 million at December 31, 2013. The unallocated portion of the Allowance is maintained to provide for additional credit risk which may exist but may 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.

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

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

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

Table 15. Nonperforming Assets, Past Due and Restructured Loans

	December 31, 2014	2013	2012	2011	2010
	(Dollars in thousands)				
Nonaccrual loans					
Commercial, financial & agricultural	$ 13,007	$ 3,533	$ 3,510	$ 1,367	$ 982
Real estate:					
Construction	310	4,015	38,742	69,765	182,073
Mortgage - residential	13,048	20,271	27,499	46,960	45,581
Mortgage - commercial	12,722	13,769	9,487	15,821	16,443
Consumer					225
Leases			94		
Total nonaccrual loans	39,087	41,588	79,332	133,913	245,304
Other real estate					
Real estate:					
Construction	747	3,770	8,105	56,429	54,507
Mortgage - residential	2,201	1,184	2,372	5,252	3,000
Mortgage - commercial		209	209		
Other real estate	2,948	5,163	10,686	61,681	57,507
Total nonperforming assets	42,035	46,751	90,018	195,594	302,811
Accruing loans delinquent for 90 days or more					
Real estate:					
Construction					6,550
Mortgage - residential			387		1,800
Consumer	77		116	28	181
Leases		15			
Total accruing loans delinquent for 90 days or more	77	15	503	28	8,531
Restructured loans still accruing interest					
Commercial, financial & agricultural	361	406	447		
Real estate:					
Construction	892	3,857	9,522	5,170	
Mortgage - residential	17,845	16,508	15,366	3,093	13,401
Mortgage - commercial	10,405	2,502	6,425		
Total restructured loans still accruing interest	29,503	23,273	31,760	8,263	13,401
Total nonperforming assets, accruing loans delinquent for 90 days or more and restructured loans still accruing interest	$ 71,615	$ 70,039	$ 122,281	$ 203,885	$ 324,743

Total nonperforming assets as a percentage of loans and leases and other real estate		1.43%		1.77%		4.06%		9.20%		13.60%
Total nonperforming assets and accruing loans delinquent for 90 days or more as a percentage of loans and leases and other real estate		1.43%		1.77%		4.09%		9.20%		13.98%
Total nonperforming assets, accruing loans delinquent for 90 days or more and restructured loans still accruing interest as a percentage of loans and leases and other real estate		2.44%		2.66%		5.52%		9.59%		14.58%
Year-to-date changes in nonperforming assets:										
Balance at beginning of year	$	46,751	$	90,018	$	195,594	$	302,811	$	499,804
Additions		28,295		27,648		46,641		73,248		240,322
Reductions:										
Payments		(9,630)		(41,766)		(63,107)		(106,529)		(237,263)
Return to accrual status		(15,761)		(17,247)		(26,261)		(9,482)		(25,666)
Sales of foreclosed assets		(3,457)		(9,519)		(53,029)		(36,221)		(29,456)
Charge-offs and/or writedowns		(4,163)		(2,383)		(9,820)		(28,233)		(144,930)
Total reductions		(33,011)		(70,915)		(152,217)		(180,465)		(437,315)
Balance at end of year	$	42,035	$	46,751	$	90,018	$	195,594	$	302,811

Nonperforming assets, which includes nonaccrual loans and leases, nonperforming loans classified as held for sale and other real estate, totaled $42.0 million at December 31, 2014, compared to $46.8 million at year-end 2013. Nonperforming assets at December 31, 2014 were comprised of $39.1 million in nonaccrual loans, none of which were loans classified as held for sale, and $2.9 million in other real estate.

The decrease in 2014 was attributable to $15.8 million in loans restored to accrual status, $9.6 million in repayments, charge-offs and write-downs totaling $4.2 million, and the sale of $3.5 million in other real estate. All of these decreases were offset by $28.3 million in gross additions.

Net changes to nonperforming assets by category during 2014 included net decreases in U.S. Mainland commercial mortgage assets totaling $7.3 million, Hawaii residential mortgage assets totaling $6.2 million, Hawaii construction and development assets totaling $5.9 million, U.S. Mainland construction and development assets totaling $0.8 million, and Hawaii commercial assets totaling $0.7 million. Partially offsetting these decreases were net increases in U.S. Mainland commercial assets totaling $10.1 million and Hawaii commercial mortgage assets totaling $6.1 million.

Loans delinquent for 90 days or more still accruing interest were less than $0.1 million at December 31, 2014 and 2013.

Investment Portfolio

The following table sets forth the amounts and distribution of investment securities held as of the dates indicated.

Table 16. Distribution of Investment Securities

	December 31, 2014		2013		2012	
	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)					
Debt securities:						
U.S. Government sponsored entities	$	$	$	$	$	$ 280,939
States and political subdivisions		191,645		179,357		185,911
Corporate securities		100,604		158,095		127,946
Mortgage-backed securities:						
U.S. Government sponsored entities	238,287	751,558	252,047	927,626	161,848	941,043
Non-agency collateralized mortgage obligations		184,334		142,046		
Other		877		875		906
Total	$ 238,287	$ 1,229,018	$ 252,047	$ 1,407,999	$ 161,848	$ 1,536,745

Investment securities totaled $1.5 billion at December 31, 2014, decreasing by $192.7 million, or 11.6%, from the $1.7 billion held at December 31, 2013, which decreased by $38.5 million, or 2.3%, from the $1.7 billion at year-end 2012.

In the second quarter of 2014, $162.3 million in available-for-sale agency securities were sold as part of a balance sheet optimization strategy designed to improve our interest rate risk profile. We received $162.5 million in gross proceeds and gross realized gains and losses on the sales of the available-for-sale investment securities were $0.9 million and $0.7 million, respectively. The investment securities sold had a weighted average life of 5.7 years and average net yield of 2.68%. The specific identification method was used as the basis for determining the cost of all securities sold.

In the fourth quarter of 2013, we executed a bond swap where we sold $271.5 million in lower-yielding available-for-sale agency debentures and agency mortgage-backed securities with an average net yield of 1.87% and a weighted average life of 2.9 years and reinvested the majority of the proceeds in $242.5 million of higher-yielding agency mortgage-backed securities, non-agency commercial mortgage-backed securities, and corporate bond securities with an average yield of 3.21% and a weighted average life of 7.4 years. The specific identification method was used as the basis for determining the cost of all securities sold and the new securities were classified in the available-for-sale portfolio. We received $271.9 million in gross proceeds and gross realized gains and losses on the sales of the available-for-sale investment securities were $3.9 million and $3.4 million, respectively.

Maturity Distribution of Investment Portfolio

The following table sets forth the maturity distribution of the investment portfolio and weighted average yields by investment type and maturity grouping at December 31, 2014.

