

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

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2019

or

**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**  
(State or other jurisdiction of incorporation or organization)

**99-0212597**  
(I.R.S. Employer Identification No.)

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

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

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

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, No Par Value	CPF	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  No

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  No

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the Registrant was required to submit such files). Yes  No

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

Large Accelerated Filer	<input checked="" type="checkbox"/>	Accelerated Filer	<input type="checkbox"/>
Non-Accelerated Filer	<input type="checkbox"/>	Smaller Reporting Company	<input type="checkbox"/>
		Emerging Growth Company	<input type="checkbox"/>

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of June 30, 2019, the aggregate market value of the common stock held by non-affiliates of the registrant was approximately \$830,574,000. As of January 31, 2020, the number of shares of common stock of the registrant outstanding was 28,531,087 shares.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant's proxy statement for the 2020 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.

**CENTRAL PACIFIC FINANCIAL CORP. AND SUBSIDIARIES**  
**Form 10-K**

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## PART I

### Forward-Looking Statements and Factors that Could Affect Future Results

Certain statements contained in this annual report on Form 10-K that are not statements of historical fact constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 (the "Act"), notwithstanding that such statements are not specifically identified. In addition, certain statements may be contained in our future filings with the U.S. Securities and Exchange Commission ("SEC"), in press releases and in oral and written statements made by 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, net interest margin or 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 including anticipated performance results from our RISE2020 initiative; and (iv) statements of assumptions underlying or relating to any of the foregoing. Words such as "believes," "plans," "anticipates," "expects," "intends," "forecasts," "hopes," "targeting," "continue," "remain," "will," "should," "estimates," "may" and other similar expressions are intended to identify forward-looking statements but are not the exclusive means of identifying such statements.

While we believe that our forward-looking statements and the assumptions underlying them are reasonably based, such statements and assumptions are by their nature subject to risks and uncertainties, and thus could later prove to be inaccurate or incorrect. Accordingly, actual results could differ materially from those in such statements or projections. 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;
- our ability to successfully implement and achieve the objectives of our RISE2020 initiative;
- the impact of local, national, and international economies and events (including natural disasters such as wildfires, volcanic eruptions, hurricanes, tsunamis, storms, earthquakes and pandemic virus and disease) 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 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 and federal and state legislation, 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, the results of regulatory examinations or reviews and the effect of, and our ability to comply with, any regulatory orders or actions we are or may become subject to;
- ability to successfully implement our initiatives to lower our efficiency ratio;
- 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, including the anticipated replacement of the London Interbank Offered Rate ("LIBOR") Index and the impact on our loans and debt which are tied to that index;

- negative trends in our market capitalization and adverse changes in the price of the Company's common stock;
- 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;
- cybersecurity and data privacy breaches and the consequences therefrom;
- the ability to address deficiencies in our internal controls 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 and the cost and resources required to implement such changes;
- our ability to attract and retain key personnel;
- changes in our organization, compensation and benefit plans; and
- our success at managing any of the risks involved in the foregoing items.

For further information with respect to factors that could cause actual results to materially differ from the expectations or projections stated in the forward-looking statements, please 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 statements 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. As of December 31, 2019, we had total assets of \$6.01 billion, total loans of \$4.45 billion, total deposits of \$5.12 billion and shareholders' equity of \$528.5 million.

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 35 bank branches and 77 ATMs located throughout the state of Hawaii. Our administrative and main offices are located in Honolulu and we have 27 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 26 - 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 and the tourism industry, as well as the fiscal and regulatory policies of the federal and state government and the regulatory authorities that govern financial institutions. See the "Supervision and Regulation" section below for other information about the regulation of our holding company and bank.

## **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-rate 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 have an average loan size of approximately \$0.5 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. A portion of our first residential mortgage loan originations are sold in the secondary market and a portion is put into our loan portfolio.
- (2) *Commercial, Financial and Agricultural Lending and Leasing.* Loans in this category consist primarily of term loans and lines of credit 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 Mortgage 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 policies and practices generally requires net cash flow from the property to cover the debt service while maintaining an appropriate amount of reserves and permits consideration of liquidation of the collateral as a secondary source of repayment.
- (4) *Construction Lending.* Construction land development and other land loans encompasses the financing of residential and commercial construction projects.
- (5) *Consumer Lending.* Loans in this category are generally either unsecured or secured by personal assets, such as automobiles, and the average loan size is generally small.

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, 2019.

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, financial technology ("fintech") companies, mortgage companies, insurance companies, finance companies, credit unions and other nonbank financial service providers, including mortgage providers and brokers, operating via the internet and other technology platforms. Some of these competitors are much larger by total assets and capitalization, and have greater access to capital markets.

In order to compete with the other financial services providers in the state of Hawaii, we principally rely upon 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 to our customers, coupled with competitive interest rates and pricing and local promotional activities.

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 74% of our loan portfolio at December 31, 2019 consisted of real estate-related loans, including residential mortgage loans, home equity loans, commercial mortgage loans and construction 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. As of December 31, 2019, other wholly-owned subsidiaries include CPB Capital Trust IV and CPB Statutory Trust V. CPB Capital Trust II and CPB Statutory Trust III were terminated in January 2019.

As of December 31, 2019, Central Pacific Bank does not have any wholly-owned subsidiaries. Central Pacific Bank owns 50% of Gentry HomeLoans, LLC, Haseko HomeLoans, LLC and Island Pacific HomeLoans, LLC.

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

### **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 United States of America ("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 also 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 and practices 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. We also cannot predict whether or when regulatory requirements may be reduced or eliminated and the overall affect such reduction or elimination may have on the Company and the bank.

## ***Regulatory Agencies***

Central Pacific Financial Corp. is a legal entity separate and distinct from its subsidiaries. As the bank holding company for Central Pacific Bank, 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 Hawaii Division of Financial Institutions ("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.

In addition, 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 establishment and testing on internal control over financial reporting.

Central Pacific Bank, as a Hawaii state-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 Consumer Financial Protection Bureau ("CFPB"), Federal Trade Commission ("FTC"), and FRB. In periodic examinations, the DFI, FDIC, and FRB assesses our financial condition, capital resources, asset quality, earnings prospects, management, liquidity, market sensitivity and other aspects of our operations. These bodies also determine whether our management is effectively managing the bank and the holding company and whether we are in compliance with all applicable laws or regulations.

## ***Legislative and Regulatory Developments***

The federal banking agencies continue to implement the remaining requirements in the Dodd-Frank Act, as well as promulgating other regulations and guidelines intended to assure the financial strength and safety and soundness of banks and the stability of the U.S. banking system. Following on the implementation of the new capital rules under Basel III ("Basel III Capital Rule") and the so-called Volcker Rule which restricts certain proprietary trading and investment activities, on February 3, 2017 the President of the United States of America issued an executive order identifying certain "core principles" for the administration's financial services regulatory policy and directing the Secretary of the Treasury, in consultation with the heads of other financial regulatory agencies, to evaluate how the current regulatory framework promotes or inhibits the principles and what actions have been, and are being, taken to promote the principles. In response to the executive order, on June 12, 2017, October 6, 2017, October 26, 2017 and July 31, 2018, respectively, the U.S. Department of the Treasury issued four reports recommending a number of comprehensive changes in the current regulatory system for U.S. depository institutions, the U.S. capital markets, the U.S. asset management and insurance industries, and non-bank financial institutions, fintech and financial innovation around the following principles.

- Improving regulatory efficiency and effectiveness by critically evaluating mandates and regulatory fragmentation, overlap, and duplication across regulatory agencies;
- Aligning the financial system to help support the U.S. economy;
- Reducing regulatory burden by decreasing unnecessary complexity;
- Tailoring the regulatory approach based on size and complexity of regulated firms and requiring greater regulatory cooperation and coordination among financial regulators; and
- Aligning regulations to support market liquidity, investment, and lending in the U.S. economy.
- Creating a regulatory landscape that better supports nonbank financial institutions, embraces financial technology and fosters innovation.

The scope and breadth of regulatory changes that will be implemented in response to the President's executive order continue to be determined.

In 2018, President Trump signed the Economic Growth, Regulatory Relief and Consumer Protection Act which repeals or modifies certain provisions of the Dodd-Frank Act and eases regulations on all but the largest banks. Highlights from this legislation include, among other things: (i) creating a new category of "qualified mortgages" presumed to satisfy ability-to-repay requirements for loans that meet certain criteria and are held in portfolio by banks with less than \$10 billion in assets from the ability-to-repay requirements for certain qualified residential mortgage loans held in portfolio; (ii) not require appraisals for certain transactions valued at less than \$400,000 in rural areas; (iii) clarify that, subject to various conditions, reciprocal deposits of another depository institution obtained using a deposit broker through a deposit placement network for purposes of obtaining maximum deposit insurance would not be considered brokered deposits subject to the FDIC's brokered-deposit regulations; and (iv) simplify capital calculations by requiring regulators to establish for institutions under \$10 billion in assets a community bank leverage ratio (tangible equity to average consolidated assets) at a percentage not less than 8% and not greater than 10% that such institutions may elect to replace the general applicable risk-based capital requirements for determining well-capitalized status (discussed in further detail below).

### ***Capital Adequacy Requirements***

Bank holding companies and banks are subject to various regulatory capital requirements administered by state and federal banking agencies. The Basel III Capital Rule, which initially became effective on January 1, 2015 have now been fully phased in. 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.

The Federal Reserve monitors our capital adequacy on a consolidated basis, and the FDIC and the DFI monitor the capital adequacy of our bank. The Company and the bank are required to maintain minimum risk-based and leverage capital ratios, as well as a Capital Conservation Buffer, pursuant to the Basel III Capital Rule.

### ***Regulatory Capital and Risk-weighted Assets***

The Federal Reserve monitors our capital adequacy on a consolidated basis, and the FDIC and the DFI monitor the capital adequacy of our bank. These rules implement the Basel III international regulatory capital standards in the United States, as well as certain provisions of the Dodd-Frank Act. These quantitative calculations are minimums, and the Federal Reserve, FDIC or DFI may determine that a banking organization, based on its size, complexity or risk profile, must maintain a higher level of capital in order to operate in a safe and sound manner.

Under the Basel III Capital Rule, the Company's and the bank's assets, exposures and certain off-balance sheet items are subject to risk weights used to determine the institutions' risk-weighted assets. These risk-weighted assets are used to calculate the following minimum capital ratios for the Company and the bank:

- **Tier 1 Leverage Ratio**, equal to the ratio of Tier 1 capital to quarterly average assets (net of goodwill, certain other intangible assets and certain other deductions).
- **Common Equity Tier 1 ("CET1") Risk-Based Capital Ratio**, equal to the ratio of CET1 capital to risk-weighted assets. CET1 capital primarily includes common stockholders' equity subject to certain regulatory adjustments and deductions, including with respect to goodwill, intangible assets and certain deferred tax assets. Certain of these adjustments and deductions were subject to phase-in periods that began on January 1, 2015 and ended on January 1, 2018. The last phase of the Basel III Capital Rule's transition provisions relating to capital deductions for mortgage servicing assets, certain deferred tax assets and investments in the capital instruments of unconsolidated financial institutions, and the recognition of minority interests in regulatory capital was delayed for certain bank holding companies and banks, including us and the bank, but a revised rule was finalized in July 2019 that will be effective in April 2020. Hybrid securities, such as trust preferred securities, generally are excluded from being counted as Tier 1 capital. However, for bank holding companies like us that have less than \$15 billion in total consolidated assets, certain trust preferred securities were grandfathered in as a component of Tier 1 capital. In addition, because we are a not an advanced approach banking organization, we were permitted to make a one-time permanent election to exclude accumulated other comprehensive income items from regulatory capital. We made this election in order to avoid



significant variations in our levels of capital depending upon the impact of interest rate fluctuations on the fair value of our bank's available-for-sale securities portfolio.

- **Tier 1 Risk-Based Capital Ratio**, equal to the ratio of Tier 1 capital to risk-weighted assets. Tier 1 capital is primarily comprised of CET1 capital, perpetual preferred stock and certain qualifying capital instruments.
- **Total Risk-Based Capital Ratio**, equal to the ratio of total capital, including CET1 capital, Tier 1 capital and Tier 2 capital, to risk-weighted assets. Tier 2 capital primarily includes qualifying subordinated debt and qualifying ALLL. Tier 2 capital also includes, among other things, certain trust preferred securities.

The total minimum regulatory capital ratios and well-capitalized minimum ratios are reflected in the charts below. The Federal Reserve has not yet revised the well-capitalized standard for bank holding companies to reflect the higher capital requirements imposed under the Basel III Capital Rule. For purposes of the Federal Reserve's Regulation Y, including determining whether a bank holding company meets the requirements to be a financial holding company, bank holding companies, such as the Company, must maintain a Tier 1 Risk-Based Capital Ratio of 6.0% or greater and a Total Risk-Based Capital Ratio of 10.0% or greater. If the Federal Reserve were to apply the same or a very similar well-capitalized standard to bank holding companies as that applicable to the bank, the Company's capital ratios as of December 31, 2019 would exceed such revised well-capitalized standard. The Federal Reserve may require bank holding companies, including the Company, to maintain capital ratios substantially in excess of mandated minimum levels, depending upon general economic conditions and a bank holding company's particular condition, risk profile and growth plans.

Failure to be well-capitalized or to meet minimum capital requirements could result in certain mandatory and possible additional discretionary actions by regulators that, if undertaken, could have an adverse material effect on our operations or financial condition. Failure to be well-capitalized or to meet minimum capital requirements could also result in restrictions on the Company's or the bank's ability to pay dividends or otherwise distribute capital or to receive regulatory approval of applications.

In addition to meeting the minimum capital requirements, under the Basel III Capital Rule, the Company and the bank must also maintain the required Capital Conservation Buffer to avoid becoming subject to restrictions on capital distributions and certain discretionary bonus payments to management. The Capital Conservation Buffer is calculated as a ratio of CET1 capital to risk-weighted assets, and it effectively increases the required minimum risk-based capital ratios. The Capital Conservation Buffer requirement was phased in over a three-year period that began on January 1, 2016. The phase-in period ended on January 1, 2019, and the Capital Conservation Buffer is now at its fully phased-in level of 2.5%.

The Tier 1 Leverage Ratio is not impacted by the Capital Conservation Buffer, and a banking institution may be considered well-capitalized while remaining out of compliance with the Capital Conservation Buffer.

The table below summarizes the capital requirements that the Company and the bank must satisfy to avoid limitations on capital distributions and certain discretionary bonus payments (i.e., the required minimum capital ratios plus the Capital Conservation Buffer):

	<b>Minimum Basel III Regulatory Capital Ratio Plus Capital Conservation Buffer</b>
CET1 risk-based capital ratio.....	7.0%
Tier 1 risk-based capital ratio.....	8.5%
Total risk-based capital ratio.....	10.5%

As of December 31, 2019, the Company and the bank are well-capitalized for regulatory purposes. For a tabular presentation of the Company's and the bank's capital ratios as of December 31, 2019, see Note 27 - Parent Company and Regulatory Restrictions to the Consolidated Financial Statements under "Part II, Item 8. Financial Statements and Supplementary Data."

If the Company were to cross the \$10 billion or more asset threshold, its compliance costs and regulatory requirements, would increase.

In September 2019, the FDIC finalized a rule that introduces an optional simplified measure of capital adequacy for qualifying community banking organizations (i.e., the community bank leverage ratio ("CBLR") framework), as required by the Economic Growth, Regulatory Relief and Consumer Protection Act. The CBLR framework is designed to reduce burden by removing the

15 requirements for calculating and reporting risk-based capital ratios for qualifying community banking organizations that opt into the framework. In order to qualify for the CBLR framework, a community banking organization must have a tier 1 leverage ratio of greater than 9 percent, less than \$10 billion in total consolidated assets, and limited amounts of off-balance-sheet exposures and trading assets and liabilities. A qualifying community banking organization that opts into the CBLR framework and meets all requirements under the framework will be considered to have met the well-capitalized ratio requirements under the Prompt Corrective Action regulations and will not be required to report or calculate risk-based capital. The CBLR framework will be available for banks to use in their March 31, 2020, Call Report. We have determined that we will opt out of the CBLR framework as it was currently deemed not in the Company and the bank's best interest. The FDIC also finalized a rule that permits non-advanced approaches banking organizations to use the simpler regulatory capital requirements for mortgage-servicing assets, certain deferred tax assets arising from temporary differences, investments in the capital of unconsolidated financial institutions, and minority interest when measuring their tier 1 capital as of January 1, 2020. Banking organizations may use this new measure of tier 1 capital under the CBLR framework.

In December 2017, the Basel Committee published standards that it described as the finalization of the Basel III post-crisis regulatory reforms (the standards are commonly referred to as "Basel IV"). Among other things, these standards revise the Basel Committee's standardized approach for credit risk (including by recalibrating risk weights and introducing new capital requirements for certain "unconditionally cancellable commitments," such as unused credit card lines of credit) and provides a new standardized approach for operational risk capital. Under the Basel framework, these standards will generally be effective on January 1, 2022, with an aggregate output floor phasing in through January 1, 2027. Under the current U.S. capital rules, operational risk capital requirements and a capital floor apply only to advanced approaches institutions, and not to the Company and the bank. The impact of Basel IV on us will depend on the manner in which it is implemented by the federal bank regulators.

### ***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.

The prompt corrective action standards were also changed as the Basel III Capital Rule ratios became 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).

The federal banking agencies also 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 on items such as brokered deposits.

### ***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." Notwithstanding these provisions, in July 2019, the federal bank regulatory agencies finalized a rule which provides that community banks with \$10 billion or less in total consolidated assets and total trading assets and liabilities of 5 percent or less of total consolidated assets, such as the bank, are excluded from the Volcker Rule.

## ***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 the "Capital Adequacy Requirements" section above and the "Capital Resources" section in the MD&A);
- 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 the "Prompt Corrective Action Provisions" section above);
- 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 officers 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;
- require prior approval for the acquisition of 5% or more of the voting stock of a bank or bank holding company by bank holding companies or other 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.; and
- require prior notice and/or prior approval of the acquisition of control of a bank or a bank holding company by a shareholder or individuals acting in concert with ownership or control of 10% of the voting stock being a presumption of control.

## ***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 non-banking 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 the 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 Company is also subject to restrictions on dividends under applicable Hawaii law.

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 regulatory and statutory restrictions, including restrictions 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.