Table 17. Maturity Distribution of Investment Portfolio

Portfolio Type and Maturity Grouping		Carrying Value	Weighted Average Yield (1)
		(Dollars in thousands)	
Held-to-maturity portfolio:			
U.S. Government sponsored entities mortgage-backed securities:			
Within one year	$		%
After one but within five years			
After five but within ten years			
After ten years		238,287	2.06
Total U.S. Government sponsored entities mortgage-backed securities		238,287	2.06
Total held-to-maturity portfolio	$	238,287	2.06%
Available-for-sale portfolio:			
States and political subdivisions:			
Within one year	$	3,847	4.11%
After one but within five years		7,099	5.06
After five but within ten years		63,468	2.64
After ten years		117,231	3.61
Total States and political subdivisions		191,645	3.35
Corporate securities:			
Within one year			
After one but within five years		50,888	2.85
After five but within ten years		49,716	2.94
After ten years			
Total Corporate securities		100,604	2.90
U.S. Government sponsored entities mortgage-backed securities:			
Within one year			
After one but within five years		330	5.06
After five but within ten years		45,239	2.72
After ten years		705,989	2.30
Total U.S. Government sponsored entities mortgage-backed securities		751,558	2.33
Non-agency collaterized mortgage obligations:			
Within one year			
After one but within five years			
After five but within ten years		117,635	3.06
After ten years		66,699	3.68
Total Non-agency collaterized mortgage obligations		184,334	3.29
Other:			

Within one year			
After one but within five years			
After five but within ten years			
After ten years		877	
Total Other		877	
Total available-for-sale portfolio	$	1,229,018	2.68%
Total investment securities	$	1,467,305	2.58%

(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 34%.

During 2014, the weighted average yield of the investment portfolio of 2.58% remained unchanged from the prior year.

Deposits

The primary source of our funding comes from 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 non-interest bearing and interest-bearing demand deposits, savings and money market deposits, and time deposits less than $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.

Total deposits of $4.1 billion at December 31, 2014 reflected an increase of $174.1 million, or 4.4%, from total deposits of $3.9 billion at December 31, 2013. Total deposits at December 31, 2013 increased by $255.4 million, or 6.9%, over the year-end 2012 balance of $3.7 billion. The increase in deposits in 2014 reflects increases in noninterest-bearing demand deposits, interest-bearing demand deposits, and savings and money market deposits of $143.1 million, $59.7 million, and $35.6 million, respectively, offset by decreases in other time deposits and government-owned time deposits of $52.1 million and $12.1 million, respectively.

Core deposits totaled $3.3 billion at December 31, 2014 and increased by $212.9 million, or 6.9%, from December 31, 2013, which increased by $86.6 million or 2.9% from December 31, 2012. Core deposits as a percentage of total deposits was 80.4% at December 31, 2014, compared to 78.6% at December 31, 2013 and 81.7% at December 31, 2012.

The table below sets forth information regarding the average balances and average rates paid for certain deposit categories for each of the years indicated. Average balances are computed using daily average balances. The average rate on time deposits, which are most sensitive to changes in market rates, decreased by 4 bp in 2014, while savings and money market deposit rates and interest-bearing demand deposit rates remained unchanged. The average rate paid on all deposits in 2014 decreased to 0.09% from 0.11% in 2013 and 0.14% in 2012. The drop in average rates paid in 2014 was attributable to the depressed interest rate environment in which we, as well as other financial institutions throughout the country, continued to operate in during 2014.

Table 18. Average Balances and Average Rates on Deposits

	Year Ended December 31, 2014		2013		2012	
	Average Balance	**Average Rate Paid**	**Average Balance**	**Average Rate Paid**	**Average Balance**	**Average Rate Paid**
	(Dollars in thousands)					
Noninterest-bearing demand deposits	$ 938,078	%	$ 849,371	%	$ 773,768	%
Interest-bearing demand deposits	764,504	0.05	708,658	0.05	615,960	0.05
Savings and money market deposits	1,227,049	0.07	1,191,919	0.07	1,163,963	0.09
Time deposits	1,059,435	0.23	1,054,714	0.27	978,627	0.38
Total	$ 3,989,066	0.09%	$ 3,804,662	0.11%	$ 3,532,318	0.14%

We expect overall deposit rates to remain suppressed in 2015 in response to the FRB s current monetary policy of keeping interest rates at low levels. In addition to the external interest rate environment, the overall direction of rate movements in our deposit base will largely depend on the level of deposit growth we need to maintain adequate liquidity and competitive pricing considerations, which may be impacted by the repeal of federal prohibitions on the ability of financial institutions to pay interest on demand deposit accounts as part of the Dodd-Frank Act as further described in Item 1A. Risk Factors.

Contractual Obligations

The following table sets forth contractual obligations (excluding deposit liabilities) as of December 31, 2014.

Table 19. Contractual Obligations

	Payments Due By Period				
	Less Than One Year	1-3 Years	3-5 Years	More Than 5 Years	Total
	(Dollars in thousands)				
Short-term borrowings	$ 38,000	$	$	$	$ 38,000
Long-term debt				92,785	92,785
Pension plan and SERP obligations	2,713	5,686	5,795	33,066	47,260
Operating leases	7,756	11,856	8,672	24,604	52,888
Purchase obligations	17,096	15,896	11,506	96	44,594
Total	$ 65,565	$ 33,438	$ 25,973	$ 150,551	$ 275,527

Components of short-term borrowings and long-term debt are discussed in Notes 12 and 13, respectively, to the Consolidated Financial Statements under Part II, Item 8. Financial Statements and Supplementary Data. Operating leases represent leases on bank premises as discussed in Note 18 to the Consolidated Financial Statements under Part II, Item 8. Financial Statements and Supplementary Data. Purchase obligations represent other contractual obligations to purchase goods or services at specified terms including, but not limited to, software licensing agreements, equipment maintenance contracts and professional service contracts. Pension plan obligations include obligations under our defined benefit retirement plan and Supplemental Executive Retirement Plans, which are discussed in Note 16 to the Consolidated Financial Statements under Part II, Item 8. Financial Statements and Supplementary Data.

Capital Resources

In order to ensure adequate levels of capital, we conduct an ongoing assessment of projected sources and uses of capital in conjunction with an analysis of the size and quality of our assets and the level of risk. As part of this ongoing assessment, the Board of Directors reviews our capital position on an ongoing basis to ensure it is adequate, including, but not limited to, need for raising additional capital or returning capital to our shareholders, including the ability to declare cash dividends or repurchase our securities.

Common and Preferred Equity

Shareholders equity totaled $568.0 million at December 31, 2014, a decrease of $92.1 million, or 13.9%, from the $660.1 million at December 31, 2013, which increased by $155.3 million, or 30.8%, from 2012. When expressed as a percentage of total assets, shareholders equity was 11.7% at December 31, 2014, compared to 13.9% at December 31, 2013 and 11.6% at December 31, 2012.

The significant decrease in shareholders equity from 2013 was primarily attributable to : 1) the purchase of 3,405,888 shares of our common stock for a total cost of $68.8 million, excluding fees and expenses, related to a tender offer, 2) the purchase of 2,782,178 shares of our common stock for a total cost of $56.2 million, excluding fees and expenses, related to repurchase agreements with our two largest shareholders, 3) the repurchase of 857,554 shares of our common stock for a total cost of $16.5 million, under our stock repurchase program, and 4) cash dividends paid of $13.4 million. These decreases were partially offset by $40.5 million and $19.0 million in net income and accumulated other comprehensive income in 2014, respectively. During 2014 we repurchased approximately 16.73% of our common stock outstanding at December 31, 2013.

The significant increase in shareholders equity from 2012 to 2013 was primarily attributable to the $172.1 million in net income recognized in 2013. As previously mentioned, net income in 2013 included a non-cash income tax benefit of $119.8 million recorded in the first quarter of 2013 related to the reversal of a significant portion of a valuation allowance that was established against the Company s net DTA during the third quarter of 2009.

In June 2013, the Treasury held a private auction to sell its warrant positions in several financial institutions which included the Company s warrant to purchase up to 79,288 shares of our common stock at a purchase price of $10 per share. On June 6, 2013, we were notified that we were the winning bidder of the warrant at our bid of $0.8 million. The warrant was being carried as a derivative liability on our balance sheet at $0.8 million at March 31, 2013. Accordingly, we recorded a credit to other noninterest expense of $0.1 million during the quarter related to the gain on the purchase of the warrant. After the completion of this transaction, the Treasury no longer holds any outstanding shares of our common stock, or any warrants to purchase our common stock they received in connection with our participation in the Troubled Assets Relief Program.