## ***Regulation of the Bank***

As a Hawaii state-chartered 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 state nonmember 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 collateral for certain loans, servicing and foreclosing on loans, transactions with affiliates, officers, directors and other insiders, 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, market sensitivity, 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 state-chartered bank would result in a revocation of its charter.

## ***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 Dodd-Frank Act revised the FDIC's DIF management authority by setting requirements for the Designated Reserve Ratio (the "DRR", calculated as the DIF balance divided by estimated insured deposits) and redefining the assessment base which is used to calculate banks' quarterly assessments. 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. We are generally unable to control the amount of premiums that we are required to pay for FDIC insurance. On September 30, 2018, the DRR reached 1.36%. Because the reserve ratio has exceeded 1.35%, two deposit insurance assessment changes occurred under the FDIC regulations: 1) Surcharges on large banks (total consolidated assets of \$10 billion or more) ended; the last surcharge on large banks was collected on December 28, 2018. and 2) Small banks (total consolidated assets of less than \$10 billion) were awarded assessment credits for the portion of their assessments that contributed to the growth in the reserve ratio from 1.15% to 1.35%. Credits will be applied until exhausted when the reserve ratio is at least 1.35%. The reserve ratio reached 1.40% and 1.41% on June 30, 2019 and September 30, 2019, respectively. Therefore, credits were applied on the September 30, 2019 and December 31, 2019 invoices.

If there are additional bank or financial institution failures or if the FDIC otherwise determines, we may be required to pay 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.

## ***Compensation***

The Dodd-Frank Act requires the federal bank regulators and the SEC to establish joint regulations or guidelines prohibiting incentive-based payment arrangements at specified regulated entities, including the Company and the bank, having at least \$1 billion in total assets that encourage inappropriate risks by providing an executive officer, employee, director or principal stockholder with excessive compensation, fees or benefits or that could lead to material financial loss to the entity. In addition, these regulators must establish regulations or guidelines requiring enhanced disclosure to regulators of incentive-based compensation arrangements. The agencies proposed such regulations initially in April 2011 and in April 2016, the Federal Reserve and other federal financial agencies re-proposed restrictions on incentive-based compensation. For institutions with at least \$1 billion but less than \$50 billion in total consolidated assets, such as the Company and the bank, the proposal would impose principles-based restrictions that are broadly consistent with existing interagency guidance on incentive-based compensation. Such institutions would be prohibited from entering into incentive compensation arrangements that encourage inappropriate risks by the institution (1) by providing an executive officer, employee, director, or principal shareholder with excessive compensation, fees, or benefits, or (2) that could lead to material financial loss to the institution. The proposal would also impose certain governance and record-keeping requirements on institutions of the Company's and the bank's size. The regulatory organizations would reserve the authority to impose more stringent requirements on institutions of the Company's and the bank's size.

## ***Cybersecurity***

Federal regulators have issued multiple statements regarding cybersecurity stating that financial institutions need to design multiple layers of security controls to establish lines of defense and to ensure that their risk management processes also address the risk posed by compromised customer credentials, including security measures to reliably authenticate customers accessing internet-based services of the financial institution. In addition, a financial institution's management is expected to maintain sufficient business continuity planning processes to ensure the rapid recovery, resumption and maintenance of the institution's operations after a cyber-attack involving destructive malware. A financial institution is also expected to develop appropriate processes to enable recovery of data and business operations and address rebuilding network capabilities and restoring data if the institution or its critical service providers fall victim to this type of cyber-attack. If we fail to observe the regulatory guidance, we could be subject to various regulatory sanctions, including financial penalties.

State regulators have also been increasingly active in implementing privacy and cybersecurity standards and regulations, including California which adopted the California Consumer Privacy Act in 2018 and New York which adopted the Shield Act in 2019. Recently, several states have adopted regulations requiring certain financial institutions to implement cybersecurity programs and providing detailed requirements with respect to these programs, including data encryption requirements. Many states have also recently implemented or modified their data breach notification and data privacy requirements. We expect this trend of state-level activity in those areas to continue, and are continually monitoring developments in the states in which our customers are located in or in which we conduct business.

In the ordinary course of business, we rely on electronic communications and information systems to conduct our operations and to store sensitive data. We employ an in-depth, layered, defensive approach that leverages people, processes and technology to manage and maintain cybersecurity controls. We employ a variety of preventative and detective tools to monitor, block, and provide alerts regarding suspicious activity, as well as to report on any suspected advanced persistent threats. Notwithstanding the strength of our defensive measures, the threat from cyber-attacks is severe, attacks are sophisticated and increasing in volume, and attackers respond rapidly to changes in defensive measures. While to date we have not detected a significant compromise, significant data loss or any material financial losses related to cybersecurity attacks, our systems and those of our customers and third-party service providers are under constant threat and it is possible that we could experience a significant event in the future. Risks and exposures related to cybersecurity attacks are expected to remain high for the foreseeable future due to the rapidly evolving nature and sophistication of these threats, as well as due to the expanding use of Internet banking, mobile banking and other technology-based products and services by us and our customers. See Item 1A. Risk Factors for a further discussion of risks related to cybersecurity.

### ***Office of Foreign Assets Control Regulation***

The U.S. Treasury Department's Office of Foreign Assets Control, or OFAC, administers and enforces economic and trade sanctions against targeted foreign countries and regimes, under authority of various laws, including designated foreign countries, nationals and others. OFAC publishes lists of specially designated targets and countries. We are responsible for, among other things, blocking accounts of, and transactions with, such targets and countries, prohibiting unlicensed trade and financial transactions with them and reporting blocked transactions after their occurrence. Failure to comply with these sanctions could have serious financial, legal and reputational consequences, including causing applicable bank regulatory authorities not to approve merger or acquisition transactions when regulatory approval is required or to prohibit such transactions even if approval is not required. Regulatory authorities have imposed cease and desist orders and civil money penalties against institutions found to be violating these obligations.

### ***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, the CRA, the Fair Debt Collection Practices Act, 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, and various federal and state privacy protection laws, including the Telephone Consumer Protection Act and the CAN-SPAM Act. Noncompliance with these laws could subject the bank to lawsuits and could also result in administrative penalties, including, fines and reimbursements. CPF and the bank 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, and the loss of certain contractual rights.

The bank received an "Outstanding" rating in the FDIC's 2017 Community Reinvestment Act 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 with broad rulemaking, supervisory and enforcement authority over consumer financial products and services, including deposit products, residential mortgages, home equity loans and credit cards. The CFPB's functions include investigating consumer complaints, conducting market research, rulemaking, and enforcing rules related to consumer financial products and services. CFPB regulations and guidance apply to all covered persons, and banks with \$10 billion or more in assets are subject to supervision including 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.

The CFPB has finalized a number of significant rules which impact nearly every aspect of the lifecycle of a residential mortgage loan. These rules implement the Dodd-Frank Act amendments to the Equal Credit Opportunity Act, the Truth in Lending Act and the Real Estate Settlement Procedures Act. Among other things, the rules adopted by the CFPB require

covered persons including banks making residential mortgage loans to: (i) develop and implement procedures to ensure compliance with an "ability-to-repay" test and identify whether a loan meets a new definition for a "qualified mortgage", in which case a rebuttable presumption exists that the creditor extending the loan has satisfied the ability-to-repay test; (ii) implement new or revised disclosures, policies and procedures for originating and servicing mortgages including, but not limited to, pre-loan counseling, early intervention with delinquent borrowers and specific loss mitigation procedures for loans secured by a borrower's principal residence; (iii) comply with additional restrictions on mortgage loan originator hiring and compensation; (iv) comply with new disclosure requirements and standards for appraisals and certain financial products; and (v) maintain escrow accounts for higher-priced mortgage loans for a longer period of time.

The review of products and practices to prevent unfair, deceptive or abusive acts or practices ("UDAAP") has been a focus of the CFPB, and of banking regulators more broadly. In addition, the Dodd-Frank Act provides the CFPB with broad supervisory, examination and enforcement authority over various consumer financial products and services, including the ability to require reimbursements and other payments to customers for alleged violations of UDAAP and other legal requirements and to impose significant penalties, as well as injunctive relief that prohibits lenders from engaging in allegedly unlawful practices. The CFPB also has the authority to obtain cease and desist orders providing for affirmative relief or monetary penalties. The Dodd-Frank Act does not prevent states from adopting stricter consumer protection standards. State regulation of financial products and potential enforcement actions could also adversely affect the bank's business, financial condition or results of operations. The federal bank regulators have adopted rules limiting the ability of banks and other financial institutions to disclose non-public information about consumers to unaffiliated third parties. These limitations require disclosure of privacy policies to consumers and, in some circumstances, allow consumers to prevent disclosure of certain personal information to a nonaffiliated third party. These regulations affect how consumer information is transmitted through diversified financial companies and conveyed to outside vendors. In addition, consumers may also prevent disclosure of certain information among affiliated companies that is assembled or used to determine eligibility for a product or service, such as that shown on consumer credit reports and asset and income information from applications. Consumers also have the option to direct banks and other financial institutions not to share information about transactions and experiences with affiliated companies for the purpose of marketing products or services.

Under the Durbin Amendment to the Dodd-Frank Act, the Federal Reserve adopted rules establishing standards for assessing whether the interchange fees that may be charged with respect to certain electronic debit transactions are "reasonable and proportional" to the costs incurred by issuers for processing such transactions.

Interchange fees, or "swipe" fees, are charges that merchants pay to us and other card-issuing banks for processing electronic payment transactions. Under the final rules, the maximum permissible interchange fee is equal to no more than 21 cents plus 5 basis points of the transaction value for many types of debit interchange transactions. The Federal Reserve also adopted a rule to allow a debit card issuer to recover one cent per transaction for fraud prevention purposes if the issuer complies with certain fraud-related requirements required by the Federal Reserve. The Federal Reserve also has rules governing routing and exclusivity that require issuers to offer two unaffiliated networks for routing transactions on each debit or prepaid product.

Currently, we qualify for the small issuer exemption from the interchange fee cap, which applies to any debit card issuer that, together with its affiliates, has total assets of less than \$10 billion as of the end of the previous calendar year. We will become subject to the interchange fee cap beginning July 1 of the year following the time when our total assets reaches or exceeds \$10 billion. Reliance on the small issuer exemption does not exempt us from federal regulations prohibiting network exclusivity arrangements or from routing restrictions.

### ***Commercial Real Estate Concentration Limits***

In December 2006, the federal banking regulators issued guidance entitled "Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices" to address increased concentrations in commercial real estate and construction, or "CRE", loans. In addition, in December 2015, the federal bank agencies issued additional guidance entitled "Statement on Prudent Risk Management for Commercial Real Estate Lending." Together, these guidelines describe the criteria the agencies will use as indicators to identify institutions potentially exposed to CRE concentration risk. An institution that has (i) experienced rapid growth in CRE lending, (ii) notable exposure to a specific type of CRE, (iii) total reported loans for construction, land development, and other land representing 100% or more of the institution's capital, or (iv) total CRE loans representing 300% or more of the institution's capital, and the outstanding balance of the institutions CRE portfolio has increased by 50% or more in the prior 36 months, may be identified for further supervisory analysis of the level and nature of its CRE concentration risk. As of December 31, 2019, the bank's construction, land development, and other land and total CRE loans represented 18.1% and 230.7% of its capital, respectively.

### ***Future Legislation and Regulation***

Congress may enact, modify or repeal legislation from time to time that affects the regulation of the financial services industry, and state legislatures may enact, modify or repeal legislation from time to time affecting the regulation of financial institutions chartered by or operating in those states. Federal and state regulatory agencies also periodically propose and adopt changes to their regulations or change the manner in which existing regulations are applied. The substance or impact of pending or future legislation or regulation, or the application thereof, cannot be predicted, although enactment of proposed legislation (or modification or repeal of existing legislation) could impact the regulatory structure under which the Company and bank operate and may significantly increase its costs, impede the efficiency of its internal business processes, require the bank to increase its regulatory capital and modify its business strategy, and limit its ability to pursue business opportunities in an efficient manner. Under these circumstances, the Company's business, financial condition, results of operations or prospects may be adversely affected, perhaps materially.

### **Employees**

At December 31, 2019, we employed 854 persons, 789 on a full-time basis and 65 on a part-time basis. We are not a party to any collective bargaining agreement.

### **Available Information**

Our internet website can be found at [www.cpb.bank](http://www.cpb.bank). 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](http://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.***

Our business and operations are sensitive to business and economic conditions globally and domestically. Adverse economic and business conditions in the U.S. generally, and in our market areas, in particular, could reduce our growth rate, affect our borrowers' ability to repay their loans and, consequently, adversely affect our financial condition and performance. Other economic conditions that affect our financial performance include short-term and long-term interest rates, the prevailing yield curve, inflation and price levels (particularly for real estate), monetary policy, unemployment and the strength of the domestic economy as a whole. Unfavorable market conditions can result in a deterioration in the credit quality of our borrowers and the demand for our products and services, an increase in the number of loan delinquencies, defaults and charge-offs, additional provisions for loan losses, adverse asset values and an overall material adverse effect on the quality of our loan portfolio. Unfavorable or uncertain economic and market conditions can be caused by declines in economic growth, business activity or investor or business confidence; limitations on the availability or increases in the cost of credit and capital; increases in inflation or interest rates; high unemployment; natural disasters; or a combination of these or other factors.

***Difficult economic and market conditions in Hawaii would result in significant adverse effects on us because of the geographic concentration of our business.***

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.

In addition, the high concentration of Hawaii real estate loans in our portfolio, combined with the deterioration in these sectors caused by an economic downturn, previously had and could have in the future a significantly more adverse impact on our operating results than many other banks across the nation. If our borrowers experience financial difficulty, or if property values securing our real estate loans decline, we will incur elevated credit costs due to the composition and concentration of our loan portfolio, which will have an adverse effect on our financial condition and results of operations.

***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 strength of the real estate markets in which we operate. As we have previously seen in the Hawaii and California construction and real estate markets, 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 projects, 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.

***A large percentage of our loans are collateralized by real estate and any 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 74% of our loan portfolio as of

December 31, 2019 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, domestic or foreign, 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. The underwriting and credit monitoring policies and procedures that we have adopted to address this risk may not prevent unexpected losses that could have a material adverse effect on our business, financial condition, results of operations and cash flows. We maintain an allowance for loan and lease losses to provide for loan and lease defaults and non-performance, which also includes increases for new loan growth. While we believe that our allowance for loan and lease losses is appropriate to cover inherent losses, we cannot assure you that we will not increase the allowance for loan and lease losses further or that regulators will not require us to increase the allowance for loan and lease losses which could have a material adverse effect on our net income and financial condition.

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. If our assumptions prove to be incorrect, our current allowance for loan and lease losses may not be sufficient to cover the losses.

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 which could have a material adverse effect on our net income and financial condition. See Note 1 - Summary of Significant Accounting Policies to the Consolidated Financial Statements under "Part II, Item 8. Financial Statements and Supplementary Data."

***The implementation of CECL, including the design and maintenance of related internal controls over financial reporting, will require a significant amount of time and resources which may have a material impact on our results of operations, and we anticipate will require us to increase our allowance for credit losses.***

The Financial Accounting Standards Board (the "FASB") has adopted a new accounting standard that is effective for our fiscal year beginning on January 1, 2020. This standard, referred to as Current Expected Credit Loss, or ("CECL"), requires financial institutions to determine periodic estimates of lifetime expected credit losses on financial instruments, and recognize the expected credit losses as allowances for credit losses. This changes the current method of providing allowances for credit losses that are probable, which we anticipate will require us to increase our allowance for credit losses. Our CECL implementation initiative has increased the amount of data and assumptions we need to collect and review to determine the appropriate level of the allowance for credit losses. A significant amount of time and resources has been spent and will continue to be spent in order to implement CECL effectively, including the design and implementation of related adequate internal controls, which may adversely affect our results of operations. If we are unable to maintain effective internal control over financial reporting relating to CECL, our ability to report our financial condition and results of operations accurately and on a timely basis could also be adversely affected.

***Our RISE2020 initiative may not be successful.***

During the second half of 2019 and throughout 2020, we intend to invest an aggregate of approximately \$40 million to upgrade our branch spaces, digital banking platforms and ATM network through a new initiative we call RISE2020. RISE2020 is intended to enhance customer experience, drive stronger long-term growth and profitability, improve shareholder returns and lower our efficiency ratio. However, we cannot provide any assurance that RISE2020 will achieve any of our objectives or will achieve our objectives to the extent we have forecasted. In particular, the costs of RISE2020 may exceed our expectations; there may be timing delays as we execute our plans; we may not be able to attract new business from existing customers; new customers may not be attracted to our platform despite the amount of expense we incur; and implementation of RISE2020 initiatives may disrupt our operations. Additionally, given the number of key projects involved in our RISE2020 initiative, there is execution risk which may include vendors failing to perform or deliver as expected, issues with system conversions or integrations, lack of internal resource capacity, among other things. If our RISE2020 initiative is not successful, our overall noninterest expense will have increased without a corresponding increase in revenue and growth which could have a material adverse effect on our business, financial condition or results of operations.

***We are required to act as a source of financial and managerial strength for our bank.***

We are required to act as a source of financial and managerial strength to the bank. We may be required to commit additional resources to the bank at times when we may not be in a financial position to provide such resources or when it may not be in our, or our shareholders' best interests to do so. Providing such support is more likely during times of financial stress for us and the bank, which may make any capital we are required to raise to provide such support more expensive than it might otherwise be. In addition, any capital loans we make to the bank are subordinate in right of payment to depositors and to certain other indebtedness of the bank.

***Changes in our accounting policies or in accounting standards could materially affect how we report our financial results and condition.***

Periodically the FASB and the SEC change the financial accounting and reporting standards that govern the preparation of our financial statements. As a result of changes to financial accounting or reporting standards, whether promulgated or required by the FASB or other regulators, we could be required to change certain of the assumptions or estimates we have previously used in preparing our financial statements, which could adversely affect our business, financial condition and results of operations. See Note 1 - Summary of Significant Accounting Policies to the Consolidated Financial Statements under "Part II, Item 8. Financial Statements and Supplementary Data."

***Our commercial, financial and agricultural loan and commercial real estate loan portfolios expose us to risks that may be greater than the risks related to our other loans.***

Our loan portfolio includes commercial, financial and agricultural loans and commercial real estate loans, which are 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. Commercial, financial and agricultural and commercial real estate loans carry more risk as compared to other types of lending, because they typically involve larger loan balances often concentrated with a single borrower or groups of related borrowers.