Our tangible common equity ratio was 11.52% at December 31, 2014, compared to 13.69% at December 31, 2013 and 11.24% at December 31, 2012. Our book value per share was $16.12, $15.68, and $12.06 at year-end 2014, 2013 and 2012, respectively. The decrease in our tangible common equity ratio from 2013 was primarily attributable to the reduction in our common equity due to the common stock repurchases completed in 2014 under the aforementioned tender offer, repurchase agreements with our two largest shareholders, and stock repurchase program. The increase in our book value per share from 2013 was primarily attributable to net income and accumulated other comprehensive income recorded in 2014 of $40.5 million and $19.0 million, respectively, combined with the reduction in common shares outstanding due to the aforementioned common stock repurchases completed in 2014.

The tangible common equity ratio is a non-GAAP financial measure which should be read and used in conjunction with the Company s GAAP financial information. Comparison of our tangible common equity ratio with those of other companies may not be possible because other companies may calculate the tangible common equity ratio differently. Our tangible common equity ratio is derived by dividing common shareholders equity, less intangible assets (excluding mortgage servicing rights), by total assets, less intangible assets (excluding mortgage servicing rights).

The following table sets forth a reconciliation of our tangible common equity ratio for each of the dates indicated:

Table 20. Reconciliation to Tangible Common Equity Ratio

	December 31, 2014	December 31, 2013 (Dollars in thousands)	December 31, 2012
Total shareholders equity	$ 568,041	$ 660,113	$ 504,822
Less:			
Preferred stock			
Other intangible assets (excluding mortgage servicing rights)	(10,029)	(12,704)	(15,378)
Tangible common equity	558,012	647,409	489,444
Total assets	4,852,987	4,741,198	4,370,368
	(10,029)	(12,704)	(15,378)

Less: Other intangible assets (excluding mortgage servicing rights)			
Tangible assets	4,842,958	4,728,494	4,354,990
Tangible common equity to Tangible assets	11.52%	13.69%	11.24%

Trust Preferred Securities

We have four statutory trusts, CPB Capital Trust II, CPB Statutory Trust III, CPB Capital Trust IV and CPB Statutory Trust V, which issued a total of $90.0 million in trust preferred securities. Our obligations with respect to the issuance of the trust preferred securities constitute a full and unconditional guarantee by the Company of the each trust s obligations with respect to its trust preferred securities. Subject to certain exceptions and limitations, we may elect from time to time to defer subordinated debenture interest payments, which would result in a deferral of dividend payments on the related trust preferred securities, for up to 20 consecutive quarterly periods without default or penalty.

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

In June 2013, the Company was notified that $10.0 million of the $15.0 million in trust preferred securities of CPB Capital Trust I (Trust I) would be auctioned off as part of a larger pooled collateralized debt obligation liquidation. The Company placed a bid of $9.0 million for the securities which was accepted by the trustee and the transaction closed on June 18, 2013. Because our accepted bid of $9.0 million was less than the $10.0 million carrying value, we recognized a gain of $1.0 million related to this transaction on October 7, 2013, when these securities were called. The Company determined that its investment in Trust I did not represent a variable interest and therefore the Company was not the primary beneficiary of Trust I. As a result, consolidation of Trust I by the Company was not required. In October 2013, the Company purchased the remaining $5.0 million in trust preferred securities of Trust I and in April 2014, the remaining $0.5 million in common stock of the Trust I was called. On August 27, 2014, Trust I was cancelled with the state of Delaware.

Holding Company Capital Resources

CPF is required to act as a source of strength to the bank under the Dodd-Frank Act. All of the funds CPF received from the sale of the TARP preferred stock were contributed by CPF to the bank as capital. CPF is obligated to pay its expenses and payments on its junior subordinated debentures which fund payments on the outstanding trust preferred securities. CPF deferred the payment of dividends on our TARP preferred stock and trust preferred securities (along with interest on the related junior subordinated debentures) beginning in the third quarter of 2009. As mentioned in the previous section, in March 2013, the Company elected to resume quarterly payments for each outstanding trust and all deferred interest on its subordinated debentures and related dividend payments on its trust preferred securities were paid in full.

In 2013, in light of the Company s improved capital position and financial condition, our Board of Directors and management, in consultation with our regulators, reinstated and declared quarterly cash dividends on the Company s outstanding common shares to shareholders.

On March 21, 2014, CPF received its first dividend from the bank since September 2008 of $125.0 million in order to meet its obligations under the Tender Offer and Private Repurchases. In the second, third and fourth quarters of 2014, CPF received dividends from the bank totaling $16.1 million, $9.6 million, and $8.6 million, respectively, to fund the quarterly cash dividends and share repurchases. As of December 31, 2014, on a stand-alone basis, CPF had an available cash balance of approximately $22.8 million in order to meet its ongoing obligations.

As a Hawaii state-chartered bank, the bank may only pay dividends to the extent it has retained earnings as defined under Hawaii banking law (Statutory Retained Earnings), which differs from GAAP retained earnings. As of December 31, 2014, the bank had Statutory Retained Earnings of $123.8 million.

Dividends are payable at the discretion of the Board of Directors and there can be no assurance that the Board of Directors will continue to pay dividends at the same rate, or at all, in the future. Our ability to pay cash dividends to our shareholders is subject to restrictions under federal and Hawaii law, including restrictions imposed by the FRB and covenants set forth in various agreements we are a party to, including covenants set forth in our subordinated debentures. For further information, see Dividends Market for Registrant s Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities.

On February 21, 2014, we announced a tender offer to purchase for cash up to $68.8 million in value of shares of our common stock at a price not greater than $21.00 nor less than $18.50 per share (the Tender Offer).

The Tender Offer expired on March 21, 2014 and we accepted for purchase 3,405,888 shares of our common stock at the purchase price of $20.20 per share for a total cost of $68.8 million, excluding fees and expenses related to the Tender Offer. The Tender Offer closed on March 28, 2014.

Share Repurchases

On February 20, 2014, we also entered into repurchase agreements (the Repurchase Agreements) with each of Carlyle Financial Services Harbor, L.P. (Carlyle) and ACMO-CPF, L.L.C. (Anchorage and together with Carlyle, the Lead Investors), each of whom was the owner of 9,463,095 shares (representing 22.5% of the outstanding shares or 44.9% in the aggregate at that time) of our common stock, pursuant to which we agreed to purchase up to $28.1 million of shares of common stock from each of the Lead Investors at the Purchase Price of the Tender Offer (the Private Repurchases) (or an aggregate of $56.2 million of shares). Conditions to the Private Repurchases were satisfied and we purchased 1,391,089 shares from each of Carlyle and Anchorage at the Purchase Price for a total cost of $56.2 million, excluding fees and expenses related to the Private Repurchases. The Private Repurchases closed on April 7, 2014, the eleventh business day following the expiration of the Tender Offer.

The completion of the Tender Offer and the Private Repurchases resulted in the aggregate repurchase by us of 6,188,066 shares totaling $125 million, or 14.7% of our issued and outstanding shares of our common stock prior to the completion of the Tender Offer and the Private Repurchases.