Accordingly, charge-offs on commercial, financial and agricultural and commercial real estate loans may be larger on a per loan basis than those incurred with our residential or consumer loan portfolios. In addition, these loans expose a lender to greater credit risk than loans secured by residential real estate. The payment experience on commercial real estate loans that are secured by income producing properties are typically dependent on the successful operation of the related real estate project and thus, may subject us to adverse conditions in the real estate market or to the general economy. The collateral securing these loans typically cannot be liquidated as easily as residential real estate. If we foreclose on these loans, our holding period for the collateral typically is longer than residential properties because there are fewer potential purchasers of the collateral.

Unexpected deterioration in the credit quality of our commercial or commercial real estate loan portfolios would require us to increase our provision for loan losses, which would reduce our profitability and could materially adversely affect our business, financial condition, results of operations and prospects.

In addition, with respect to commercial real estate loans, federal and state banking regulators are examining commercial real estate lending activity with heightened scrutiny and may require banks with higher levels of commercial real estate loans to implement more stringent underwriting, internal controls, risk management policies and portfolio stress testing, as well as possibly higher levels of allowances for losses and capital levels as a result of commercial real estate lending growth and exposures. Because a significant portion of our loan portfolio is comprised of commercial real estate loans, the banking regulators may require us to maintain higher levels of capital than we would otherwise be expected to maintain, which could limit our ability to leverage our capital and have a material adverse effect on our business, financial condition, results of operations and prospects.

***We rely on the mortgage secondary market for some of our liquidity.***

We originate and sell mortgage loans. We rely on Federal National Mortgage Association ("Fannie Mae"), Federal Home Loan Mortgage Corporation ("Freddie Mac") and other purchasers to purchase first mortgage loans in order to reduce our credit risk and interest rate risk and provide funding for additional loans we desire to originate. We cannot provide assurance that these purchasers will not materially limit their purchases from us due to capital constraints or other factors, including, with respect to Fannie Mae and Freddie Mac, a change in the criteria for conforming loans. In addition, various proposals have been made to reform the U.S. residential mortgage finance market, including the role of Fannie Mae and Freddie Mac. The exact effects of any such reforms are not yet known, but may limit our ability to sell conforming loans to Fannie Mae or Freddie Mac. In addition, mortgage lending is highly regulated, and our inability to comply with all federal and state regulations and investor guidelines regarding the origination, underwriting, documentation and servicing of mortgage loans may also impact our ability to continue selling mortgage loans. If we are unable to continue to sell loans in the secondary market, our ability to fund, and thus originate, additional mortgage loans may be adversely affected, which could have a material adverse effect on our business, financial condition or results of operations.

***We may incur future losses in connection with certain representations and warranties we have made with respect to mortgages that we have sold in the secondary market.***

In connection with the sale of mortgage loans into the secondary market, we make representations and warranties, which, if breached, may require us to repurchase such loans, substitute other loans or indemnify the purchasers of such loans for actual losses incurred in respect of such loans. A substantial decline in residential real estate values in the markets in which we originated such loans could increase the risk of such consequences. While we currently believe our repurchase risk is low, it is possible that requests to repurchase loans could occur in the future and such requests may have a material adverse effect on our financial condition and results of operations.

***Consumer protection initiatives related to the foreclosure process could materially affect our ability as a creditor to obtain remedies.***

In 2011, Hawaii revised its rules for nonjudicial, or out-of-court, foreclosures. Prior to the revision, most lenders used the nonjudicial foreclosure method to handle foreclosures in Hawaii, as the process was less expensive and quicker than going through the court foreclosure process. After the revised rules went into effect, many lenders ended up forgoing nonjudicial foreclosures entirely and filing all foreclosures in court, which has created a backlog and slowed the judicial foreclosure process. Many lenders continue to exclusively use the judicial foreclosure process, making the foreclosure process very lengthy. Additionally, the joint federal-state settlement with several mortgage servicers over abuse of foreclosure practices creates further uncertainty for us and the mortgage servicing industry in general with respect to implementation of mortgage loan modifications and loss mitigation practices going forward. The manner in which these issues are ultimately resolved could impact our foreclosure procedures, which in turn could adversely affect our business, financial condition or results of operations.

***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 which could affect or limit our ability to satisfy our obligations and our ability to grow profitability at the same rate. Our access to funding sources in amounts adequate to finance our activities on terms that are acceptable to us could be impaired by factors that affect us specifically, the financial services industry, or the 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, and 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 parties could adversely impact our sources of liquidity, financial position, including regulatory capital ratios, results of operations and our business prospects.

If our 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 Des Moines ("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 a 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;
- market conditions;
- 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 impair our operations or restrict our growth.***

As a regulated financial institution, we are subject to significant governmental supervision and regulation. 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 FRB, the FDIC and the DFI, and certain rules and regulations promulgated by the CFPB. In addition, we are subject to the rules and regulation of the NYSE and the SEC and are subject to enforcement actions and other punitive actions by these agencies. 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;
- conditions and restrictions on our executive compensation; and
- how much cash we must set aside as reserves for deposits.

In addition, bank regulatory authorities may bring enforcement actions against banks and bank holding companies, including CPF and the bank, 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. In addition, if we were to grow beyond \$10 billion in assets, we would be subject to enhanced CFPB examination and our compliance costs would increase.

***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 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.

***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 as well as our financial condition 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 and risk 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 15.0% of our interest income in the year ended December 31, 2019, as compared to 19.3% of our interest income in the year ended December 31, 2018. 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, remains 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.

The FRB has increased interest rates seven times over the last two years. Should the FRB continue to 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 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 may be adversely impacted by the transition from LIBOR as a reference rate.***

In 2017, the United Kingdom's Financial Conduct Authority announced that after 2021 it would no longer compel banks to submit the rates required to calculate the LIBOR. This announcement indicates that the continuation of LIBOR on the current basis cannot and will not be guaranteed after 2021. Consequently, at this time, it is not possible to predict whether and to what extent banks will continue to provide submissions for the calculation of LIBOR. Similarly, it is not possible to predict whether LIBOR will continue to be viewed as an acceptable market benchmark, what rate or rates may become accepted alternatives to LIBOR or what the effect of any such changes in views or alternatives may be on the markets for LIBOR-indexed financial instruments.

We have a significant number of loans and debt with attributes that are either directly or indirectly dependent on LIBOR. The transition from LIBOR could create considerable costs and additional risk. Since proposed alternative rates are calculated differently, payments under contracts referencing new rates will differ from those referencing LIBOR. The transition may change our market risk profile, and require changes to risk and pricing models, valuation tools, product design and hedging strategies. Furthermore, failure to adequately manage this transition process with our customers could adversely impact our reputation. Although we are currently unable to assess what the ultimate impact of the transition from LIBOR will be, failure to adequately manage the transition could have a material adverse effect on our business, financial condition and results of operations.

***We rely on dividends from our subsidiary 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 and our liquidity.

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. As of December 31, 2019, the bank had Statutory Retained Earnings of \$66.6 million. In addition, regulatory authorities could limit the ability of the bank to pay dividends to CPF. The inability to receive dividends from the bank could have a material adverse effect on our financial condition, results of operations and prospects.



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. We cannot provide any assurance that we will continue to pay dividends.

***The occurrence of fraudulent activity, data privacy breaches, 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, our customers or our business partners, which may result in financial losses or increased costs to us or, our customers or our business partners, 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, our vendors, 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 third-party 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 data security breaches and cyber-attacks and periodically test our security, we may fail to anticipate or adequately mitigate breaches of security or experience data privacy breaches that 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, including resulting violations of law (whether federal or one or more various states); 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 and other data privacy breaches 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 materially 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.

***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 whom 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 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, financial service providers, including mortgage providers and brokers, operating via the internet and other technology platforms, 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.

In addition, 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 President, our Group Executive Vice President of Revenue, our Executive Vice President and Small Business and Wealth Management Manager, our Executive Vice President of Retail Markets, our Executive Vice President and Chief Marketing Officer, our Executive Vice President and Chief Financial Officer, and certain other employees.

***We are subject to environmental liability risk associated with our bank branches and any real estate collateral we acquire upon foreclosure.***

During the ordinary course of business, we may foreclose on and take title to properties securing certain loans that we have originated or acquired. We also own several of our branch locations. For any real property that we may possess, there is a risk that hazardous or toxic substances could be found on these properties. If hazardous or toxic substances are found, we may be liable for remediation costs, as well as for personal injury and property damage and costs of complying with applicable environmental regulatory requirements. Failure to comply with such requirements can result in penalties. Environmental laws may require us to incur substantial expenses and may materially reduce the affected property's value or limit our ability to use, sell or lease the affected property. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws may increase our exposure to environmental liability. The remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect on our business, financial condition or results of operations.

***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.

***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. Frequent or rapid changes in procedures, methodologies, systems, personnel and technology exacerbate the challenge of

developing and maintaining a system of internal controls and can increase the cost and level of effort to develop and maintain such systems.

***Natural disasters and other external events (including pandemic viruses or disease) could have a material adverse effect on our financial condition and results of operations.***

Our branch offices as well as a substantial majority of our loan portfolio is in the state of Hawaii. As a result, natural disasters and other severe weather occurrences such as tsunamis, volcanic eruptions (such as the recent eruption of Mount Kilauea), hurricanes and earthquakes and other adverse external events, including the effects of any pandemic viruses or diseases, could have a significant effect on our ability to conduct our business and adversely affect the tourism and visitor industry in the state of Hawaii. Such events could affect the ability of our borrowers to repay their outstanding loans, impair the value of collateral securing our loans, cause significant property damage, result in loss of revenue, adversely impact our deposit base and/or cause us to incur additional expenses. Accordingly, the occurrence of any such natural disasters, severe weather events, or other occurrences over which we have no control could have a material adverse effect on our business, which, in turn, could adversely affect our financial condition and results of operations.

### **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 mergers, acquisitions, restructurings, or public offerings;
- additions or departures of key personnel;
- actions by institutional shareholders;
- fluctuations in the stock price and operating results of our competitors;
- future sales of other equity or debt securities, including our common stock;
- 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 generally may experience significant volatility. In addition, the trading volume in our common stock may fluctuate more than usual and cause significant price variations to occur. 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.

***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 or a significant block of common stock, 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 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. In particular, both federal and state law limit the acquisition of ownership of certain percentage thresholds of our common stock without providing prior notice to the regulatory agencies and obtaining prior regulatory approval or nonobjection or being able to rely on an exemption from such acquisition. See the "Supervision and Regulation" section. We are also subject to the provisions of the Hawaii Control Share Acquisitions Act which prohibits the consummation of a "control share acquisition" (with threshold ranges starting at 10% and set at 10% intervals up to a majority) unless approved by our shareholders or otherwise exempt. Unless approved or otherwise exempt, for a period of one year after acquisition, the shares acquired by a person in a control share acquisition will be (i) denied voting rights, (ii) be nontransferable, and (iii) be subject to redemption at our option. Collectively, these provisions of our restated articles of incorporation and bylaws and applicable federal and state law may prevent a merger or acquisition that would be attractive to shareholders, limit the ability of another party to acquire a significant block of our common stock, and could limit the price investors would be willing to pay in the future for our common stock.

***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, 2019, we had \$50.0 million in face amount of trust preferred securities outstanding and accrued and unpaid dividends thereon of \$0.1 million. We also had short-term FHLB borrowings of \$150.0 million and long-term FHLB borrowings of \$50.0 million as of December 31, 2019. 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 at the time you otherwise may desire.***

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. As a result, you may not be able to resell your common stock at or above the price you pay or at the time(s) you otherwise may desire.

***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, 2019. Last year, we submitted to the NYSE on April 29, 2019 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 23, 2020.

**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 a portion of the land on which our operations center is located. The remaining portion of the land where our operations center is located is 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 bank training classes are held and residential mortgage sales and operations are located. In February 2020, the Company closed on the purchase of a parcel of land where our Kaneohe branch is 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 2045 and generally contain renewal options for periods ranging from 5 to 15 years. For additional information relating to lease rental expense and commitments as of December 31, 2019, see Note 19 - Operating Leases 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**

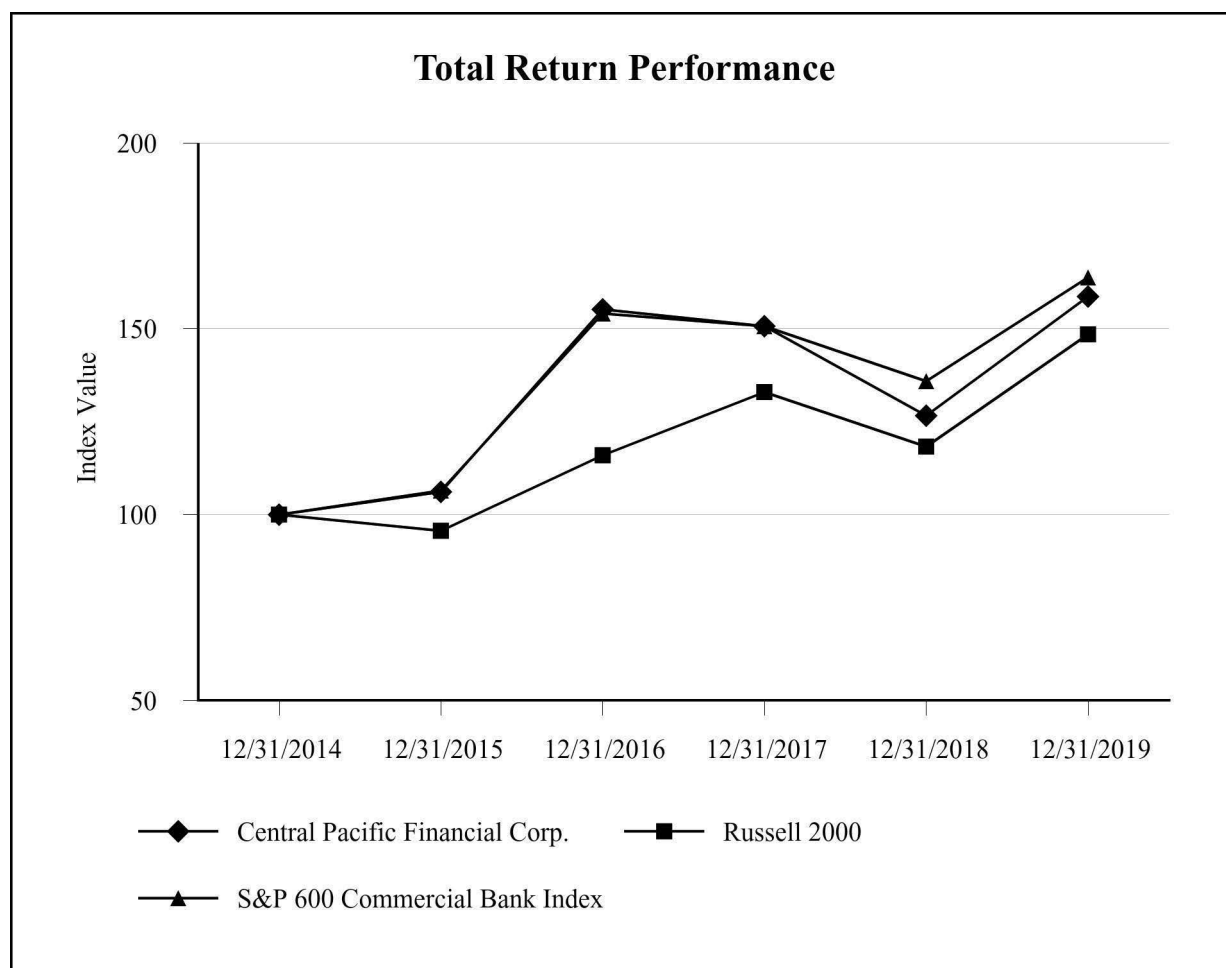
Not applicable

**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 Standard and Poor's ("S&P") SmallCap 600 Commercial Bank Index for the five year period commencing December 31, 2014 and ending December 31, 2019. The graph assumes the investment of \$100 on December 31, 2014.

**Indexed Total Annual Return**  
(as of December 31, 2019)



Index	December 31,					
	2014	2015	2016	2017	2018	2019
Central Pacific Financial Corp. ....	\$ 100.00	\$ 106.14	\$ 155.22	\$ 150.73	\$ 126.63	\$ 158.74
Russell 2000 .....	100.00	95.59	115.95	132.94	118.30	148.49
S&P 600 Commercial Bank Index .....	100.00	106.44	154.13	150.74	135.89	163.84

As of January 31, 2020, there were 2,830 shareholders of record, excluding individuals and institutions for which shares were held in the names of nominees and brokerage firms.

## Dividends

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.

Under the terms of our trust preferred securities, our ability to pay dividends with respect to common stock would be restricted if our obligations under our trust preferred securities were not current. Our obligations on our outstanding trust preferred securities are current as of December 31, 2019.

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, 2019, the bank had Statutory Retained Earnings of \$66.6 million. In addition, the bank's regulators could impose limitations or conditions on the bank's ability to pay dividends to the Company.

See "Part I, Item 1. Business — Supervision and Regulation — Regulatory Actions" for a discussion on regulatory restrictions.

## Issuer Purchases of Equity Securities

In June 2019, the Company's Board of Directors authorized the repurchase of up to \$30.0 million of its common stock from time to time on the open market or in privately negotiated transactions, pursuant to a newly authorized share repurchase program (the "2019 Repurchase Plan"). The 2019 Repurchase Plan replaced and superseded in its entirety the share repurchase program previously approved by the Company's Board of Directors, which had \$6.8 million in remaining repurchase authority.

During the quarter ended December 31, 2019, 165,703 shares of common stock, at a cost of \$4.8 million, were repurchased under the 2019 Repurchase Plan. A total of \$21.1 million remained available for repurchase under the 2019 Repurchase Plan at December 31, 2019. In January 2020, our Board of Directors authorized the repurchase of up to \$30 million of our common stock. This authorization supersedes the remaining repurchase authority under our 2019 Repurchase Plan. The current repurchase plan is subject to a one year expiration.

### Issuer Purchases of Equity Securities

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
October 1-31.....	71,000	\$ 28.53	71,000	—	\$ 2,025,739	\$ 23,901,697
November 1-30.....	47,535	29.56	47,535	—	1,405,354	22,496,343
December 1-31.....	47,168	29.59	47,168	—	1,395,484	21,100,859
Total.....	<u>165,703</u>	29.13	<u>165,703</u>	<u>—</u>	<u>\$ 4,826,577</u>	21,100,859

During the entire year of 2019, 797,003 shares of common stock, at a cost of \$22.8 million or an average cost per share of \$28.60, were repurchased under the Company's share repurchase programs.

**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, 2019. 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." Significant items affecting the comparability of the information presented in this table follows this presentation.

Selected Financial Data	Year Ended December 31,				
	2019	2018	2017	2016	2015
	(Dollars in thousands, except per share data)				
<b>Statement of Income Data:</b>					
Total interest income.....	\$ 216,383	\$ 198,294	\$ 182,562	\$ 167,139	\$ 156,035
Total interest expense.....	32,309	25,296	14,859	9,189	6,507
Net interest income.....	184,074	172,998	167,703	157,950	149,528
Provision (credit) for loan and lease losses.....	6,317	(1,124)	(2,674)	(5,517)	(15,671)
Net interest income after provision for loan and lease losses.....	177,757	174,122	170,377	163,467	165,199
Other operating income.....	41,801	38,804	36,496	42,316	34,799
Other operating expense (1).....	141,631	134,682	131,073	132,518	125,964
Income before income taxes.....	77,927	78,244	75,800	73,265	74,034
Income tax expense (1).....	19,605	18,758	34,596	26,273	28,166
Net income.....	58,322	59,486	41,204	46,992	45,868
<b>Balance Sheet Data (as of Year-End):</b>					
Interest-bearing deposits in other financial institutions.....	\$ 24,554	\$ 21,617	\$ 6,975	\$ 9,069	\$ 8,397
Investment securities (2).....	1,128,110	1,354,812	1,496,644	1,461,515	1,520,172
Loans and leases.....	4,449,540	4,078,366	3,770,615	3,524,890	3,211,532
Allowance for loan and lease losses.....	47,971	47,916	50,001	56,631	63,314
Mortgage servicing rights.....	14,718	15,596	15,843	15,779	17,797
Core deposit premium.....	—	—	2,006	4,680	7,355
Total assets.....	6,012,672	5,807,026	5,623,708	5,384,236	5,131,288
Core deposits (3).....	4,259,325	4,015,942	3,991,234	3,713,567	3,582,178
Total deposits.....	5,120,023	4,946,490	4,956,354	4,608,201	4,433,439
Long-term debt.....	101,547	122,166	92,785	92,785	92,785
Total shareholders' equity.....	528,520	491,725	500,011	504,650	494,614
<b>Per Share Data:</b>					
Basic earnings per common share.....	\$ 2.05	\$ 2.02	\$ 1.36	\$ 1.52	\$ 1.42
Diluted earnings per common share.....	2.03	2.01	1.34	1.50	1.40
Cash dividends declared per common share.....	0.90	0.82	0.70	0.60	0.82
Book value per common share.....	18.68	16.97	16.65	16.39	16.06
Diluted weighted average shares outstanding (in thousands).....	28,677	29,610	30,638	31,225	32,651
<b>Financial Ratios:</b>					
Return on average assets.....	0.99%	1.05%	0.75%	0.90%	0.92 %
Return on average shareholders' equity.....	11.36	12.22	8.03	9.16	8.91
Net income to average tangible shareholders' equity.....	11.36	12.24	8.08	9.27	9.06
Average shareholders' equity to average assets.....	8.72	8.56	9.32	9.78	10.37
Dividend payout ratio.....	44.33	40.80	52.24	40.00	58.57
Efficiency ratio (1).....	62.70	63.59	64.19	66.17	68.34
Net interest margin (4).....	3.35	3.22	3.28	3.27	3.30
<b>Regulatory Capital Ratios:</b>					
Leverage capital.....	9.5%	9.9%	10.4%	10.6%	10.7 %
Tier 1 risk-based capital.....	12.6	13.5	14.7	14.2	14.4
Total risk-based capital.....	13.6	14.7	15.9	15.5	15.7
CET1 risk-based capital.....	11.5	11.9	12.4	12.3	12.8

Selected Financial Data	Year Ended December 31,				
	2019	2018	2017	2016	2015
	(Dollars in thousands, except per share data)				
<b>Asset Quality:</b>					
Net loan charge-offs (recoveries) to average loans and leases.....	0.15%	0.02%	0.11%	0.03%	(0.16)%
Nonaccrual loans to total loans and leases.....	0.03	0.06	0.07	0.24	0.44
Allowance for loan and lease losses to total loans and leases.....	1.08	1.17	1.33	1.61	1.97
Allowance for loan and lease losses to nonaccrual loans.....	3,084.95	2,062.68	1,801.84	674.50	443.75

- (1) 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). Prior period other operating expense, income tax expense and efficiency ratio have been revised to conform to current period, which reflects reclassifications related to the change in accounting policy for our investments in low-income housing tax credit partnerships referred to in Note 1 - Summary of Significant Accounting Policies. See Item 7 — Management's Discussion and Analysis of Financial Condition and Results of Operations — Table 5 - Reconciliation of Efficiency Ratio.
- (2) Held-to-maturity securities at amortized cost, available-for-sale securities at fair value.
- (3) Noninterest-bearing demand, interest-bearing demand and savings deposits, and time deposits under \$100,000.
- (4) Computed on a taxable-equivalent basis using a federal statutory tax rate of 21% for the years ended December 31, 2019 and 2018 and 35% for the previous years.

## Five Year Performance Comparison

Significant items affecting the comparability of the five years' performance include:

(Dollars in thousands)	Year Ended December 31,				
	2019	2018	2017	2016	2015
Provision (credit) for loan and lease losses.....	\$ 6,317	\$ (1,124)	\$ (2,674)	\$ (5,517)	\$ (15,671)
Other operating income:					
Mortgage banking income.....	5,983	7,315	6,962	8,069	7,254
Net gain (loss) on sales of foreclosed assets .....	(145)	—	205	607	568
Gain on sale of premises and equipment.....	—	—	—	3,537	—
Investment securities gains (losses) .....	36	(279)	(1,410)	—	(1,866)
Gain on sale of MasterCard stock (included in other).....	2,555	—	—	—	—
Other operating expense:					
Share-based compensation (included in salaries and employee benefits).....	4,289	3,787	3,266	3,094	4,181
Pension obligation settlement (included in salaries and employee benefits).....	—	—	—	3,848	—
One-time reversal of an accrual for a former executive's retirement benefits that will not be paid (included in salaries and employee benefits) .....	—	—	—	—	(2,400)
Foreclosed asset expense.....	251	574	151	152	486
Charitable contributions (included in other) .....	681	635	593	660	2,559
FDIC insurance premium (included in other) .....	868	1,732	1,724	2,052	2,706
Provision (credit) for residential mortgage loan repurchase losses (included in other) .....	(403)	150	209	(387)	(1,352)
Reserve (credit) for unfunded loan commitments (included in other) .....	29	(425)	94	141	(271)
Branch consolidation and relocation costs (included in other) .....	—	—	—	737	—
Income tax expense .....	19,605	18,758	34,596	26,273	28,166

## 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.

We strive to provide exceptional customer service and products that meet our customers' needs. Our products and services consist primarily of the following:

- *Loans:* Our loans consist of commercial, financial and agricultural, commercial mortgage, and construction loans to small and medium-sized companies, business professionals, and real estate investors and developers, as well as residential mortgage, home equity and consumer loans to local homeowners and individuals. Our lending activities contribute to a key component of our revenues reported in interest income.
- *Deposits:* We offer a full range of deposit products and services including checking, savings and time deposits, cash management, and electronic banking services. 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.

### Executive Overview

In 2019 we continued to deliver strong financial performance for the Company.

- We recorded net income of \$58.3 million, or \$2.03 per diluted common share in 2019, compared to \$59.5 million, or \$2.01 per diluted common share in 2018.
- We recorded return on average assets ("ROA") and return on average shareholders' equity ("ROE") ratios of 0.99% and 11.36%, respectively, in 2019, compared to ROA and ROE ratios of 1.05% and 12.22%, respectively, in 2018.
- We saw continued improvement in our asset quality as our nonperforming assets declined by \$1.0 million to \$1.7 million at December 31, 2019 from \$2.7 million at December 31, 2018.
- With the healthy market conditions in Hawaii, together with our efforts to expand and strengthen customer relationships, we realized strong loan growth of \$371.2 million, or 9.1%, as well as core deposit growth of \$243.4 million, or 6.1% in 2019.
- Our capital position remained strong, supported by nine consecutive years of profitability and the improvements in our asset quality. With consistent profitability, we were able to increase our regular cash dividends paid from \$0.82 per share in 2018 to \$0.90 per share in 2019.
- In 2019, our strong capital position and consistent profitability also allowed us to execute on our stock repurchase program and repurchase 797,003 shares, or approximately 2.8% of outstanding shares as of December 31, 2018.

### RISE2020

Commencing in the second quarter of 2019, the Company launched RISE2020, a new multifaceted initiative intended to enhance customer experience, drive stronger long-term growth and profitability, improve shareholder returns and lower our efficiency ratio. RISE2020 includes initiatives in the following key areas of opportunity: Digital Banking, Revenue Enhancements, Branch Transformation and Operational Excellence. RISE2020 is intended to provide Central Pacific Bank with best-in class products and services in several strategic areas. During 2019, the outsourcing of the Company's residential mortgage loan servicing, the launch of its new website under the cpb.bank domain name and the implementation of its end-to-end commercial loan origination system was completed. The development of the Company's new online and mobile banking platforms is progressing, with a pilot of the new platforms scheduled for the first half of 2020. Key steps toward the Company's

2020 milestones in the areas of branch and ATM modernization were achieved with construction underway at the Main Branch headquarters and new ATMs selected.

The Company plans to invest approximately \$40 million in RISE2020 in 2019 and 2020. Some of these investments will be capitalized, while others are recurring annually. During 2019, the Company incurred approximately \$3.5 million in RISE2020-related expenses. While operating expenses are expected to increase, the Company is forecasting enhanced revenue growth. As a result, we expect our efficiency ratio to be in the 63-65% range in 2020. Longer-term, the Company is targeting a 15% return on average shareholders' equity and a 57% efficiency ratio by the fourth quarter of 2022.

### **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**

The majority of our operations are concentrated in the state of Hawaii. As a result, our performance is significantly influenced by the real estate markets and economic environment in Hawaii. Macroeconomic conditions also influence our performance. 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.

Following the solid performances of our leading economic indicators in 2018, Hawaii's general economic conditions continued to improve but at a slower pace in 2019. Tourism continues to be Hawaii's center of strength and its most significant economic driver. For the eighth consecutive year, Hawaii's strong visitor industry broke records in several key categories, including visitor arrivals and visitor spending. According to preliminary year-end statistics from the Hawaii Tourism Authority ("HTA"), approximately 10.4 million total visitors arrived in the state in 2019. This was an increase of 5.4% from the previous record high of 9.9 million visitor arrivals in 2018. The HTA also reported that total spending by visitors increased to \$17.75 billion in 2019, an increase of 1.4%, from the previous record high of \$17.51 billion in 2018. According to the Hawaii Department of Business Economic Development and Tourism ("DBEDT"), total visitor arrivals and visitor spending are expected to increase by 2.5% and 2.5% in 2020, respectively.

DBEDT reported Hawaii's economy, as measured by the growth of real personal income and real gross state product, continued positive growth in 2019. DBEDT is expected to report real personal income and real gross state product growth of approximately 1.7% and 1.2%, respectively, for 2019 and projects a growth rate of 1.7% and 1.2%, respectively, for 2020.

Hawaii's labor market continues to be among the best in the nation. The Department of Labor and Industrial Relations reported that Hawaii's seasonally adjusted annual unemployment rate in December 2019, which was 2.6%, compared to 2.5% in December 2018. Hawaii's unemployment rate in December 2019 of 2.6%, which is among the lowest in the nation, remained below the national seasonally adjusted unemployment rate of 3.5%. DBEDT projects Hawaii's seasonally adjusted annual unemployment rate to be at 3.2% in 2020.

Real estate lending is a primary focus for us, including residential mortgage and commercial mortgage loans. As a result, we are dependent on the strength of Hawaii's real estate market. The Oahu real estate market saw steady activity in 2019. According to the Honolulu Board of Realtors, the median price for a single-family home on Oahu for the year ended December 31, 2019 was \$789,000, representing a decrease of 0.1% from the median resale price of \$790,000 for the year ended December 31, 2018. The median resale price for condominiums on Oahu was \$425,000 for the year ended December 31, 2019, representing an increase of 1.2% from the median resale price of \$420,000 for the year ended December 31, 2018. Oahu unit sales volume increased by 3.9% for single-family homes, but decreased by 4.8% for condominiums in 2019 from 2018.

As we have seen in the past, our operating results are significantly impacted by the economy in Hawaii and the composition of our loan portfolio. Loan demand, deposit growth, Provision, asset quality, noninterest income and noninterest expense are all affected by changes in economic conditions. If the residential and commercial real estate markets we have exposure to deteriorate our results of operations would be negatively impacted. See the "Overview of Results of Operations— Concentrations of Credit Risk" section 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.

In late 2008, the Federal Reserve lowered the target Federal Funds range to 0%-0.25%. In an attempt to help the overall economy, the FRB has kept interest rates low through its targeted Fed Funds rate until the recession was safely over. In recent years, the Federal Reserve has begun raising the target Federal Funds range. During 2018, the Federal Reserve increased the

Federal Funds range four times, each by 25 basis points to 2.25%-2.50% as of December 31, 2018. The Federal Reserve left the Federal Funds range unchanged during the first half of 2019 but cut the Federal Funds range three times by 25 basis points during the second half of 2019 to 1.50%-1.75% as of December 31, 2019.

Further decreases in the Federal Funds rate would likely result in lower overall interest rates and may support the continued expansion of the U.S. economy. Changes in monetary policy, including changes in interest rates, could influence, among other things, (i) the amount of interest we receive on loans and securities, (ii) the amount of interest we pay on deposits and borrowings, (iii) our ability to originate loans and obtain deposits, and (iv) the fair value of our assets and liabilities.

### **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 a number of judgments, estimates and assumptions that affect the reported amounts of assets, liabilities, income and expense in the financial statements and the related disclosures made. Various elements of our accounting policies, by their nature, involve the application of highly sensitive and judgmental estimates and assumptions. Some of these policies and estimates relate to matters that are highly complex and contain substantial inherent uncertainties. Actual amounts and values as of the balance sheet dates may be materially different than the amounts and values reported due to the inherent uncertainty in the estimation process. Also, future amounts and values could differ materially from those estimates due to changes in values and circumstances after the balance sheet date.

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 identified the following accounting policy and estimates that, due to inherent judgments and assumptions and the potential sensitivity of the financial statements to those judgments and assumptions, are critical to an understanding of our financial statements. Management has discussed the development and selection of the critical accounting policy and 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 ("Allowance")***

The Allowance is management's estimate of incurred 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 incurred in our loan and lease portfolio.

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 qualitative adjustments based on environmental and other factors which may be internal or external to the Company.

#### ***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. The Company recorded a specific reserve of \$0.2 million as of December 31, 2019. The Company did not record a specific reserve as of December 31, 2018.

#### ***General Allowance***

In determining the general allowance component of the Allowance, the Company utilizes a comprehensive approach to segment the loan portfolio into homogeneous groups. The methodology segments the portfolio generally by FDIC Call Report codes. In the second quarter of 2017, an additional segment was added for auto dealer purchased loans. In the third quarter of 2018, another segment was broken out for multifamily commercial real estate loans. This results in eleven segments, and is consistent with general industry practice. For the purpose of determining general allowance loss factors, loss experience is derived from a migration analysis, with the exception of national syndicated loans and auto dealer purchased loans where an average historical loss rate is applied due to limited historical loss experience. The key inputs to run a migration analysis are the length of the migration period, the dates for the migration periods to start and the number of migration periods used for the analysis. For

each migration period, the analysis will determine the outstanding balance in each segment and/or sub-segment at the start of each period. These loans will then be followed for the length of the migration period to identify the amount of associated charge-offs and recoveries. A loss rate for each migration period is calculated using the formula 'net charge-offs over the period divided by beginning loan balance'. The Allowance methodology applies a look back period to January 1, 2010. The Company extends its look back period with each additional quarter passing. As of December 31, 2019, the look back period was ten years.

### *Qualitative Adjustments*

Our Allowance methodology uses qualitative adjustments to address changes in conditions, trends, and circumstances such as economic conditions and industry changes that could have a significant impact on the risk profile of the loan portfolio, and provide for losses in the loan portfolio that may not be reflected and/or captured in the historical loss data. In order to ensure that the qualitative adjustments are in compliance with current regulatory standards and U.S. GAAP, the Company is primarily basing adjustments on the nine standard factors outlined in the 2006 Interagency Policy Statement on the Allowance for Loan and Lease Losses. These factors include: lending policies, economic conditions, loan profile, lending staff, problem loan trends, loan review, collateral, credit concentrations and other internal and external factors.

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 adjustments are applied to factor in current loan portfolio and market intelligence. These adjustments, which are added to the historical loss rate, consider the nature of the Company's primary markets and are reasonable, consistently determined and appropriately documented. Management reviews the results of the qualitative adjustment quarterly to ensure it is consistent with the trends in the overall economy, and from time to time may make adjustments, if necessary, to ensure directional consistency.

## **Overview of Results of Operations**

### ***2019 vs. 2018 Comparison***

In 2019, we recognized net income of \$58.3 million, or \$2.03 per diluted common share, compared to net income of \$59.5 million, or \$2.01 per diluted common share, in 2018. Our ROA and ROE for 2019 was 0.99% and 11.36%, respectively, compared to 1.05% and 12.22%, respectively, in 2018.

We recorded a provision for loan and lease losses of \$6.3 million in 2019, compared to a credit of \$1.1 million in 2018.

Net interest income increased by \$11.1 million from 2018 to 2019, primarily due to a significant increase in average loans and leases funded by runoff of the investment securities portfolio and a significant increase in core deposits, combined with an increase in average yields earned on loans and leases and higher interest recoveries on nonaccrual loans. In addition, average government time deposits (included in time deposits of \$100,000 and over) declined significantly. Partially offsetting these positive variances were increases in interest rates paid on interest-bearing deposits, primarily attributable to the four 25 basis point increases in the Federal Funds rate in 2018.