In January 2008, our Board of Directors authorized the repurchase and retirement of up to 60,000 shares of the Company s common stock (the 2008 Repurchase Plan). Repurchases under the 2008 Repurchase Plan may be made from time to time on the open market or in privately negotiated transactions. There were no repurchases of common stock during 2012 and 2013. A total of 55,000 shares remained available for repurchase under the 2008 Repurchase Plan at December 31, 2013. In January 2014, the 2008 Repurchase Plan and the remaining 55,000 shares were superseded by the Tender Offer and Repurchase Agreements with our Lead Investors.

On May 20, 2014, our Board of Directors authorized the repurchase and retirement of up to $30.0 million of the Company s outstanding common stock (the 2014 Repurchase Plan). Repurchases under the 2014 Repurchase Plan may be made from time to time on the open market or in privately negotiated transactions. In 2014, 857,554 shares of common stock, at a cost of $16.5 million, were repurchased under this program. A total of $13.5 million remained available for repurchase under the 2014 Repurchase Plan at December 31, 2014.

In January 2015, our Board of Directors increased our repurchase authority by an additional $25.0 million. We continue to explore opportunities to expand our ability to repurchase shares from shareholders.

Asset/Liability Management and Interest Rate Risk

Our earnings and capital are sensitive to risk of interest rate fluctuations. Interest rate risk arises when rate-sensitive assets and rate-sensitive liabilities mature or reprice during different periods or in differing amounts. In the normal course of business, we are subjected to interest rate risk through the activities of making loans and taking deposits, as well as from our investment securities portfolio and other interest-bearing funding sources. Asset/liability management attempts to coordinate our rate-sensitive assets and rate-sensitive liabilities to meet our financial objectives.

Our Asset/Liability Management Policy seeks to maximize the risk-adjusted return to shareholders while maintaining consistently acceptable levels of liquidity, interest rate risk and capitalization. Our Asset/Liability Management Committee, or ALCO, monitors interest rate risk through the use of interest rate sensitivity gap, net interest income and market value of portfolio equity simulation and rate shock analyses. This process is designed to measure the impact of future changes in interest rates on net interest income and market value of portfolio equity. Adverse interest rate risk exposures are managed through the shortening or lengthening of the duration of assets and liabilities.

Interest rate risk can be analyzed by monitoring an institution s interest rate sensitivity gap and changes in the gap over time. An asset or liability is said to be interest rate sensitive within a specific time period if it will mature or reprice within that time period. The interest rate sensitivity gap is defined as the difference between the amount of interest-earning assets and the amount of interest-bearing liabilities maturing or repricing within a specified time period. A gap is considered positive when the amount of interest rate sensitive assets exceeds the amount of interest rate sensitive liabilities. A gap is considered negative when the amount of interest rate sensitive liabilities exceeds the amount of interest rate sensitive assets. During a period of rising interest rates, the earnings of an institution with a positive gap theoretically may be positively affected due to its interest-earning assets repricing to a greater extent than its interest-bearing liabilities. An adverse impact would be expected for an institution with a negative gap.

The following table sets forth information regarding our interest rate sensitivity gap at December 31, 2014. The assumptions used in determining interest rate sensitivity of various asset and liability products had a significant impact on the resulting table. For purposes of this presentation, assets and liabilities are classified by the earliest repricing date or maturity. All interest-bearing demand and savings balances are included in the three-months-or-less category, even though repricing of these accounts is not contractually required and may not actually occur during that period. Since all interest rates and yields do not adjust at the same velocity or magnitude, and since volatility is subject to change, the interest rate sensitivity gap is only a general indicator of interest rate risk.

Table 21. Rate Sensitivity of Assets, Liabilities and Equity

	Three Months or Less	Over Three Through Six Months	Over Six Through Twelve Months	Over One Through Three Years	Over Three Years	Nonrate Sensitive	Total
				(Dollars in thousands)			
Assets							
Interest-bearing deposits in other banks	$ 13,691	$	$	$	$	$	$ 13,691
Investment securities	43,879	38,121	72,370	269,452	1,031,171	12,312	1,467,305
Loans held for sale	9,595					88	9,683
Loans and leases	808,983	197,868	350,743	759,956	809,663	4,985	2,932,198
Federal Home Loan Bank stock					43,932		43,932
Other assets						386,178	386,178
Total assets	$ 876,148	$ 235,989	$ 423,113	$ 1,029,408	$ 1,884,766	$ 403,563	$ 4,852,987
Liabilities and Equity							
Noninterest-bearing deposits	$ 1,034,146	$	$	$	$	$	$ 1,034,146
Interest-bearing deposits	2,423,860	353,343	169,957	98,458	30,536		3,076,154
Short-term borrowings	38,000						38,000
Long-term debt	92,785						92,785
Other liabilities						43,861	43,861
Equity						568,041	568,041
Total liabilities and equity	$ 3,588,791	$ 353,343	$ 169,957	$ 98,458	$ 30,536	$ 611,902	$ 4,852,987
Interest rate sensitivity gap	$ (2,712,643)	$ (117,354)	$ 253,156	$ 930,950	$ 1,854,230	$ (208,339)	$
Cumulative interest rate sensitivity gap	$ (2,712,643)	$ (2,829,997)	$ (2,576,841)	$ (1,645,891)	$ 208,339	$	$

ALCO also utilizes a detailed and dynamic simulation model to measure and manage interest rate risk exposures. The monthly simulation process is designed to measure the impact of future changes in interest rates on net interest income and market value of portfolio equity and to allow ALCO to model alternative balance sheet strategies. The following reflects our net interest income sensitivity analysis as of December 31, 2014, over a one-year horizon, assuming no balance sheet growth and given both a 200 bp upward and 100 bp downward parallel shift in interest rates.

Rate Change	**Estimated Net Interest Income Sensitivity**
+200bp	1.51%
-100bp	(3.41)%

Table 22. Interest Rate Sensitivity

	Expected Maturity Within							
	One Year	**Two Years**	**Three Years**	**Four Years**	**Five Years**	**Thereafter**	**Total Book Value**	**Total Fair Value**
				(Dollars in thousands)				
Interest-sensitive assets								
Interest-bearing deposits in other banks	$ 13,691	$	$	$	$	$	$ 13,691	$ 13,691
Weighted average interest rates	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	
Fixed rate investments	$ 154,369	$ 147,223	$ 122,230	$ 107,274	$ 106,540	$ 816,600	$ 1,454,236	$ 1,463,738
Weighted average interest rates	2.49%	2.58%	2.55%	2.52%	2.53%	2.62%	2.58%	
Variable rate investments	$	$	$	$	$	$	$	$
Weighted average interest rates	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	
Equity investments	$	$	$	$	$	$ 757	$ 757	$ 877
Weighted average interest rates	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	
Fixed rate loans	$ 399,443	$ 284,122	$ 205,367	$ 147,012	$ 108,032	$ 385,429	$ 1,529,405	$ 1,458,528
Weighted average interest rates	4.39%	4.39%	4.32%	4.26%	4.23%	4.27%	4.33%	
Variable rate loans	$ 473,519	$ 259,195	$ 206,181	$ 137,072	$ 101,341	$ 190,996	$ 1,368,304	$ 1,269,308
Weighted average interest rates	3.87%	3.89%	3.95%	4.27%	4.28%	4.43%	4.04%	
Total - December 31, 2014	$ 1,041,022	$ 690,540	$ 533,778	$ 391,358	$ 315,913	$ 1,393,782	$ 4,366,393	$ 4,206,142
Total - December 31, 2013	$ 959,208	$ 598,220	$ 461,619	$ 388,741	$ 289,048	$ 1,590,714	$ 4,287,550	$ 4,062,580
Interest-sensitive liabilities								
Interest-bearing demand and savings deposits	$ 2,030,870	$	$	$	$	$	$ 2,030,870	$ 2,030,870
Weighted average interest rates	0.07%	0.00%	0.00%	0.00%	0.00%	0.00%	0.07%	
Time deposits	$ 915,597	$ 71,085	$ 28,064	$ 9,214	$ 21,284	$ 40	$ 1,045,284	$ 1,047,322
Weighted average interest rates	0.16%	0.36%	0.82%	0.90%	1.20%	0.78%	0.22%	
Short-term borrowings	$ 38,000	$	$	$	$	$	$ 38,000	$ 38,000
Weighted average interest rates	0.25%	0.00%	0.00%	0.00%	0.00%	0.00%	0.25%	
Long-term debt	$	$	$	$	$	$ 92,785	$ 92,785	$ 42,454
Weighted average interest rates	0.00%	0.00%	0.00%	0.00%	0.00%	2.75%	2.75%	

Total - December 31, 2013	$	2,984,467	$	71,085	$	28,064	$	9,214	$	21,284	$	92,825	$	3,206,939	$	3,158,646
Total - December 31, 2012	$	2,932,624	$	66,874	$	29,443	$	12,518	$	9,539	$	94,972	$	3,145,970	$	3,094,415

The preceding sensitivity analysis does not represent our forecast and should not be relied upon as being indicative of expected operating results. These estimates are based upon numerous assumptions including: the magnitude and timing of interest rate changes, prepayments on loans and investment securities, deposit decay rates, pricing decisions on loans and deposits, reinvestment of asset and liability cashflows and others.

The table above presents information on financial instruments held that are sensitive to changes in interest rates. For purposes of this presentation, expected maturities of interest-sensitive assets and liabilities are contractual maturities. Interest-bearing demand and savings deposits, which have indeterminate maturities, are included in the earliest maturity category. The resulting table is based on numerous assumptions including prepayment rates on mortgage-related assets and forecasted market interest rates. See Note 24 to the Consolidated Financial Statements under Part II, Item 8. Financial Statements and Supplementary Data for a discussion of the calculation of fair values.

Maturities and fair values of interest-sensitive assets and liabilities may vary from expectation if actual experience differs from the assumptions used.

Liquidity

Our objective in managing liquidity is to maintain a balance between sources and uses of funds in order to economically meet the cash requirements of customers for loans and deposit withdrawals and participate in lending and investment opportunities as they arise. We monitor our liquidity position in relation to changes in loan and deposit balances on a daily basis to assure maximum utilization, maintenance of an adequate level of readily marketable assets and access to short-term funding sources. Our loan-to-deposit ratio at December 31, 2014 was 71.3% compared to 66.8% at December 31, 2013. Our liquidity may be negatively impacted by unforeseen demands on cash or if our deposit customers withdraw funds due to uncertainties surrounding our financial condition or prospects.

The consolidated statements of cash flows identify the three major categories of sources and uses of cash as operating, investing and financing activities. As presented in the consolidated statements of cash flows, cash provided by operating activities has provided a significant source of funds during the past three years. Cash provided by operating activities totaled $71.4 million in 2014, $84.5 million in 2013, and $39.4 million in 2012. The primary source of cash provided by operating activities continues to be our net operating income, exclusive of non-cash items such as the Provision and asset impairments.

Net cash used in investing activities amounted to $83.1 million, $442.1 million and $306.3 million in 2014, 2013 and 2012, respectively. Investment securities and lending activities generally comprise the largest components of investing activities, although the level of investment securities activities are impacted by the relationship of loan and deposit growth during the period. In 2014, 2013 and 2012, net loan originations accounted for $245.1 million, $357.9 million and $152.4 million, respectively, of cash used in investing activities. Net proceeds received from sales and maturities of investment securities totaled $223.0 million in 2014, compared to net purchases of investment securities of $24.2 million and $220.8 million in 2013 and 2012, respectively. Investing activities included proceeds from sales of loans originated for investment of $10.7 million, and $10.3 million in 2013 and 2012, respectively, and other real estate of $3.9 million, $17.9 million, and $56.9 million in 2014, 2013, and 2012, respectively. We did not sell any loans originated for investment in 2014.

Cash provided by financing activities totaled $48.4 million, $229.5 million, and $187.2 million in 2014, 2013, and 2012, respectively. Deposit activities, borrowings and capital transactions represent the major components of financing activities. In 2014, 2013 and 2012, we increased net deposits by $174.1 million, $255.4 million and $237.2 million, respectively. Net cash inflows from short-term debt totaled $30.0 million in 2014 and $8.0 million in 2013, compared to net cash outflow of $34 thousand in 2012. Net cash outflows for long-term debt totaled $14 thousand in 2014, $15.5 million in 2013 and $50.0 million in 2012. As with investment securities, the level of net borrowings is impacted by the levels of loan and deposit growth/contraction during the period. Capital transactions, primarily dividends and stock repurchases totaled $155.7 million of cash used in 2014, due primarily to share repurchases under the Tender Offer, the Private Repurchases, and the 2014 Repurchase Plan.

Core deposits have historically provided us with a sizeable source of relatively stable and low cost funds but are subject to competitive pressure in our market. In addition to core deposit funding, we also have access to a variety of other short-term and long-term funding sources, which include proceeds from maturities of our investment securities, as well as secondary funding sources such as the FHLB, secured repurchase agreements and the Federal Reserve discount window, available to meet our liquidity needs. While we historically have had access to these other funding sources, continued access to these sources may not be guaranteed and can be restricted in the future as a result of market conditions or the Company s and bank s financial position.

The bank is a member of and maintained a $945.0 million line of credit with the FHLB as of December 31, 2014. Short-term and long-term borrowings under this arrangement totaled $38.0 million and nil at December 31, 2014, respectively, compared to $8.0 million and $14 thousand at December 31, 2013, respectively. FHLB advances outstanding at December 31, 2014 were secured by unencumbered investment securities with a fair value of $0.8 million and certain real estate loans with a carrying value of $1.5 billion in accordance with the collateral provisions of the Advances, Security and Deposit Agreement with the FHLB. At December 31, 2014, $907.0 million was undrawn under this arrangement.

The bank also maintained a line of credit with the Federal Reserve discount window of $33.3 million and $46.5 million as of December 31, 2014 and 2013, respectively. There were no advances outstanding under this arrangement at December 31, 2014 and 2013. Advances under this arrangement would have been secured by certain commercial and commercial real estate loans with a carrying value totaling $72.9 million. The Federal Reserve does not have the right to sell or repledge these loans. See Note 12 to the Consolidated Financial Statements under Part II, Item 8. Financial Statements and Supplementary Data for additional information regarding our short-term borrowings.

Our ability to maintain adequate levels of liquidity is dependent on our ability to continue to maintain our strong risk profile and capital base. Our liquidity may also be negatively impacted by weakness in the financial markets and industry-wide reductions in liquidity.

Holding Company Liquidity

For the holding company on a stand-alone basis, in 2014, net cash provided by operating activities amounted to $157.9 million. The primary source of funds in operating activities included dividends received from the bank of $159.3 million. Net cash provided by investing activities amounted to $1.0 million. Net cash used in financing activities amounted to $155.7 million. The primary use of funds in financing activities included the repurchases of common stock totaling $142.4 million and cash dividends of $13.4 million paid to our common shareholders.