Other operating income increased by \$3.0 million from 2018 to 2019. The increase in other operating income was primarily due to conversion of MasterCard Class B common stock received during their initial public offering to Class A common stock and immediate sale of the converted shares resulting in a gain of \$2.6 million during the first quarter of 2019, combined with higher income from bank-owned life insurance, higher merchant and bank card fees and higher commissions and fees on investment services. These increases were partially offset by lower mortgage banking income and lower income recovered on nonaccrual loans previously charged-off. See Table 3 - Components of Other Operating Income for more information.

Other operating expense increased by \$6.9 million from 2018 to 2019. The increase was primarily due to higher salaries and employee benefits, higher entertainment and promotions expense (included in other), higher computer software expense and higher net occupancy expense. These increases were partially offset by lower amortization of core deposit premium, lower FDIC insurance expense and a credit to the reserve for residential mortgage loan repurchase losses in 2019, compared to an increase to the reserve in 2018. See Table 4 - Components of Other Operating Expense for more information.

## ***2018 vs. 2017 Comparison***

In 2018, we recognized net income of \$59.5 million, or \$2.01 per diluted common share, compared to net income of \$41.2 million, or \$1.34 per diluted common share, in 2017. Our ROA and ROE for 2018 was 1.05% and 12.22%, respectively, compared to 0.75% and 8.03%, respectively, in 2017. Our ROA and ROE in 2017 were negatively impacted by a one-time non-cash charge of \$7.4 million to income tax expense related to the estimated impact of Tax Reform, as defined below, on our DTA.

The significant increase in net income and diluted earnings per share was primarily due to lower income tax expense of \$15.8 million, primarily attributable to federal tax legislation. On December 22, 2017, the U.S. government enacted comprehensive tax legislation H.R.1., commonly referred to as the Tax Cuts and Jobs Act ("Tax Reform"), which among other items, reduced the corporate federal income tax rate from 35% to 21% and changed or limited certain tax deductions effective January 1, 2018. The Company's net deferred tax assets ("DTA") represent expected corporate tax benefits anticipated to be realized in the future. The reduction in the corporate federal income tax rate reduced these benefits. Based on the Company's evaluation of the estimated impact of Tax Reform on its DTA, the Company recorded a one-time, non-cash estimated charge of \$7.4 million of additional income tax expense in December 2017. In the first quarter of 2018, the Company recorded an income tax benefit of \$0.7 million related to a refinement of the revaluation of our DTA. In the second quarter of 2018, the Company recorded an income tax benefit of \$0.6 million related to a tax accounting method change strategy that allows the deduction for certain expenses to be accelerated into the 2017 tax year under the higher corporate tax rate.

We recorded a credit to the provision for loan and lease losses of \$1.1 million in 2018, compared to a credit of \$2.7 million in 2017.

Net interest income increased by \$5.3 million from 2017 to 2018, primarily due to a significant increase in average loans and leases, combined with increases in average yields earned on the loans and leases and taxable investment securities portfolios. Partially offsetting the increase was the significant increase in rates paid on time deposits of \$100,000 and over, which primarily consists of public funds.

Other operating income increased by \$2.3 million from 2017 to 2018. The increase in other operating income was primarily due to net losses on sales of investment securities recognized in 2017 primarily attributable to an investment portfolio repositioning. In addition, in 2018 we recognized higher commissions and fees on investment services, higher income from fiduciary activities, higher mortgage banking income and higher fees on foreign exchange. These increases were partially offset by lower income from bank-owned life insurance and lower equity in earnings of unconsolidated subsidiaries. See Table 3 - Components of Other Operating Income for more information.

Other operating expense increased by \$3.6 million, primarily due to the increase in salaries and employee benefits, higher ATM and debit card expenses, higher computer software expense and higher equipment expense. These increases were partially offset by lower amortization of core deposit premium, lower entertainment and promotions expense and a credit to the reserve for unfunded commitments. See Table 4 - Components of Other Operating Expense for more information.



**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 a federal statutory tax rate of 21% for the years ended December 31, 2019 and December 31, 2018 and 35% for the year ended December 31, 2017. Table 2 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 and (ii) changes in rates. The change in volume is calculated as change in average balance, multiplied by prior period average yield/rate. The change in rate is calculated as change in average yield/rate, multiplied by current period volume. The change in interest income not solely due to change in volume or change in rate has been allocated proportionately to change in volume and change in average yield/rate.

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

	2019			2018			2017		
	Average Balance	Average Yield/Rate	Amount of Interest	Average Balance	Average Yield/Rate	Amount of Interest	Average Balance	Average Yield/Rate	Amount of Interest
(Dollars in thousands)									
<b>Assets</b>									
Interest-earning assets:									
Interest-bearing deposits in other financial institutions .....	\$ 9,842	2.04%	\$ 201	\$ 20,104	1.81%	\$ 365	\$ 33,012	1.08%	\$ 356
Investment securities, excluding valuation allowance:									
Taxable (1).....	1,120,711	2.63	29,517	1,304,523	2.65	34,562	1,351,436	2.51	33,982
Tax-exempt (1) .....	130,411	2.95	3,853	163,610	2.86	4,678	169,318	3.52	5,960
Total investment securities.....	1,251,122	2.67	33,370	1,468,133	2.67	39,240	1,520,754	2.63	39,942
Loans and leases, incl. loans-held-for-sale (2)	4,241,308	4.31	182,657	3,898,250	4.09	159,456	3,622,033	3.98	144,224
Federal Home Loan Bank ("FHLB") stock .....	16,369	5.89	964	8,990	2.40	215	7,033	1.79	126
Total interest-earning assets.....	5,518,641	3.94	217,192	5,395,477	3.69	199,276	5,182,832	3.56	184,648
Noninterest-earning assets .....	369,974			292,599			328,174		
Total assets.....	<u>\$ 5,888,615</u>			<u>\$ 5,688,076</u>			<u>\$ 5,511,006</u>		
<b>Liabilities and Equity</b>									
Interest-bearing liabilities:									
Interest-bearing demand deposits .....	\$ 984,298	0.08%	\$ 800	\$ 936,034	0.08%	\$ 734	\$ 901,171	0.07%	\$ 641
Savings and money market deposits.....	1,556,766	0.33	5,100	1,494,658	0.13	2,000	1,449,379	0.08	1,099
Time deposits under \$100,000.....	171,064	0.69	1,183	177,936	0.51	910	188,951	0.40	758
Time deposits of \$100,000 and over.....	897,670	1.88	16,861	1,016,643	1.56	15,860	984,069	0.88	8,699
Total interest-bearing deposits .....	3,609,798	0.66	23,944	3,625,271	0.54	19,504	3,523,570	0.32	11,197
FHLB advances and other short-term borrowings .....	185,909	2.31	4,285	50,630	2.44	1,236	15,531	1.18	183
Long-term debt .....	101,547	4.02	4,080	97,746	4.66	4,556	92,785	3.75	3,479
Total interest-bearing liabilities .....	3,897,254	0.83	32,309	3,773,647	0.67	25,296	3,631,886	0.41	14,859
Noninterest-bearing deposits.....	1,375,903			1,385,427			1,325,583		
Other liabilities.....	101,848			42,157			40,097		
Total liabilities .....	<u>5,375,005</u>			<u>5,201,231</u>			<u>4,997,566</u>		
Shareholders' equity .....	513,610			486,841			513,416		
Non-controlling interest .....	—			4			24		
Total equity .....	<u>513,610</u>			<u>486,845</u>			<u>513,440</u>		
Total liabilities and equity.....	<u>\$ 5,888,615</u>			<u>\$ 5,688,076</u>			<u>\$ 5,511,006</u>		
Net interest income .....			<u>\$ 184,883</u>			<u>\$ 173,980</u>			<u>\$ 169,789</u>
Interest rate spread .....		<u>3.11%</u>			<u>3.02%</u>			<u>3.15%</u>	
Net interest margin .....		<u>3.35%</u>			<u>3.22%</u>			<u>3.28%</u>	

(1) At amortized cost.

(2) Includes nonaccrual loans.

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

	2019 Compared to 2018			2018 Compared to 2017		
	Increase (Decrease) Due to Change In:		Net Change	Increase (Decrease) Due to Change In:		Net Change
	Volume	Rate		Volume	Rate	
	(Dollars in thousands)					
<b>Interest-earning assets</b>						
Interest-bearing deposits in other financial institutions .....	\$ (187)	\$ 23	\$ (164)	\$ (156)	\$ 165	\$ 9
Investment securities, excluding valuation allowance:						
Taxable .....	(4,823)	(222)	(5,045)	(1,054)	1,634	580
Tax-exempt .....	(941)	116	(825)	(201)	(1,081)	(1,282)
Total investment securities .....	(5,764)	(106)	(5,870)	(1,255)	553	(702)
Loans and leases, incl. loans-held-for-sale .....	13,934	9,267	23,201	10,958	4,274	15,232
FHLB stock .....	177	572	749	35	54	89
Total interest-earning assets .....	8,160	9,756	17,916	9,582	5,046	14,628
<b>Interest-bearing liabilities</b>						
Interest-bearing demand deposits .....	66	—	66	19	74	93
Savings and money market deposits .....	79	3,021	3,100	41	860	901
Time deposits under \$100,000 .....	(35)	308	273	(44)	196	152
Time deposits of \$100,000 and over .....	(1,827)	2,828	1,001	285	6,876	7,161
Total interest-bearing deposits .....	(1,717)	6,157	4,440	301	8,006	8,307
FHLB advances and other short-term borrowings ...	3,290	(241)	3,049	414	639	1,053
Long-term debt .....	178	(654)	(476)	186	891	1,077
Total interest-bearing liabilities .....	1,751	5,262	7,013	901	9,536	10,437
Net interest income .....	\$ 6,409	\$ 4,494	\$ 10,903	\$ 8,681	\$ (4,490)	\$ 4,191

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 \$184.9 million in 2019, which increased by \$10.9 million, or 6.3%, from \$174.0 million in 2018, which increased by \$4.2 million, or 2.5%, from net interest income of \$169.8 million recognized in 2017. The increase in net interest income for 2019 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, combined with an increase in average yields earned on loans and leases and higher nonrecurring interest recoveries. Partially offsetting the increase was the 12 basis points ("bp") increase in interest rates paid on interest-bearing deposits and higher average Federal Home Loan Bank ("FHLB") advances and other short-term borrowings.

Average yields earned on our interest-earning assets increased by 25 bp in the year ended December 31, 2019, from the year ended December 31, 2018. Average rates paid on our interest-bearing liabilities in the year ended December 31, 2019 increased by 16 bp from the year ended December 31, 2018. The increase in average rates paid on our interest-bearing liabilities in 2019 was primarily attributable to the 20 bp increase in average rates paid on our savings and money market deposits and the 32 bp increase in average rates paid on our time deposits of \$100,000 and over. Time deposits of \$100,000 and over primarily consists of public funds which may be opportunistic sources of funding, but fluctuate more directly with changes in Federal Funds rates.

In the third quarter of 2019, \$53.9 million in lower-yielding available-for-sale securities were sold as part of an investment portfolio repositioning strategy designed to enhance potential prospective earnings and improve net interest margin. We received \$53.9 million in gross proceeds and reinvested the proceeds in \$52.5 million in higher-yielding, longer duration investment securities with an average yield of 2.54% and a weighted average life of 6.6 years. The investment securities sold had an average yield of 2.10% and a weighted average life of 3.2 years. Gross realized gains on the sale of the investment

securities were \$36 thousand. The specific identification method was used as the basis for determining the cost of all securities sold.

In the second quarter of 2017, we completed an investment portfolio repositioning strategy designed to enhance potential prospective earnings and improve net interest margin. In connection with the repositioning, we sold \$97.7 million in lower-yielding available-for-sale securities, and purchased \$97.4 million in higher-yielding, longer duration investment securities. The investment securities sold had an average yield of 1.91% and a weighted average life of 3.3 years. Gross proceeds of the sale of \$96.0 million were immediately reinvested back into investment securities with an average yield of 2.57% and a weighted average life of 4.6 years. The new securities were classified in the available-for-sale portfolio. There were no gross realized gains on the sale of the investment securities. Gross realized losses on the sale of the investment securities were \$1.6 million. The specific identification method was used as the basis for determining the cost of all securities sold.

### Interest Income

Our primary sources of interest income include interest on loans and leases, which represented 84.1%, 80.0%, and 78.1% of taxable-equivalent interest income in 2019, 2018 and 2017, respectively, as well as interest earned on investment securities, which represented 15.4%, 19.7% and 21.6% of taxable-equivalent interest income, respectively. Interest income expressed on a taxable-equivalent basis of \$217.2 million in 2019 increased by \$17.9 million, or 9.0%, from the \$199.3 million earned in 2018, which increased by \$14.6 million, or 7.9%, from the \$184.6 million earned in 2017.

As depicted in Table 2, the increase in interest income in 2019 from 2018 was primarily due to a significant increase in average loans and leases, combined with higher yields earned on loans and leases and higher nonrecurring interest. The \$343.1 million increase in average loans and leases contributed to an increase of \$13.9 million in current year interest income. The 22 bp increase in average yields earned on loans and leases, which was benefited by higher interest recoveries of \$1.9 million, contributed to an increase of \$9.3 million in current year interest income. These positive variances were partially offset by the \$217.0 million decrease in average investment securities which contributed to a decrease of \$5.8 million in current year interest income.

The increase in interest income in 2018 from 2017 was primarily due to a significant increase in average loans and leases and taxable investment securities balances, combined with higher yields earned on the loans and leases and taxable investment securities portfolios. The \$276.2 million increase in average loans and leases contributed to an increase of \$11.0 million in current year interest income. The 11 bp and 14 bp increases in average yields earned on loans and leases and taxable investment securities contributed to increases of \$4.3 million and \$1.6 million in current year interest income, respectively. These positive variances were partially offset by the \$46.9 million decrease in average taxable investment securities which contributed to a decrease of \$1.1 million in current year interest income, combined with a \$1.0 million lower taxable-equivalent adjustment on tax-exempt investment securities due to the reduction in the corporate federal income tax rate from 35% to 21% due to Tax Reform.

### Interest Expense

In 2019, interest expense was \$32.3 million which represented an increase of \$7.0 million, or 27.7%, compared to interest expense of \$25.3 million in 2018, which was an increase of \$10.4 million, or 70.2%, compared to \$14.9 million in 2017.

In 2019, the increase in the average rates paid on savings and money market deposits of 20 bp and time deposits of \$100,000 and over of 32 bp contributed to the increase in interest expense in 2019 from 2018 of \$3.0 million and \$2.8 million, respectively. In addition, the increase in average FHLB advances and other short-term borrowings contributed to the increase in interest expense of \$3.3 million. These increases were partially offset by the 64 bp decrease in rates paid on long-term debt resulting in a \$0.7 million decline in interest expense. The decline in rates paid were primarily attributable to the pay off of junior subordinated debentures of CPB Capital Trust II ("Trust II") and CPB Statutory Trust III ("Trust III"), both of which carried an interest rate of three-month LIBOR plus 2.85%.

In 2018, the increase in the average rates paid on time deposits of \$100,000 and over of 68 bp, long-term debt of 91 bp, and FHLB advances and other short-term borrowings of 126 bp contributed to the increase in interest expense in 2018 from 2017 of \$6.9 million, \$0.9 million, and \$0.6 million, respectively.

### Net Interest Margin

Our net interest margin was 3.35%, 3.22% and 3.28% in 2019, 2018 and 2017, respectively. The increase in our net interest margin in 2019 from 2018 was primarily due to a significant increase in loans and leases, combined with the 25 bp increase in

the average yield earned on total interest-earning assets, which outpaced the 16 bp increase in average rates paid on total interest-bearing liabilities. The average yield earned on loans and leases increased by 22 bp, which was benefited by higher nonrecurring interest recoveries of \$1.9 million.

The decline in our net interest margin in 2018 from 2017 was primarily due to the 68 bp, 91 bp and 126 bp increases in average rates paid on time deposits of \$100,000 and over, long-term debt, and FHLB advances and other short-term borrowings, respectively. The decline also reflected the reduction of the taxable-equivalent yield on tax-exempt investment securities due to Tax Reform, which resulted in an approximate 2 bp reduction of the net interest margin.

In late 2008, the Federal Reserve lowered the target Federal Funds range to 0%-0.25%. In an attempt to help the overall economy, the FRB has kept interest rates low through its targeted Fed Funds rate until the recession was safely over. In recent years, the Federal Reserve has begun raising the target Federal Funds range. During 2018, the Federal Reserve increased the Federal Funds range four times, each by 25 basis points to 2.25%-2.50% as of December 31, 2018. The Federal Reserve left the Federal Funds range unchanged during the first half of 2019 but cut the Federal Funds range three times by 25 basis points during the second half of 2019 to 1.50%-1.75% as of December 31, 2019.

In light of global economic and financial developments and muted inflation pressures, the Federal Reserve indicated it will be patient as it determines what future adjustments to the target Federal Funds rate may be appropriate.

### ***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 3.** Components of Other Operating Income

(Dollars in thousands)	Year Ended December 31,			Dollar Change		Percent Change	
				2019	2018	2019	2018
	2019	2018	2017	to 2018	to 2017	to 2018	to 2017
Mortgage banking income:							
Net loan servicing fees.....	\$ 4,252	\$ 5,159	\$ 5,337	\$ (907)	\$ (178)	(17.6)%	(3.3)%
Amortization of mortgage servicing rights.....	(2,460)	(1,859)	(2,288)	(601)	429	32.3	(18.8)
Net gain on sale of residential mortgage loans.....	4,128	4,085	4,069	43	16	1.1	0.4
Unrealized gain (loss) on interest rate locks...	63	(70)	(156)	133	86	(190.0)	(55.1)
Service charges on deposit accounts.....	8,406	8,406	8,468	—	(62)	—	(0.7)
Other service charges and fees.....	14,358	13,123	11,518	1,235	1,605	9.4	13.9
Income from fiduciary activities.....	4,395	4,245	3,674	150	571	3.5	15.5
Income from bank-owned life insurance.....	3,105	2,117	3,388	988	(1,271)	46.7	(37.5)
Net gain (loss) on sales of foreclosed assets.....	(145)	—	205	(145)	(205)	N.M.	(100.0) *
Equity in earnings of unconsolidated subsidiaries.....	257	233	602	24	(369)	10.3	(61.3)
Fees on foreign exchange.....	755	905	529	(150)	376	(16.6)	71.1
Loan placement fees.....	702	747	536	(45)	211	(6.0)	39.4
Net gains (losses) on sales of investment securities.....	36	(279)	(1,410)	315	1,131	(112.9)	(80.2)
Other:							
Income recovered on nonaccrual loans previously charged-off.....	320	720	767	(400)	(47)	(55.6)	(6.1)
Other recoveries.....	130	221	149	(91)	72	(41.2)	48.3
Commissions on sale of checks.....	309	328	341	(19)	(13)	(5.8)	(3.8)
Gain on sale of MasterCard stock.....	2,555	—	—	2,555	—	N.M.	N.M. *
Other.....	635	723	767	(88)	(44)	(12.2)	(5.7)
Total other operating income.....	<u>\$ 41,801</u>	<u>\$ 38,804</u>	<u>\$ 36,496</u>	<u>\$ 2,997</u>	<u>\$ 2,308</u>	7.7	6.3
Total other operating income as a percentage of average assets.....	<u>0.71%</u>	<u>0.68%</u>	<u>0.66%</u>				

\* Not meaningful ("N.M.")