In 2013, net cash used in operating activities of the holding company amounted to $4.9 million. The primary use of funds in operating activities included the payment of deferred accrued interest on its subordinated debentures of $13.0 million. Net cash used in financing activities amounted to $22.1 million. The primary use of funds in financing activities included the repurchase of trust preferred securities of Trust I and subsequent retirement of long-term debt of Trust I totaling $15.5 million, and cash dividends of $6.7 million paid to our common shareholders.

In 2012, net cash provided by operating activities of the holding company amounted to $1.1 million.

Off-Balance Sheet Arrangements

In the normal course of business, we enter into off-balance sheet arrangements to meet the financing needs of our banking customers. These financial instruments include commitments to extend credit, standby letters of credit and financial guarantees written, forward foreign exchange contracts, forward interest rate contracts and interest rate swaps and options. These instruments and the related off-balance sheet exposures are discussed in detail in Note 23 to the Consolidated Financial Statements under Part II, Item 8. Financial Statements and Supplementary Data. In the unlikely event that we must satisfy a significant amount of outstanding commitments to extend credit, liquidity will be adversely impacted, as will credit risk. The remaining components of off-balance sheet arrangements, primarily interest rate options and forward interest rate contracts related to our mortgage banking activities, are not expected to have a material impact on our consolidated financial position or results of operations.

Impact of New Accounting Standards

In January 2014, the FASB issued Accounting Standards Update (ASU) 2014-01, *Investments Equity Method and Joint Ventures: Accounting for Investments in Qualified Affordable Housing Projects.* The provisions of ASU 2014-01 provide guidance on accounting for investments by a reporting entity in flow-through limited liability entities that manage or invest in affordable housing projects that qualify for the low-income housing tax credit. The ASU permits entities to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. ASU 2014-01 is effective with retroactive application for the Company s reporting period beginning on January 1, 2015. We are currently evaluating whether we will adopt the provisions of ASU 2014-01.We do not expect the adoption of this guidance to have a material impact on our consolidated financial statements.

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In January 2014, the FASB issued ASU 2014-04, *Receivables Troubled Debt Restructurings by Creditors Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure.* The provisions of ASU 2014-04 provide guidance on when an in substance repossession or foreclosure occurs, which is, when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan should be derecognized and the real estate property recognized. ASU 2014-04 is effective for the Company s reporting period beginning on January 1, 2015. We do not expect the adoption of this guidance to have a material impact on our consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers.* ASU 2014-09 requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. This ASU will replace most existing revenue recognition guidance in GAAP when it becomes effective. ASU 2014-09 is effective for the Company s reporting period beginning on January 1, 2017. We do not expect the adoption of this guidance to have a material impact on our consolidated financial statements.

In June 2014, the FASB issued ASU 2014-11, *Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures.* ASU 2014-11 requires two accounting changes. First, the amendments change the accounting for repurchase-to-maturity transactions to secured borrowings. Second, for repurchase financing arrangements, the amendments require separate accounting for a transfer of a financial asset executed contemporaneously with a repurchase agreement with the same counterparty, which will result in secured borrowing accounting for the repurchase agreement. ASU 2014-11 requires disclosures for certain transactions comprising a transfer of a financial asset accounted for as a sale, and an agreement with the same transferee entered into in contemplation of the initial transfer which results in the transferor retaining substantially all of the exposure to the economic return on the transferred financial asset throughout the term of the transaction. ASU 2014-11 also requires additional disclosures for repurchase agreements, securities lending transactions, and repurchase-to-maturity transactions that are accounted for as secured borrowings. ASU 2014-11 is effective for the Company s reporting period beginning on January 1, 2015. We do not expect the adoption of this guidance to have a material impact on our consolidated financial statements.

In June 2014, the FASB Issued ASU 2014-12, *Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance target Could Be Achieved after the Requisite Service Period.* ASU 2014-12 requires that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. ASU 2014-12 is effective for the Company s reporting period beginning on January 1, 2016. As of December 31, 2014, the Company did not have any share-based payment awards that included performance targets that could be achieved after the requisite service period. As such, we do not expect the adoption of this guidance to have a material impact on our consolidated financial statements.

In August 2014, the FASB issued ASU 2014-14, *Receivables Troubled Debt Restructurings by Creditors Subtopic 310-40): Classification of Certain Government-Guaranteed Mortgage Loans upon Foreclosure.* ASU 2014-14 requires that a mortgage loan be derecognized and that a separate other receivable be recognized upon foreclosure if the following conditions are met: 1) the loan has a government guarantee that is not separable from the loan before foreclosure; 2) at the time of foreclosure, the creditor has the intent to convey the real estate property to the guarantor and make a claim on the guarantee, and the creditor has the ability to recover under that claim; and 3) at the time of foreclosure, any amount of the claim that is determined on the basis of the fair value of the real estate is fixed. Upon foreclosure, the separate other receivable should be measured based on the amount of the loan balance expected to be recovered from the guarantor. ASU 2014-14 is effective for the Company s reporting period beginning on January 1, 2015. We do not expect the adoption of this guidance to have a material impact on our consolidated financial statements.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Quantitative and qualitative disclosures about market risk is set forth under Part II, Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations Asset/Liability Management and Interest Rate Risk and in Note 24 to the Consolidated Financial Statements under Part II, Item 8. Financial Statements and Supplementary Data.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders

Central Pacific Financial Corp.:

We have audited the accompanying consolidated balance sheets of Central Pacific Financial Corp. and subsidiaries as of December 31, 2014 and 2013, and the related consolidated statements of income, comprehensive income, changes in equity, and cash flows for each of the years in the three-year period ended December 31, 2014. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Central Pacific Financial Corp. and subsidiaries as of December 31, 2014 and 2013, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2014, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Central Pacific Financial Corp. s internal control over financial reporting as of December 31, 2014, based on *Internal Control Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 27, 2015 expressed an unqualified opinion on the effectiveness of the Company s internal control over financial reporting.

/s/ KPMG LLP
Honolulu, Hawaii
February 27, 2015

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders

Central Pacific Financial Corp.:

We have audited Central Pacific Financial Corp. s (the Company s) internal control over financial reporting as of December 31, 2014, based on criteria established in *Internal Control Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management s Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2014, based on based on criteria established in *Internal Control Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Central Pacific Financial Corp. and subsidiaries as of December 31, 2014 and 2013, and the related consolidated statements of income, comprehensive income, changes in equity, and cash flows for each of the years in the three-year period ended December 31, 2014, and our report dated February 27, 2015 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP
Honolulu, Hawaii
February 27, 2015

CENTRAL PACIFIC FINANCIAL CORP. & SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	December 31, 2014	December 31, 2013
	(Dollars in thousands)	
Assets		
Cash and due from banks	$ 72,316	$ 45,092
Interest-bearing deposits in other banks	13,691	4,256
Investment securities:		
Available for sale, at fair value	1,229,018	1,407,999
Held to maturity, at amortized cost (fair value of $235,597 at December 31, 2014 and $238,705 at December 31, 2013)	238,287	252,047
Total investment securities	1,467,305	1,660,046
Loans held for sale	9,683	12,370
Loans and leases	2,932,198	2,630,601
Allowance for loan and lease losses	(74,040)	(83,820)
Net loans and leases	2,858,158	2,546,781
Premises and equipment, net	49,214	49,039
Accrued interest receivable	13,584	14,072
Investment in unconsolidated subsidiaries	7,246	9,127
Other real estate	2,948	5,163
Other intangible assets	29,697	32,783
Bank-owned life insurance	152,283	149,604
Federal Home Loan Bank stock	43,932	46,193
Other assets	132,930	166,672
Total assets	$ 4,852,987	$ 4,741,198
Liabilities and Equity		
Deposits:		
Noninterest-bearing demand	$ 1,034,146	$ 891,017
Interest-bearing demand	788,272	728,619
Savings and money market	1,242,598	1,207,016
Time	1,045,284	1,109,521
Total deposits	4,110,300	3,936,173
Short-term borrowings	38,000	8,015
Long-term debt	92,785	92,799
Other liabilities	43,861	44,037
Total liabilities	4,284,946	4,081,024
Equity:		
Preferred stock, no par value, authorized 1,100,000 shares, issued and outstanding none at December 31, 2014 and 2013		
Common stock, no par value, authorized 185,000,000 shares, issued and outstanding 35,233,674 and 42,107,633 shares at December 31, 2014 and 2013, respectively	642,205	784,547
Surplus	79,716	75,498
Accumulated deficit	(157,039)	(184,087)
Accumulated other comprehensive income (loss)	3,159	(15,845)
Total shareholders equity	568,041	660,113
Non-controlling interest		61
Total equity	568,041	660,174
Total liabilities and equity	$ 4,852,987	$ 4,741,198

See accompanying notes to consolidated financial statements.

CENTRAL PACIFIC FINANCIAL CORP. & SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

	Year Ended December 31,		
	2014	**2013**	**2012**
	(Dollars in thousands, except per share data)		
Interest income:			
Interest and fees on loans and leases	$ 112,137	$ 104,479	$ 97,029
Interest and dividends on investment securities:			
Taxable interest	33,574	31,498	28,803
Tax-exempt interest	3,996	4,051	2,312
Dividends	23	23	16
Interest on deposits in other banks	33	203	285
Dividends on Federal Home Loan Bank stock	46	24	
Total interest income	149,809	140,278	128,445
Interest expense:			
Interest on deposits:			
Demand	373	349	339
Savings and money market	901	894	1,006
Time	2,453	2,801	3,688
Interest on short-term borrowings	92	6	
Interest on long-term debt	2,572	3,119	3,701
Total interest expense	6,391	7,169	8,734
Net interest income	143,418	133,109	119,711
Provision (credit) for loan and lease losses	(6,414)	(11,310)	(18,885)
Net interest income after provision for loan and lease losses	149,832	144,419	138,596
Other operating income:			
Other service charges and fees	11,754	12,490	11,083
Service charges on deposit accounts	8,113	7,041	8,367
Loan servicing fees	5,798	6,057	6,486
Net gain on sales of residential loans	5,545	9,986	17,095
Income from fiduciary activities	3,552	2,855	2,599
Income from bank-owned life insurance	2,922	2,333	2,899
Net gain on sales of foreclosed assets	971	8,584	4,999
Equity in earnings of unconsolidated subsidiaries	480	790	574
Fees on foreign exchange	464	508	551
Loan placement fees	437	570	690
Investment securities gains	240	482	789
Other	3,547	3,249	4,611
Total other operating income	43,823	54,945	60,743
Other operating expense:			
Salaries and employee benefits	67,941	76,294	69,344
Net occupancy	15,252	14,323	13,920
Legal and professional services	7,806	8,094	13,824
Computer software expense	6,327	4,579	3,961
Amortization and impairment of other intangible assets	5,332	7,418	10,179
Communication expense	3,635	3,523	3,428
Equipment	3,582	3,676	3,966
Advertising expense	2,342	2,666	3,516
Foreclosed asset expense	1,710	1,036	6,887
Write down of assets			2,586

Other		18,886		17,927		20,307
Total other operating expense		132,813		139,536		151,918
Income before income taxes		60,842		59,828		47,421
Income tax expense (benefit)		20,389		(112,247)		
Net income		40,453		172,075		47,421
Per common share data:						
Basic earnings per share	$	1.08	$	4.10	$	1.14
Diluted earnings per share		1.07		4.07		1.13
Cash dividends declared		0.36		0.16		

See accompanying notes to consolidated financial statements.

CENTRAL PACIFIC FINANCIAL CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Year Ended December 31, 2014	2013 (Dollars in thousands)	2012
Net income	$ 40,453	$ 172,075	$ 47,421
Other comprehensive income (loss), net of tax			
Net change in unrealized gain (loss) on investment securities	22,711	(31,865)	(1,271)
Net change in unrealized gain (loss) on derivatives		10,993	(434)
Minimum pension liability adjustment	(3,707)	5,857	(1,289)
Other comprehensive income (loss), net of tax	19,004	(15,015)	(2,994)
Comprehensive income	$ 59,457	$ 157,060	$ 44,427

See accompanying notes to consolidated financial statements.

CENTRAL PACIFIC FINANCIAL CORP. & SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

	Common Shares Outstanding	Preferred Stock	Common Stock	Surplus	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Non Controlling Interests	Total
	(Dollars in thousands, except per share data)							
Balance at December 31, 2011	41,749,116	$	$ 784,539	$ 66,585	$ (396,848)	$ 2,164	$ 9,980	$ 466,420
Net income					47,421			47,421
Other comprehensive loss						(2,994)		(2,994)
4,291 net shares of common stock purchased by directors deferred compensation plan			(27)					(27)
Share-based compensation	117,930			3,982				3,982
Non-controlling interests							(23)	(23)
Balance at December 31, 2012	41,867,046	$	$ 784,512	$ 70,567	$ (349,427)	$ (830)	$ 9,957	$ 514,779
Net income					172,075			172,075
Other comprehensive loss						(15,015)		(15,015)
Cash dividends ($0.16 per share)					(6,735)			(6,735)
1,782 net shares of common stock purchased by directors deferred compensation plan			(39)					(39)
Share-based compensation	240,587		74	4,931				5,005
Non-controlling interests							(9,896)	(9,896)
Balance at December 31, 2013	42,107,633	$	$ 784,547	$ 75,498	$ (184,087)	$ (15,845)	$ 61	$ 660,174
Net income					40,453			40,453
Other comprehensive income						19,004		19,004
Cash dividends ($0.36 per share)					(13,405)			(13,405)
1,118 net shares of common stock sold by directors deferred compensation plan			(11)					(11)
7,045,620 shares of common stock repurchased and other related costs	(7,045,620)		(142,405)					(142,405)
Share-based compensation	171,661		74	4,218				4,292
Non-controlling interests							(61)	(61)
Balance at December 31, 2014	35,233,674	$	$ 642,205	$ 79,716	$ (157,039)	$ 3,159	$	$ 568,041

See accompanying notes to consolidated financial statements.