Total other operating income of \$41.8 million in 2019 increased by \$3.0 million, or 7.7%, from the \$38.8 million earned in 2018, which increased by \$2.3 million, or 6.3%, from the \$36.5 million earned in 2017.

The increase in other operating income in 2019 from 2018 was primarily due to the conversion of MasterCard Class B common stock received during their initial public offering to Class A common stock and immediate sale of the converted shares resulting in a gain of \$2.6 million in the first quarter of 2019, combined with higher income from bank-owned life insurance of \$1.0 million, higher merchant and bank card fees of \$0.7 million (included in other service charges and fees) and higher commissions and fees on investment services of \$0.7 million (included in other service charges and fees). The higher income from bank-owned life insurance was primarily attributable to volatility in the equity markets. These increases were partially offset by lower mortgage banking income of \$1.3 million and lower income recovered on nonaccrual loans previously charged-off of \$0.4 million. During the third quarter of 2019, the outsourcing of the Company's residential mortgage loans servicing was completed. Costs related to the outsourcing are included in net loan servicing fees as a component of mortgage banking income.

The increase in other operating income in 2018 from 2017 was primarily due to net losses on sales of investment securities of \$1.4 million recognized in 2017, primarily attributable to the investment portfolio repositioning completed in 2017, compared to net losses on sales of investment securities of \$0.3 million recognized in 2018. In addition, in 2018 we recognized higher commissions and fees on investment services of \$1.2 million (included in other service charges and fees), higher income from

fiduciary activities of \$0.6 million, higher mortgage banking income of \$0.4 million and higher fees on foreign exchange of \$0.4 million. The higher mortgage banking income was primarily due to lower amortization of mortgage servicing rights of \$0.4 million. These increases were partially offset by lower income from bank-owned life insurance of \$1.3 million and lower equity in earnings of unconsolidated subsidiaries of \$0.4 million. The lower income from bank-owned life insurance was primarily attributable to death benefit income of \$1.1 million recognized in 2017 compared to \$0.5 million recognized in 2018, combined with volatility in the equity markets in 2018.

### ***Other Operating Expense***

As discussed in Note 1 - Summary of Significant Accounting Policies, during the fourth quarter of 2018, we voluntarily changed our accounting policy for investments in low income housing tax credit ("LIHTC") partnerships from the cost method to the proportional amortization method using the practical expedient available under Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 323, *Investments - Equity Method and Joint Ventures*, which permits an investor to amortize the initial cost of the investment in proportion to only the tax credits allocated to the investor. We believe the proportional amortization method is preferable because it better reflects the economics of an investment that is made for the primary purpose of receiving tax credits and other tax benefits and is consistent with the accounting method used by most financial institutions that have disclosed their accounting policies for investments in LIHTC partnerships. In addition to a change in the timing of the recognition of amortization of investments in LIHTC partnerships, amortization expense is now reflected in the income tax expense line, which provides users a better understanding of the nature of the returns of such investments, instead of in other operating expenses on the consolidated statements of income. The change did not impact net income, the consolidated balance sheets and the consolidated statements of cash flows. As a result of this accounting policy change, other operating expenses on our consolidated statements of income were retrospectively adjusted for periods prior to the fourth quarter of 2018.

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

**Table 4.** Components of Other Operating Expense

(Dollars in thousands)	Year Ended December 31,			Dollar Change		Percent Change	
	2019	2018	2017	2019 to 2018	2018 to 2017	2019 to 2018	2018 to 2017
Salaries and employee benefits .....	\$ 82,290	\$ 75,352	\$ 72,286	\$ 6,938	\$ 3,066	9.2%	4.2%
Net occupancy .....	14,299	13,763	13,571	536	192	3.9	1.4
Legal and professional services.....	7,354	7,330	7,724	24	(394)	0.3	(5.1)
Computer software expense .....	10,812	9,841	9,192	971	649	9.9	7.1
Amortization of core deposit premium.....	—	2,006	2,674	(2,006)	(668)	(100.0)	(25.0)
Communication expense .....	3,551	3,410	3,659	141	(249)	4.1	(6.8)
Equipment.....	4,353	4,239	3,785	114	454	2.7	12.0
Advertising expense .....	2,661	2,675	2,408	(14)	267	(0.5)	11.1
Foreclosed asset expense.....	251	574	151	(323)	423	(56.3)	280.1
Other:							
Charitable contributions.....	681	635	593	46	42	7.2	7.1
FDIC insurance assessment .....	868	1,732	1,724	(864)	8	(49.9)	0.5
Miscellaneous loan expenses.....	1,246	1,365	1,144	(119)	221	(8.7)	19.3
ATM and debit card expenses.....	2,602	2,645	1,961	(43)	684	(1.6)	34.9
Armored car expenses.....	815	822	873	(7)	(51)	(0.9)	(5.8)
Entertainment and promotions.....	2,071	1,062	1,660	1,009	(598)	95.0	(36.0)
Stationery and supplies .....	1,049	914	814	135	100	14.8	12.3
Directors' fees and expenses .....	968	1,040	873	(72)	167	(6.9)	19.1
Provision (credit) for residential mortgage loan repurchase losses.....	(403)	150	209	(553)	(59)	(368.7)	(28.2)
Reserve (credit) for unfunded loan commitments.....	29	(425)	94	454	(519)	(106.8)	(552.1)
Other .....	6,134	5,552	5,678	582	(126)	10.5	(2.2)
Total other operating expense.....	<u>\$141,631</u>	<u>\$134,682</u>	<u>\$131,073</u>	<u>\$ 6,949</u>	<u>\$ 3,609</u>	5.2	2.8
Total other operating expense as a percentage of average assets .....	<u>2.41%</u>	<u>2.37%</u>	<u>2.38%</u>				

Total other operating expense of \$141.6 million in 2019 increased by \$6.9 million, or 5.2%, from total operating expense of \$134.7 million in 2018, which increased by \$3.6 million, or 2.8%, compared to 2017.

The increase in total other operating expense in 2019, compared to 2018, was primarily due to higher salaries and employee benefits of \$6.9 million, higher entertainment and promotions expense of \$1.0 million and higher computer software expense of \$1.0 million. The increase in salaries and employee benefits was partially attributable to the addition of positions in strategic areas and higher commissions, combined with annual merit increases effective beginning the second quarter of 2019. These increases were partially offset by lower amortization of core deposit premium of \$2.0 million, as the intangible asset was fully amortized as of September 30, 2018, and lower FDIC insurance expense of \$0.9 million, primarily attributable to \$0.9 million in Small Bank Assessment Credits received in the second half of 2019. During 2019, the Company incurred approximately \$3.5 million in RISE2020-related expenses.

The increase in total other operating expense in 2018, compared to 2017, was primarily due to the increase in salaries and employee benefits of \$3.1 million, higher ATM and debit card expenses of \$0.7 million, higher computer software expense of \$0.6 million and higher equipment expense of \$0.5 million. The increase in salaries and employee benefits was primarily attributable to increases in the Company's starting pay rate effective January 1, 2018, combined with merit salary increases effective beginning the second quarter of 2018. During the fourth quarter of 2018, the Company increased its starting pay rate



for the second time in a year, effective December 1, 2018. These increases were partially offset by lower amortization of core deposit premium of \$0.7 million, lower entertainment and promotions expense of \$0.6 million and a credit to the reserve for unfunded commitments of \$0.4 million in 2018, compared to an increase to the reserve for unfunded commitments of \$0.1 million in 2017.

A key measure of operating efficiency tracked by management is the efficiency ratio, which is calculated by dividing total other operating expenses by total pre-provision revenue (net interest income plus other operating income). 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 improved to 62.70% in 2019, compared to 63.59% in 2018 and 64.19% in 2017. The improvement in our efficiency ratio in 2019 was primarily driven by the aforementioned increases in net interest income and other operating income, partially offset by an increase in other operating expenses.

As previously discussed, in 2018, the amortization of investments in LIHTC partnerships was reclassified from other operating expense and is now included in income tax expense in the consolidated statements of income, which provides users a better understanding of the nature of the returns of such investments. The efficiency ratio in periods prior to the fourth quarter of 2018 have been adjusted retrospectively to reflect this change.

The following table sets forth a reconciliation to our efficiency ratio for each of the dates indicated and the impact of the reclassification of amortization of investments in LIHTC partnerships in the consolidated statements of income:

**Table 5. Reconciliation of Efficiency Ratio**

	Year Ended December 31, 2019				
	2019	2018	2017	2016	2015
	(Dollars in thousands)				
<b>As Reclassified:</b>					
Total other operating expenses.....	\$ 141,631	\$ 134,682	\$ 131,073	\$ 132,518	\$ 125,964
Net interest income.....	184,074	172,998	167,703	\$ 157,950	\$ 149,528
Total other operating income.....	41,801	38,804	36,496	42,316	34,799
Total revenue .....	\$ 225,875	\$ 211,802	\$ 204,199	\$ 200,266	\$ 184,327
Efficiency ratio .....	62.70%	63.59 %	64.19 %	66.17 %	68.34 %
<b>Unadjusted:</b>					
Total other operating expenses.....	\$ 141,631	\$ 135,687	\$ 131,817	\$ 133,563	\$ 127,042
Net interest income.....	\$ 184,074	\$ 172,998	\$ 167,703	\$ 157,950	\$ 149,528
Total other operating income.....	41,801	38,804	36,496	42,316	34,799
Total revenue .....	\$ 225,875	\$ 211,802	\$ 204,199	\$ 200,266	\$ 184,327
Efficiency ratio .....	62.70%	64.06 %	64.55 %	66.69 %	68.92 %
<b>Impact of Change:</b>					
Total operating expenses .....	\$ —	\$ (1,005)	\$ (744)	\$ (1,045)	\$ (1,078)
Net interest income.....	—	—	—	\$ —	\$ —
Total other operating income.....	—	—	—	—	—
Total revenue .....	\$ —	\$ —	\$ —	\$ —	\$ —
Efficiency ratio .....	—%	(0.47)%	(0.36)%	(0.52)%	(0.58)%

## ***Income Taxes***

In 2019, the Company recorded income tax expense of \$19.6 million, compared to \$18.8 million in 2018, and \$34.6 million in 2017. Our effective tax rate was 25.2% in 2019 compared to 24.0% in 2018 and 45.6% in 2017.

The decreases in income tax expense and the effective tax rate in 2018 from 2017 were primarily due to the reduction in the corporate federal income tax rate due to Tax Reform. In addition and as previously discussed, based on the Company's evaluation of the impact of Tax Reform on its DTA, the Company recorded a one-time, non-cash estimated charge of \$7.4 million of additional income tax expense in December 2017 to reflect the reduction of the future tax benefits and liabilities in the balance sheet based on this reduced rate. In 2018, the Company recorded an income tax benefit of \$1.5 million related to the finalization of the impact of Tax Reform, which also included the impact of a tax method change for software development and prepaid expenses that was filed in 2018.

The increase in income tax expense and the effective tax rate in 2019 from 2018 was primarily attributable to the aforementioned \$1.5 million income tax benefit recorded in 2018 related to the finalization of the impact of Tax Reform and the impact of a tax method change for software development and prepaid expenses.

As of December 31, 2019, the valuation allowance on our net DTA totaled \$3.4 million, of which \$3.2 million related to our DTA from net apportioned net operating loss ("NOL") carryforwards for California state income tax purposes as we do not expect to generate sufficient income in California to utilize the DTA. The remaining \$0.2 million relates to a valuation allowance on the Hawaii capital loss carryforward balance that we do not expect to be able to utilize. Net of this valuation allowance, the Company's net DTA totaled \$16.5 million as of December 31, 2019, compared to a net DTA of \$21.5 million as of December 31, 2018, and is included in other assets on our consolidated balance sheets.

As discussed in Note 1 - Summary of Significant Accounting Policies, in 2018, the amortization expense related to our investments in LIHTC partnerships was reclassified from other operating expense and is now included in income tax expense. Income tax expense and the Company's effective tax rate in periods prior to the fourth quarter of 2018 have been retrospectively adjusted to reflect this change.

## **Financial Condition**

Total assets of \$6.01 billion at December 31, 2019 increased by \$205.6 million, or 3.5%, from the \$5.81 billion at December 31, 2018, and total liabilities of \$5.48 billion at December 31, 2019 increased by \$168.9 million, or 3.2%, from the \$5.32 billion at December 31, 2018. The increase in total assets and total liabilities in 2019 was primarily due to our strong loan growth, funded by the proceeds from maturities of our available-for-sale investment securities portfolio and an increase in core deposits.

## ***Loan Portfolio***

Our lending activities are focused on commercial, financial and agricultural loans, commercial mortgages, and construction loans to small and medium-sized companies, business professionals, and real estate investors and developers, as well as residential mortgages, home equity and consumer loans to local home-buyers 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 underwriting matrices ("Scorecards") developed based on the results of an analysis from a reputable national credit scoring company commissioned by our bank. The Scorecards use the attributes that

were determined to most highly correlate with probability of repayment. Those attributes include (i) credit score, (ii) credit limit amount, and (iii) debt-to-income ratio.

Loans and leases totaled \$4.45 billion at December 31, 2019, which increased by \$371.2 million, or 9.1%, from the \$4.08 billion at December 31, 2018, which increased by \$307.8 million, or 8.2%, from the \$3.77 billion held at December 31, 2017. The increase in our loan portfolio in 2019 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 following loan portfolios: residential mortgage of \$171.6 million, or 12.0%, commercial mortgage of \$83.1 million, or 8.0%, consumer of \$77.2 million, or 15.7%, construction of \$28.9 million, or 43.2%, and home equity of \$21.8 million, or 4.6%, partially offset by a decrease in commercial, financial, and agricultural of \$11.4 million, or 2.0%. In 2019, we foreclosed on one portfolio loan with a carrying value of \$0.1 million, and recorded a gain on the transfer of \$22 thousand. In addition, we recorded charge-offs of loans and leases of \$10.7 million.

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

**Table 6. Loans by Categories**

	December 31,				
	2019	2018	2017	2016	2015
(Dollars in thousands)					
Commercial, financial and agricultural .....	\$ 570,304	\$ 581,660	\$ 504,019	\$ 510,440	\$ 521,086
Real estate:					
Construction .....	95,854	66,927	64,240	101,538	84,885
Residential mortgage .....	1,599,801	1,428,205	1,341,221	1,217,234	1,134,325
Home equity .....	490,734	468,966	412,230	361,209	301,980
Commercial mortgage .....	1,123,415	1,040,278	977,797	885,439	760,749
Consumer .....	569,432	492,206	470,746	448,353	407,479
Leases .....	—	124	362	677	1,028
Total loans and leases .....	4,449,540	4,078,366	3,770,615	3,524,890	3,211,532
Allowance for loan and lease losses .....	(47,971)	(47,916)	(50,001)	(56,631)	(63,314)
Net loans and leases .....	<u>\$ 4,401,569</u>	<u>\$ 4,030,450</u>	<u>\$ 3,720,614</u>	<u>\$ 3,468,259</u>	<u>\$ 3,148,218</u>

The following table sets forth the geographic distribution of our loan portfolio and related Allowance as of the dates indicated.

**Table 7. Geographic Distribution**

	December 31, 2019			December 31, 2018		
	Hawaii	U.S. Mainland	Total	Hawaii	U.S. Mainland	Total
(Dollars in thousands)						
Commercial, financial and agricultural .....	\$ 454,582	\$ 115,722	\$ 570,304	\$ 439,112	\$ 142,548	\$ 581,660
Real estate:						
Construction .....	95,854	—	95,854	64,654	2,273	66,927
Residential mortgage .....	1,599,801	—	1,599,801	1,428,205	—	1,428,205
Home equity .....	490,734	—	490,734	468,966	—	468,966
Commercial mortgage .....	909,798	213,617	1,123,415	861,086	179,192	1,040,278
Consumer .....	373,451	195,981	569,432	357,908	134,298	492,206
Leases .....	—	—	—	124	—	124
Total loans and leases .....	3,924,220	525,320	4,449,540	3,620,055	458,311	4,078,366
Allowance for loan and lease losses .....	(42,592)	(5,379)	(47,971)	(42,993)	(4,923)	(47,916)
Net loans and leases .....	<u>\$ 3,881,628</u>	<u>\$ 519,941</u>	<u>\$ 4,401,569</u>	<u>\$ 3,577,062</u>	<u>\$ 453,388</u>	<u>\$ 4,030,450</u>

## 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. Risk 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.

In 2019, our commercial, financial, and agricultural loan portfolio decreased by \$11.4 million. Our commercial, financial, and agricultural loan portfolio increased by \$77.6 million in 2018, decreased by \$6.4 million in 2017 and decreased by \$10.6 million in 2016. The decrease in 2019 was primarily attributable to planned runoff of U.S. Mainland shared national credit balances of \$26.8 million, partially offset by growth in the Hawaii portfolio of \$15.5 million.

## 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.

In 2019, our construction loan portfolio increased by \$28.9 million. Our construction loan portfolio increased by \$2.7 million in 2018, decreased by \$37.3 million in 2017, and increased by \$16.7 million in 2016. These fluctuations are driven by the start and completion of construction projects and are consistent with a normal construction cycle.

## 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 \$37.1 million at December 31, 2019, compared to \$25.2 million in the prior year, while remaining interest reserves was \$4.0 million, or 10.9% of the outstanding principal balance of loans with interest reserves at December 31, 2019, compared to \$4.0 million, or 15.7% of the outstanding principal balance of loans with interest reserves at December 31, 2018.