CENTRAL PACIFIC FINANCIAL CORP. & SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31, 2014	2013 (Dollars in thousands)	2012
Cash flows from operating activities:			
Net income	$ 40,453	$ 172,075	$ 47,421
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision (credit) for loan and lease losses	(6,414)	(11,310)	(18,885)
Depreciation and amortization	5,842	6,007	6,351
Amortization and impairment of other intangible assets	5,332	7,418	10,179
Write down of assets			2,586
Write down of other real estate, net of gain on sale	1,133	(8,011)	(358)
Net amortization of investment securities	7,807	13,283	15,670
Share-based compensation	4,218	4,931	3,982
Net gain on sale of investment securities	(240)	(482)	(789)
Net gain on sales of residential loans	(5,545)	(9,986)	(17,095)
Proceeds from sales of loans held for sale	373,061	654,005	969,089
Originations of loans held for sale	(364,828)	(618,106)	(952,402)
Equity in earnings of unconsolidated subsidiaries	(480)	(790)	(574)
Increase in cash surrender value of bank-owned life insurance	(3,161)	(2,729)	(4,934)
Deferred income taxes	20,482	(112,138)	
Premium paid on repurchases of preferred stock of subsidiaries		1,895	
Net change in other assets and liabilities	(6,228)	(11,531)	(20,853)
Net cash provided by operating activities	71,432	84,531	39,388
Cash flows from investing activities:			
Proceeds from maturities of and calls on investment securities available for sale	145,592	448,453	437,471
Proceeds from sales of investment securities available for sale	162,470	271,931	130,076
Purchases of investment securities available for sale	(98,408)	(753,496)	(627,356)
Proceeds from maturities of and calls on investment securities held to maturity	15,814	13,500	2,487
Purchases of investment securities held to maturity	(2,443)	(4,595)	(163,498)
Net loan principal repayments (loan originations)	(245,099)	(357,853)	(152,350)
Purchases of loan portfolios	(62,648)	(85,110)	
Proceeds from sales of loans originated for investment		10,679	10,340
Proceeds from sales of other real estate	3,865	17,892	56,915
Proceeds from bank-owned life insurance	481	536	1,997
Purchases of premises and equipment	(6,017)	(6,287)	(3,696)
Distributions from unconsolidated subsidiaries	531	9,615	467
Net return of capital from (contributions to) unconsolidated subsidiaries	466	(9,050)	
Proceeds from redemption of FHLB stock	2,261	1,735	869
Net cash used in investing activities	(83,135)	(442,050)	(306,278)
Cash flows from financing activities:			
Net increase in deposits	174,127	255,401	237,244
Repayments of long-term debt	(14)	(15,482)	(50,017)
Net increase (decrease) in short-term borrowings	29,985	8,015	(34)
Cash dividends paid on common stock	(13,405)	(6,735)	
Repurchases of common stock	(142,405)		
Net proceeds from issuance of common stock and stock option exercises	74	74	
Repurchases of preferred stock of subsidiaries		(11,781)	
Net cash provided by financing activities	48,362	229,492	187,193
Net increase (decrease) in cash and cash equivalents	36,659	(128,027)	(79,697)

Cash and cash equivalents:			
At beginning of year	49,348	177,375	257,072
At end of year	$ 86,007	$ 49,348	$ 177,375
Supplemental disclosure of cash flow information:			
Cash paid during the year for:			
Interest	$ 6,413	$ 19,260	$ 5,622
Income taxes		5	5
Cash received during the year for:			
Income taxes	185		430
Supplemental disclosure of noncash investing and financing activities:			
Net change in common stock held by directors deferred compensation plan	$ 11	$ 39	$ 27
Net reclassification of loans to other real estate	2,783	4,358	4,846
Net reclassification of loans held for sale to other real estate			716
Net transfer of loans to loans held for sale			1,487
Net transfer of investment securities available for sale to held to maturity		101,669	

See accompanying notes to consolidated financial statements.

CENTRAL PACIFIC FINANCIAL CORP. & SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years Ended December 31, 2014, 2013, and 2012

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Business

Central Pacific Financial Corp. is a bank holding company. Our principal operating subsidiary, Central Pacific Bank, is a full-service commercial bank with 36 branches and 110 ATMs located throughout the state of Hawaii. The bank engages in a broad range of lending activities including originating commercial loans, commercial and residential mortgage loans and consumer loans. The bank also offers a variety of deposit products and services. These include personal and business checking and savings accounts, money market accounts and time certificates of deposit. Other products and services include debit cards, internet banking, cash management services, traveler s checks, safe deposit boxes, international banking services, night depository facilities and wire transfers. Wealth management products and services include non-deposit investment products, annuities, insurance, investment management, asset custody and general consultation and planning services.

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

The banking business depends on rate differentials, the difference between the interest rates paid on deposits and other borrowings and the interest rates received on loans extended to customers and investment securities held in our portfolio. These rates are highly sensitive to many factors that are beyond our control. Accordingly, the earnings and growth of the Company are subject to the influence of domestic and foreign economic conditions, including inflation, recession and unemployment.

We have the following three reportable segments: (1) Banking Operations, (2) Treasury and (3) All Others. The Banking Operations segment includes construction and commercial real estate lending, commercial lending, residential mortgage lending, consumer lending, trust services, retail brokerage services, and our retail branch offices, which provide a full range of deposit and loan products, as well as various other banking services. The Treasury segment is responsible for managing the Company s investment securities portfolio and wholesale funding activities. The All Others segment consists of all activities not captured by the Banking Operations and Treasury segments described above and includes activities such as electronic banking, data processing and management of bank owned properties. For further information, see Note 25.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its majority-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

Central Pacific Bank had two wholly-owned subsidiaries as of December 31, 2013: CPB Real Estate, Inc. and Citibank Properties, Inc. Both were real estate investment trusts that were dissolved in 2014. Central Pacific Bank also had two other wholly-owned subsidiaries, CB Technology, Inc. and Central Pacific HomeLoans, Inc., that were dissolved in February 2013 and February 2012, respectively.

We have a 50% ownership interest in the following mortgage brokerage companies: Pacific Access Mortgage, LLC, Gentry HomeLoans, LLC, Haseko HomeLoans, LLC and Island Pacific HomeLoans, LLC. These investments are accounted for using the equity method and are included in investment in unconsolidated subsidiaries. We also have non-controlling equity investments in affiliates that are accounted for under the cost method and are included in investment in unconsolidated subsidiaries.

Our investments in unconsolidated subsidiaries accounted for under the equity and cost methods were $0.5 million and $6.7 million, respectively, at December 31, 2014 and $0.6 million and $8.5 million, respectively, at December 31, 2013. Our policy for determining impairment of these investments includes an evaluation of whether a loss in value of an investment is other than temporary. Evidence of a loss in value includes absence of an ability to recover the carrying amount of the investment or the inability of the investee to sustain an earnings capacity which would justify the carrying amount of the investment. We perform impairment tests whenever indicators of impairment are present. If the value of an investment declines and it is considered other than temporary, the investment is written down to its respective fair value in the period in which this determination is made.

The Company sponsors the Central Pacific Bank Foundation which is not consolidated in the Company s financial statements.

Use of Estimates

The preparation of the consolidated financial statements in conformity with generally accepted accounting principles in the United States (GAAP) requires management to make estimates and assumptions that reflect the reported amounts of assets and liabilities and disclosures of contingent assets and contingent liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance and provision for loan and lease losses, reserves for unfunded loan commitments, residential mortgage repurchase reserves and deferred income tax assets and income tax expense, as well as the valuation of investment securities, other intangible assets and the related amortization thereon, pension liability and the fair value of certain financial instruments.

Reclassifications

Certain prior year amounts in the Notes to the consolidated financial statements have been reclassified to conform to the fiscal 2014 presentation. Such reclassifications had no effect on the Company s reported net income or shareholders equity.

Cash and Cash Equivalents

For purposes of the consolidated statements of cash flows, we consider cash and cash equivalents to include cash and due from banks, interest-bearing deposits in other banks, federal funds sold and all highly liquid investments with maturities of three months or less at the time of purchase.

Investment Securities

Investments in debt securities and marketable equity securities are designated as trading, available for sale, or held to maturity. Securities are designated as held to maturity only if we have the positive intent and ability to hold these securities to maturity. Held to maturity debt securities are reported at amortized cost. Trading securities are reported at fair value, with changes in fair value included in earnings. Available-for-sale securities are reported at fair value with net unrealized gains and losses, net of taxes, included in accumulated other comprehensive income (loss) (AOCI).