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 we 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 proforma 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 8.** Mortgage Loan Portfolio Composition

	December 31,									
	2019		2018		2017		2016		2015	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in thousands)									
Residential:										
Closed-end loans .....	\$ 1,599,801	49.7%	\$ 1,428,205	48.6%	\$ 1,341,221	49.1%	\$ 1,217,234	49.4%	\$ 1,134,325	51.7%
Home equity line-of-credit ("HELOC") .....	490,734	15.3	468,966	16.0	412,230	15.1	361,209	14.7	301,980	13.7
Subtotal .....	<u>2,090,535</u>	<u>65.0</u>	<u>1,897,171</u>	<u>64.6</u>	<u>1,753,451</u>	<u>64.2</u>	<u>1,578,443</u>	<u>64.1</u>	<u>1,436,305</u>	<u>65.4</u>
Commercial mortgage....	1,123,415	35.0	1,040,278	35.4	977,797	35.8	885,439	35.9	760,749	34.6
Total mortgage loans.....	<u>\$ 3,213,950</u>	<u>100.0%</u>	<u>\$ 2,937,449</u>	<u>100.0%</u>	<u>\$ 2,731,248</u>	<u>100.0%</u>	<u>\$ 2,463,882</u>	<u>100.0%</u>	<u>\$ 2,197,054</u>	<u>100.0%</u>

### *Residential*

Residential mortgage loans include fixed-rate and adjustable-rate loans primarily secured by single-family owner-occupied primary residences in Hawaii. Maximum loan-to-value ratios of 80% are typically required for fixed-rate and adjustable-rate loans secured by single-family owner-occupied residences, 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 \$0.5 million, marketable collateral and a stable Hawaii residential real estate market, credit losses on residential mortgage loans have 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.

Closed-end residential mortgage loan balances as of December 31, 2019 totaled \$1.60 billion, increasing by \$171.6 million, or 12.0%, from the \$1.43 billion held at year-end 2018, which increased by \$87.0 million, or 6.5%, from the \$1.34 billion held at year-end 2017. The increase in closed-end residential mortgage loan balances in 2019 was primarily due to the reinvestment of cash flow into higher yielding assets and increased demand from both new and existing customers.

Residential mortgage loans held for sale at December 31, 2019 totaled \$9.1 million, an increase of \$2.4 million, or 36.6%, from the December 31, 2018 balance of \$6.6 million, which decreased by \$9.7 million, or 59.3%, from the December 31, 2017 balance of \$16.3 million. We did not securitize any residential mortgage loans in 2019, 2018 and 2017.

## Home Equity

Home equity lines of credit ("HELOCs"), which typically carry floating interest rates, are underwritten according to policy and guidelines reviewed and approved by the Board of Directors. 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. HELOCs are underwritten using a qualifying payment which assumes the line is fully drawn and is amortizing as if it 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). HELOCs are monitored based on default, delinquency, end of draw period, and maturity.

HELOC balances as of December 31, 2019 totaled \$490.7 million, increasing by \$21.8 million, or 4.6%, from the \$469.0 million held at December 31, 2018, which increased by \$56.7 million, or 13.8%, from the \$412.2 million held at December 31, 2017.

## 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.

Commercial mortgage balances as of December 31, 2019 totaled \$1.12 billion, increasing by \$83.1 million, or 8.0%, from the \$1.04 billion held at December 31, 2018, which increased by \$62.5 million, or 6.4%, from the \$977.8 million held at December 31, 2017. The increase in commercial mortgage balances in 2019 was primarily due to increased demand from both new and existing customers.

## Consumer Loans

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

**Table 9.** Consumer Loan Portfolio Composition

	December 31,									
	2019		2018		2017		2016		2015	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in thousands)									
Automobile .....	\$ 297,186	52.2%	\$ 284,170	57.7%	\$ 275,793	58.6%	\$ 212,926	47.5%	\$ 190,202	46.7%
Other revolving credit plans	82,089	14.4	83,158	16.9	77,305	16.4	81,124	18.1	73,756	18.1
Student loans .....	5,188	0.9	8,644	1.8	14,920	3.2	25,053	5.6	38,636	9.5
Other .....	184,969	32.5	116,234	23.6	102,728	21.8	129,250	28.8	104,885	25.7
Total consumer .....	<u>\$ 569,432</u>	<u>100.0%</u>	<u>\$ 492,206</u>	<u>100.0%</u>	<u>\$ 470,746</u>	<u>100.0%</u>	<u>\$ 448,353</u>	<u>100.0%</u>	<u>\$ 407,479</u>	<u>100.0%</u>

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. From time to time, we will tactically deploy funds, which are not utilized in our current short-term core lending markets, by purchasing certain consumer loan portfolios.

Consumer loans totaled \$569.4 million at December 31, 2019, increasing by \$77.2 million, or 15.7%, from December 31, 2018 of \$492.2 million, which increased by \$21.5 million, or 4.6%, compared to the \$470.7 million held at December 31, 2017. At December 31, 2019, automobile loans, primarily indirect dealer loans, comprised 52.2% of consumer loans outstanding.

Total automobile loans of \$297.2 million at December 31, 2019 increased by \$13.0 million, or 4.6%, from December 31, 2018 of \$284.2 million, which increased by \$8.4 million, or 3.0%, from \$275.8 million at December 31, 2017.

In 2019, we purchased a U.S. Mainland automobile loan portfolio totaling \$30.2 million, which included a \$0.6 million premium over the \$29.6 million outstanding balance. In 2018, we purchased a U.S. Mainland automobile loan portfolio totaling \$20.6 million, which included a \$0.1 million premium over the \$20.5 million outstanding balance. In 2017, we purchased three U.S. Mainland automobile loan portfolios totaling \$83.8 million, which included \$2.3 million in premiums over the \$81.4 million outstanding balance. In 2016, we purchased two U.S. Mainland automobile loan portfolios totaling \$41.2 million, which included \$0.9 million in premiums over the \$40.3 million outstanding balance. In 2015, we purchased two U.S. Mainland automobile loan portfolios totaling \$52.8 million, which included \$1.7 million in premiums over the \$51.1 million outstanding balance.

Other revolving credit plans loans include extensions of credit to individuals and totaled \$82.1 million at December 31, 2019, which decreased by \$1.1 million, or 1.3%, from December 31, 2018 of \$83.2 million, which increased by \$5.9 million, or 7.6%, from \$77.3 million at December 31, 2017.

Total student loans of \$5.2 million at December 31, 2019 decreased by \$3.5 million, or 40.0%, from December 31, 2018 of \$8.6 million, which decreased by \$6.3 million, or 42.1%, from \$14.9 million at December 31, 2017, primarily due to run-off.

Other consumer loans of \$185.0 million at December 31, 2019 increased by \$68.7 million, or 59.1%, from December 31, 2018 of \$116.2 million, which increased by \$13.5 million, or 13.1%, from \$102.7 million at December 31, 2017. Other consumer loans at December 31, 2019 include U.S. Mainland unsecured consumer loan portfolio balances of \$110.1 million, \$37.6 million and \$13.7 million at December 31, 2019,

In 2019, we purchased U.S. Mainland unsecured consumer loan portfolios (included in other) with outstanding balances totaling \$112.2 million for \$109.9 million, reflecting a net discount of \$2.3 million. In 2018, 2016 and 2015, we also purchased U.S. Mainland unsecured consumer loan portfolios totaling \$38.0 million, \$35.7 million and \$15.9 million, respectively, which represented the outstanding balances at the time of purchase.

### ***Concentrations of Credit Risk***

As of December 31, 2019, approximately \$3.31 billion, or 74.4% of loans outstanding were real estate-related, including construction loans, residential mortgage loans, home equity loans, and commercial mortgage loans.

The majority of our loans are made to companies and individuals with headquarters in, or residing in, the state of Hawaii. Consistent with our focus of being a Hawaii-based bank, 88.2% of our loan portfolio was concentrated in the Hawaii market while 11.8% was concentrated in the U.S. Mainland as of December 31, 2019.

Our foreign credit exposure as of December 31, 2019 was minimal and did not exceed 1% of total assets.

### ***Maturities and Sensitivities of Loans to Changes in Interest Rates***

At December 31, 2019, commercial, financial and agricultural loans were 44.8% fixed-rate and 55.2% variable-rate. Real estate construction loans were 46.7% fixed-rate and 53.3% variable-rate. Residential mortgage loans were 67.1% fixed-rate and 32.9% variable-rate. Home equity lines and loans were 9.9% fixed-rate and 90.1% variable-rate. Commercial mortgage loans were 38.7% fixed-rate and 61.3% variable-rate. Consumer loans were 84.8% fixed-rate and 15.2% 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%).

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 plus interest payment due during the repayment period assuming the line was fully drawn. Our consumer lines of credit use a qualifying payment based on a percentage of the credit limit that exceeds the actual required fully indexed interest rate payment calculation.

The following table sets forth the maturity distribution and sensitivities of the loan portfolio to changes in interest rates at December 31, 2019. Maturities are based on contractual maturity dates and do not factor in principal amortization. This differs from the assumptions used in Table 21 - Interest Rate Sensitivity.

**Table 10.** Maturity Distribution and Sensitivities of Loans to Changes in Interest Rates

	<b>Maturing</b>			<b>Total</b>
	<b>One Year or Less</b>	<b>Over One Through Five Years</b>	<b>Over Five Years</b>	
	(Dollars in thousands)			
<b>Commercial, financial and agricultural</b>				
With fixed interest rates.....	\$ 8,245	\$ 113,885	\$ 133,315	\$ 255,445
With variable interest rates.....	44,591	158,682	111,371	314,644
Total commercial, financial and agricultural.....	<u>52,836</u>	<u>272,567</u>	<u>244,686</u>	<u>570,089</u>
<b>Construction</b>				
With fixed interest rates.....	—	4,613	40,276	44,889
With variable interest rates.....	14,715	27,763	8,772	51,250
Total construction.....	<u>14,715</u>	<u>32,376</u>	<u>49,048</u>	<u>96,139</u>
<b>Residential mortgage</b>				
With fixed interest rates.....	87	13,858	1,057,030	1,070,975
With variable interest rates.....	603	4,126	520,097	524,826
Total residential mortgage.....	<u>690</u>	<u>17,984</u>	<u>1,577,127</u>	<u>1,595,801</u>
<b>Home equity</b>				
With fixed interest rates.....	1,000	5,695	42,051	48,746
With variable interest rates.....	6,012	9,800	425,681	441,493
Total home equity.....	<u>7,012</u>	<u>15,495</u>	<u>467,732</u>	<u>490,239</u>
<b>Commercial mortgage</b>				
With fixed interest rates.....	3,606	123,460	307,909	434,975
With variable interest rates.....	6,835	300,189	382,912	689,936
Total commercial mortgage.....	<u>10,441</u>	<u>423,649</u>	<u>690,821</u>	<u>1,124,911</u>
<b>Consumer</b>				
With fixed interest rates.....	6,477	402,066	74,298	482,841
With variable interest rates.....	38,265	22,455	25,955	86,675
Total consumer.....	<u>44,742</u>	<u>424,521</u>	<u>100,253</u>	<u>569,516</u>
<b>Leases</b>				
With fixed interest rates.....	—	—	—	—
With variable interest rates.....	—	—	—	—
Total leases.....	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
Total loans and leases.....	<u>\$ 130,436</u>	<u>\$ 1,186,592</u>	<u>\$ 3,129,667</u>	<u>\$ 4,446,695</u>
<b>All loans</b>				
With fixed interest rates.....	\$ 19,415	\$ 663,577	\$ 1,654,879	\$ 2,337,871
With variable interest rates.....	111,021	523,015	1,474,788	2,108,824
Total loans and leases.....	<u>\$ 130,436</u>	<u>\$ 1,186,592</u>	<u>\$ 3,129,667</u>	<u>\$ 4,446,695</u>



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

As described above under the "Critical Accounting Policies and Use of Estimates" section, 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.

In June 2016, the FASB issued ASU 2016-13, *"Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments,"* and subsequent amendments to the guidance, ASU 2019-04 in April 2019 and ASU 2019-05 in May 2019. The standard significantly changes how entities will measure credit losses for most financial assets and certain other instruments that aren't measured at fair value through net income. In issuing the standard, the FASB is responding to criticism that today's "incurred loss" guidance delays the recognition of credit losses on loans, leases, held-to-maturity debt securities, loan commitments, and financial guarantees, and instead provides for a current expected credit loss ("CECL") approach to determine the allowance for credit losses. At adoption, the change to the allowance for credit losses as a result of CECL implementation will be recorded as a cumulative effect adjustment to retained earnings on the consolidated balance sheet.

While the CECL implementation effort is near completion, the Company is unable to determine the final adoption impact on our consolidated financial statements as certain internal controls over the calculation and inputs have not yet fully operated. Additional work will be completed on internal controls over significant assumptions utilized. However, based on preliminary analyses completed thus far, management estimates its allowance for credit losses, including reserves for unfunded commitments, to increase by roughly 0%-15%. The foregoing range is based on the Company's calculation models and the underlying assumptions embedded in its methodology, including economic forecasts and sensitivity analyses. The final calculation, including assumptions, economic forecasts and inputs are subject to change based on the final completion of all internal controls and related testing.

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

**Table 11.** Allowance for Loan and Lease Losses

	Year Ended December 31,				
	2019	2018	2017	2016	2015
	(Dollars in thousands)				
Average loans and leases outstanding .....	\$ 4,241,308	\$ 3,898,250	\$ 3,622,033	\$ 3,385,741	\$ 3,038,100
<b>Allowance for Loan and Lease Losses</b>					
Balance at beginning of year .....	\$ 47,916	\$ 50,001	\$ 56,631	\$ 63,314	\$ 74,040
Charge-offs:					
Commercial, financial and agricultural .....	2,478	2,852	1,704	1,599	5,658
Real estate:					
Construction .....	—	—	—	—	—
Residential mortgage .....	—	—	73	—	—
Home equity .....	5	—	—	—	110
Commercial mortgage .....	—	—	—	209	838
Consumer .....	8,265	7,323	6,294	5,054	4,650
Leases .....	—	—	—	—	—
Total .....	10,748	10,175	8,071	6,862	11,256
Recoveries:					
Commercial, financial and agricultural .....	1,174	1,203	1,366	2,114	4,788
Real estate:					
Construction .....	610	5,759	169	133	880
Residential mortgage .....	524	204	879	695	1,121
Home equity .....	42	27	44	15	1,056
Commercial mortgage .....	25	52	157	1,024	6,719
Consumer .....	2,111	1,969	1,500	1,715	1,610
Leases .....	—	—	—	—	27
Total .....	4,486	9,214	4,115	5,696	16,201
Net loan charge-offs (recoveries) .....	6,262	961	3,956	1,166	(4,945)
Provision (credit) for loan and lease losses .....	6,317	(1,124)	(2,674)	(5,517)	(15,671)
Balance at end of year .....	\$ 47,971	\$ 47,916	\$ 50,001	\$ 56,631	\$ 63,314
<b>Ratios:</b>					
Allowance to loans and leases outstanding .....	1.08%	1.17%	1.33%	1.61%	1.97 %
Net loan charge-offs (recoveries) to average loans and leases outstanding .....	0.15%	0.02%	0.11%	0.03%	(0.16)%

Our Allowance at December 31, 2019 totaled \$48.0 million, which increased by \$0.1 million, or 0.1%, from December 31, 2018. When expressed as a percentage of total loans and leases, our Allowance decreased to 1.08% at December 31, 2019, from 1.17% at December 31, 2018. The Provision of \$6.3 million recognized during the year was offset by \$6.3 million in net charge-offs during the year. The decrease in our Allowance as a percentage of total loans and leases from December 31, 2018 to December 31, 2019 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 increased from 1,750.68% at December 31, 2018 to 2,790.63% at December 31, 2019. Our Allowance as a percentage of our nonaccrual loans increased from 2,062.68% at December 31, 2018 to 3,084.95% at December 31, 2019.

This trend was consistent with the improving credit quality as represented by nonperforming assets of \$1.7 million, \$2.7 million, and \$3.6 million at December 31, 2019, 2018 and 2017, respectively. Net charge-offs were \$6.3 million, \$1.0 million, and \$4.0 million, respectively, for the years ended December 31, 2019, 2018 and 2017.

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 12.** Allocation of Allowance for Loan and Lease Losses

	December 31,									
	2019		2018		2017		2016		2015	
	Allowance	Loan Category as a % of Total Loans	Allowance	Loan Category as a % of Total Loans	Allowance	Loan Category as a % of Total Loans	Allowance	Loan Category as a % of Total Loans	Allowance	Loan Category as a % of Total Loans
(Dollars in thousands)										
Commercial, financial and agricultural.....	\$ 8,136	12.8%	\$ 8,027	14.3%	\$ 7,594	13.4%	\$ 8,637	14.5%	\$ 6,905	16.2%
Real estate:										
Construction .....	1,792	2.2	1,202	1.6	1,835	1.7	4,224	2.9	8,454	2.7
Residential mortgage.....	13,327	36.0	14,349	35.0	14,328	35.6	15,055	34.5	14,642	35.3
Home equity .....	4,206	11.0	3,788	11.5	3,317	10.9	3,502	10.3	3,096	9.4
Commercial mortgage.....	11,113	25.2	13,358	25.5	16,801	25.9	19,104	25.1	21,847	23.7
Consumer.....	9,397	12.8	7,192	12.1	6,126	12.5	6,109	12.7	6,230	12.7
Leases .....	—	—	—	—	—	—	—	—	—	—
Unallocated.....	—	—	—	—	—	—	—	—	2,140	—
Total.....	<u>\$ 47,971</u>	<u>100.0%</u>	<u>\$ 47,916</u>	<u>100.0%</u>	<u>\$ 50,001</u>	<u>100.0%</u>	<u>\$ 56,631</u>	<u>100.0%</u>	<u>\$ 63,314</u>	<u>100.0%</u>

The Allowance allocated to commercial, financial and agricultural loans totaled \$8.1 million, or 1.4%, of total commercial, financial and agricultural loans at December 31, 2019, compared to \$8.0 million, or 1.4%, of related loans at December 31, 2018.

The Allowance allocated to construction loans totaled \$1.8 million, or 1.9%, of total construction loans at December 31, 2019, compared to \$1.2 million, or 1.8%, of construction loans outstanding at December 31, 2018. The increases in the ending Allowance amount and the Allowance as a percentage of construction loans were primarily due to and consistent with the increase in the construction loan portfolio. In 2018, the Company received a \$4.5 million recovery on a U.S. mainland land loan, which is included in the construction loan category.

The Allowance allocated to our residential mortgage loans totaled \$13.3 million, or 0.8%, of total residential mortgage loans at December 31, 2019, compared to \$14.3 million, or 1.0%, of related loans at December 31, 2018. The decreases in the ending Allowance amount and the Allowance as a percentage of commercial mortgage loans were due to continued improvement in credit quality of the portfolio.

The Allowance allocated to our home equity loans totaled \$4.2 million, or 0.9%, of total home equity loans at December 31, 2019, compared to \$3.8 million, or 0.8%, of related loans at December 31, 2018. The increases in the ending Allowance amount and the Allowance as a percentage of home equity loans were primarily due to and consistent with the increase in the home equity loan portfolio.

The Allowance allocated to commercial mortgage loans totaled \$11.1 million, or 1.0%, of total commercial mortgage loans at December 31, 2019, compared to \$13.4 million, or 1.3%, of related loans at December 31, 2018. The decreases in the ending Allowance amount and the Allowance as a percentage of commercial mortgage loans were due to continued improvement in credit quality of the portfolio.

The Allowance allocated to consumer loans totaled \$9.4 million, or 1.7% of total consumer loans at December 31, 2019, compared to \$7.2 million, or 1.5% of related loans at December 31, 2018. The increases in the ending Allowance amount and the Allowance as a percentage of consumer loans were consistent with the growth and increase in charge-offs in the consumer loan portfolio.

We had no remaining leases as of December 31, 2019. We did not allocate an Allowance for leases as of December 31, 2019 and 2018.

During the fourth quarter of 2016, the Company enhanced its Allowance methodology and eliminated the unallocated portion of the Allowance.

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 13.** Nonperforming Assets, Past Due and Restructured Loans

	December 31,				
	2019	2018	2017	2016	2015
(Dollars in thousands)					
<b>Nonaccrual loans</b>					
Commercial, financial and agricultural .....	\$ 467	\$ —	\$ —	\$ 1,877	\$ 1,044
Real estate:					
Residential mortgage .....	979	2,048	2,280	5,322	5,464
Home equity .....	92	275	416	333	666
Commercial mortgage .....	—	—	79	864	7,094
Consumer .....	17	—	—	—	—
Total nonaccrual loans .....	<u>1,555</u>	<u>2,323</u>	<u>2,775</u>	<u>8,396</u>	<u>14,268</u>
<b>Other real estate</b>					
Real estate:					
Residential mortgage .....	—	414	851	791	1,962
Home equity .....	164	—	—	—	—
Other real estate .....	164	414	851	791	1,962
Total nonperforming assets .....	<u>1,719</u>	<u>2,737</u>	<u>3,626</u>	<u>9,187</u>	<u>16,230</u>
<b>Accruing loans delinquent for 90 days or more</b>					
Real estate:					
Residential mortgage .....	724	—	49	—	—
Home equity .....	—	298	—	1,120	—
Consumer .....	286	238	515	271	273
Total accruing loans delinquent for 90 days or more .....	<u>1,010</u>	<u>536</u>	<u>564</u>	<u>1,391</u>	<u>273</u>
<b>Restructured loans still accruing interest</b>					
Commercial, financial and agricultural .....	135	220	491	—	—
Real estate:					
Construction .....	—	—	—	21	809
Residential mortgage .....	5,502	7,330	10,677	14,292	16,224
Commercial mortgage .....	1,839	1,036	1,466	1,879	3,224
Total restructured loans still accruing interest .....	<u>7,476</u>	<u>8,586</u>	<u>12,634</u>	<u>16,192</u>	<u>20,257</u>
Total nonperforming assets, accruing loans delinquent for 90 days or more and restructured loans still accruing interest .....	<u>\$ 10,205</u>	<u>\$ 11,859</u>	<u>\$ 16,824</u>	<u>\$ 26,770</u>	<u>\$ 36,760</u>

**December 31,**

	<b>2019</b>	<b>2018</b>	<b>2017</b>	<b>2016</b>	<b>2015</b>
	<b>(Dollars in thousands)</b>				
Total nonperforming assets as a percentage of loans and leases and other real estate .....	0.04%	0.07%	0.10%	0.26%	0.51%
Total nonperforming assets and accruing loans delinquent for 90 days or more as a percentage of loans and leases and other real estate .....	0.06%	0.08%	0.11%	0.30%	0.51%
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 .....	0.23%	0.29%	0.45%	0.76%	1.14%
Year-to-date changes in nonperforming assets:					
Balance at beginning of year .....	\$ 2,737	\$ 3,626	\$ 9,187	\$ 16,230	\$ 42,035
Additions .....	1,617	593	3,678	6,326	11,863
Reductions:					
Payments .....	(2,211)	(467)	(5,522)	(6,390)	(9,564)
Return to accrual status .....	(27)	(538)	(3,645)	(4,546)	(11,486)
Sales of foreclosed assets .....	(302)	(40)	(165)	(2,599)	(13,307)
Charge-offs, valuation and other adjustments .....	(95)	(437)	93	166	(3,311)
Total reductions .....	(2,635)	(1,482)	(9,239)	(13,369)	(37,668)
Balance at end of year .....	\$ 1,719	\$ 2,737	\$ 3,626	\$ 9,187	\$ 16,230

Nonperforming assets, which includes nonaccrual loans and leases, nonperforming loans classified as held for sale and other real estate, totaled \$1.7 million at December 31, 2019, compared to \$2.7 million at December 31, 2018. Nonperforming assets at December 31, 2019 were comprised of \$1.6 million in nonaccrual loans, none of which were loans classified as held for sale, and \$0.2 million in other real estate.

The decline in 2019 was attributable to \$2.2 million in repayments, the sale of \$0.3 million of foreclosed assets and \$0.1 million in charge-offs, valuation and other adjustments. All of these decreases were offset by \$1.6 million in gross additions.

Net changes to nonperforming assets by category during 2019 included net decreases in Hawaii residential mortgage assets totaling \$1.5 million.

Loans delinquent for 90 days or more still accruing interest totaled \$1.0 million at December 31, 2019, compared to \$0.5 million at December 31, 2018.

## Investment Portfolio

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

**Table 14.** Distribution of Investment Securities

	December 31,								
	2019			2018			2017		
	Held-to-Maturity (Amortized Cost)	Available-for-Sale (Fair Value)	Equity Securities (Fair Value)	Held-to-Maturity (Amortized Cost)	Available-for-Sale (Fair Value)	Equity Securities (Fair Value)	Held-to-Maturity (Amortized Cost)	Available-for-Sale (Fair Value)	Equity Securities (Fair Value)
	(Dollars in thousands)								
Debt securities:									
States and political subdivisions .....	\$ —	\$ 122,018	\$ —	\$ —	\$ 173,674	\$ —	\$ —	\$ 179,781	\$ —
Corporate securities .....	—	30,529	—	—	54,849	—	—	74,278	—
U.S. Treasury obligations and direct obligations of U.S. Government agencies .....	—	40,381	—	—	32,574	—	—	25,510	—
Mortgage-backed securities:									
Residential - U.S. government-sponsored entities ("GSEs") .....	—	677,822	—	83,436	717,052	—	100,279	800,683	—
Residential - Non-government sponsored entities ("Non-GSEs") .....	—	37,191	—	—	41,118	—	—	46,763	—
Commercial - U.S. GSEs and agencies .....	—	81,225	—	65,072	51,483	—	91,474	39,725	—
Commercial - Non-GSEs .....	—	137,817	—	—	134,728	—	—	137,326	—
Equity securities .....	—	—	1,127	—	—	826	—	—	825
Total .....	<u>\$ —</u>	<u>\$ 1,126,983</u>	<u>\$ 1,127</u>	<u>\$ 148,508</u>	<u>\$ 1,205,478</u>	<u>\$ 826</u>	<u>\$ 191,753</u>	<u>\$ 1,304,066</u>	<u>\$ 825</u>

Investment securities totaled \$1.13 billion at December 31, 2019, decreasing by \$226.7 million, or 16.7%, from the \$1.35 billion held at December 31, 2018, which decreased by \$141.8 million, or 9.5%, from the \$1.50 billion at year-end 2017.

In the third quarter of 2019, \$53.9 million in lower-yielding available-for-sale securities were sold as part of an investment portfolio repositioning strategy designed to enhance potential prospective earnings and improve net interest margin. We received \$53.9 million in gross proceeds and reinvested the proceeds in \$52.5 million in higher-yielding, longer duration investment securities with an average yield of 2.54% and a weighted average life of 6.6 years. The investment securities sold had an average yield of 2.10% and a weighted average life of 3.2 years. Gross realized gains on the sale of the investment securities were \$36 thousand. The specific identification method was used as the basis for determining the cost of all securities sold.

In the second quarter of 2017, \$97.7 million in lower-yielding available-for-sale securities were sold as part of an investment portfolio repositioning strategy designed to enhance potential prospective earnings and improve net interest margin. We received \$96.0 million in gross proceeds and reinvested the proceeds in \$97.4 million in higher-yielding, longer duration investment securities with an average yield of 2.57% and a weighted average life of 4.6 years. The investment securities sold had an average yield of 1.91% and a weighted average life of 3.3 years. Gross realized losses on the sale of the investment securities were \$1.6 million. The specific identification method was used as the basis for determining the cost of all securities sold.

## 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, 2019.

**Table 15. Maturity Distribution of Investment Portfolio**

Portfolio Type and Maturity Grouping	Carrying Value	Weighted Average Yield (1)
	(Dollars in thousands)	
<b>Available-for-sale portfolio:</b>		
Debt securities - States and political subdivisions:		
Within one year .....	\$ 30,716	2.89%
After one but within five years.....	34,226	2.38
After five but within ten years.....	41,323	3.50
After ten years .....	15,753	3.58
Total debt securities - States and political subdivisions .....	122,018	3.04
Debt securities - Corporate:		
Within one year .....	19,966	2.90
After one but within five years.....	10,563	2.65
After five but within ten years.....	—	—
After ten years .....	—	—
Total debt securities - Corporate.....	30,529	2.81
Debt securities - U.S. Treasury obligations and direct obligations of U.S Government agencies:		
Within one year .....	—	—
After one but within five years.....	2,468	3.24
After five but within ten years.....	22,371	2.88
After ten years .....	15,542	3.08
Total debt securities - U.S. Treasury obligations and direct obligations of U.S Government agencies ...	40,381	2.98
Residential mortgage-backed securities - U.S. GSEs:		
Within one year .....	366	2.95
After one but within five years.....	2,346	2.60
After five but within ten years.....	71,715	2.12
After ten years .....	603,395	2.53
Total residential mortgage-backed securities - U.S. GSEs.....	677,822	2.49
Residential mortgage-backed securities - Non-government sponsored entities ("Non-GSEs"):		
Within one year .....	—	—
After one but within five years.....	—	—
After five but within ten years.....	—	—
After ten years .....	37,191	3.39
Total residential mortgage-backed securities - Non-GSEs.....	37,191	3.39
Commercial mortgage-backed securities - U.S. GSEs and agencies:		
Within one year .....	—	—
After one but within five years.....	—	—
After five but within ten years.....	44,918	2.87
After ten years .....	36,307	2.54

<b>Portfolio Type and Maturity Grouping</b>	<b>Carrying Value</b>	<b>Weighted Average Yield (1)</b>
	<b>(Dollars in thousands)</b>	
Total commercial mortgage-backed securities - U.S. GSEs and agencies .....	81,225	2.72
Commercial mortgage-backed securities - Non-GSEs:		
Within one year .....	21,999	3.02
After one but within five years.....	95,157	3.11
After five but within ten years.....	20,661	4.10
After ten years .....	—	—
Total commercial mortgage-backed securities - Non-GSEs.....	137,817	3.24
Total available-for-sale portfolio .....	<u>\$ 1,126,983</u>	<u>2.71%</u>
<b>Equity securities:</b>		
No stated maturity .....	\$ 1,127	—%
Total equity securities .....	<u>\$ 1,127</u>	<u>—%</u>
Total investment securities.....	<u>\$ 1,128,110</u>	<u>2.71%</u>

(1) Weighted average yields are computed on an annual basis, and yields on tax-exempt obligations are computed on a taxable-equivalent basis using a federal statutory tax rate of 21%.

As of December 31, 2019, the weighted average yield of the investment portfolio of 2.71% decreased by 7 bp from 2.78% in 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 exceptional 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.

The following table sets forth the composition of our deposits by category as of the dates indicated.



**Table 16. Deposits by Categories**

	December 31,				
	2019	2018	2017	2016	2015
	(Dollars in thousands)				
Noninterest-bearing demand deposits .....	\$ 1,450,532	\$ 1,436,967	\$ 1,395,556	\$ 1,265,246	\$ 1,145,244
Interest-bearing demand deposits .....	1,043,010	954,011	933,054	862,991	824,895
Savings and money market deposits .....	1,600,028	1,448,257	1,481,876	1,390,600	1,399,093
Time deposits less than \$100,000 .....	165,755	176,707	180,748	194,730	212,946
Core deposits .....	4,259,325	4,015,942	3,991,234	3,713,567	3,582,178
Government time deposits .....	533,088	631,293	687,052	701,417	664,756
Other time deposits of \$100,000 to \$250,000 .....	107,550	106,783	101,560	103,720	114,083
Other time deposits greater than \$250,000 .....	220,060	192,472	176,508	89,497	72,422
Total time deposits of \$100,000 and greater .....	860,698	930,548	965,120	894,634	851,261
Total deposits .....	<u>\$ 5,120,023</u>	<u>\$ 4,946,490</u>	<u>\$ 4,956,354</u>	<u>\$ 4,608,201</u>	<u>\$ 4,433,439</u>

Total deposits of \$5.12 billion at December 31, 2019 increased by \$173.5 million, or 3.5%, from total deposits of \$4.95 billion at December 31, 2018. Total deposits at December 31, 2018 decreased by \$9.9 million, or 0.2%, over the year-end 2017 balance of \$4.96 billion. The increase in deposits in 2019 reflects net increases in savings and money market deposits of \$151.8 million, interest-bearing demand deposits of \$89.0 million, other time deposits greater than \$100,000 (excluding government time deposits) totaling \$28.4 million, and noninterest-bearing demand deposits of \$13.6 million. The net increases were partially offset by decreases in government time deposits of \$98.2 million and time deposits less than \$100,000 of \$11.0 million. In 2018 and 2019, FHLB advances were used to replace government time deposits and fund loan growth.

Core deposits totaled \$4.26 billion at December 31, 2019 and increased by \$243.4 million, or 6.1%, from December 31, 2018, which increased by \$24.7 million or 0.6% from December 31, 2017. Core deposits as a percentage of total deposits was 83.2% at December 31, 2019, compared to 81.2% at December 31, 2018 and 80.5% at December 31, 2017. For additional information regarding the contractual maturities of our time deposits, See Note 10 - Deposits to the Consolidated Financial Statements under "Part II, Item 8. Financial Statements and Supplementary Data."

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, increased by 29 bp in 2019, while savings and money market deposit rates increased by 20 bp. The average rate paid on all deposits increased 9 bp to 0.48% in 2019 from 0.39% in 2018, which increased from 0.23% in 2017.

**Table 17. Average Balances and Average Rates on Deposits**

	Year Ended December 31,					
	2019		2018		2017	
	Average Balance	Average Rate Paid	Average Balance	Average Rate Paid	Average Balance	Average Rate Paid
	(Dollars in thousands)					
Noninterest-bearing demand deposits .....	\$ 1,375,903	—%	\$ 1,385,427	—%	\$ 1,325,583	—%
Interest-bearing demand deposits .....	984,298	0.08	936,034	0.08	901,171	0.07
Savings and money market deposits .....	1,556,766	0.33	1,494,658	0.13	1,449,379	0.08
Time deposits .....	1,068,734	1.69	1,194,579	1.40	1,173,020	0.81
Total .....	<u>\$ 4,985,701</u>	0.48	<u>\$ 5,010,698</u>	0.39	<u>\$ 4,849,153</u>	0.23

We expect overall deposit rates to hold relatively steady in 2020 based on the Federal Open Market Committee's recent statements. In addition to the external interest rate environment, the overall direction and magnitude 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.

## Contractual Obligations

The following table sets forth contractual obligations (excluding deposit liabilities) as of December 31, 2019.

**Table 18.** Contractual Obligations

	Payments Due By Period				Total
	Less Than One Year	1-3 Years	3-5 Years	More Than 5 Years	
	(Dollars in thousands)				
Short-term borrowings .....	\$ 150,000	\$ —	\$ —	\$ —	\$ 150,000
Long-term debt .....	25,000	25,000	—	51,547	101,547
Pension plan and SERP obligations .....	2,098	4,180	4,461	22,835	33,574
Operating leases .....	6,216	11,379	10,122	40,920	68,637
Purchase obligations .....	27,989	30,537	20,620	946	80,092
Other long-term liabilities .....	6,873	4,504	36	49	11,462
Total .....	<u>\$ 218,176</u>	<u>\$ 75,600</u>	<u>\$ 35,239</u>	<u>\$ 116,297</u>	<u>\$ 445,312</u>

Components of short-term borrowings and long-term debt are discussed in Note 11 - Short-Term Borrowings and Note 12 - Long-Term Debt, respectively, to the Consolidated Financial Statements under "Part II, Item 8. Financial Statements and Supplementary Data." Pension plan obligations include obligations under our defined benefit retirement plan and Supplemental Executive Retirement Plans, which are discussed in Note 17 - Pension Plans 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 19 - Operating Leases 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. Other long-term liabilities represent expected payments for unfunded commitments related to our investments in LIHTC partnerships.

Contractual obligations in Table 18 - Contractual Obligations do not include off-balance sheet arrangements. 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 24 - Financial Instruments With Off-Balance Sheet Risk 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, the need for raising additional capital (whether debt and/or equity) or returning capital to our shareholders, and the ability to declare cash dividends or repurchase our securities.

## Common and Preferred Equity

Shareholders' equity totaled \$528.5 million at December 31, 2019, an increase of \$36.8 million, or 7.5%, from the \$491.7 million at December 31, 2018, which decreased by \$8.3 million, or 1.7%, from December 31, 2017. When expressed as a percentage of total assets, shareholders' equity was 8.8% at December 31, 2019, compared to 8.5% at December 31, 2018 and 8.9% at December 31, 2017.

The increase in shareholders' equity from December 31, 2018 to December 31, 2019 was primarily attributable to: 1) net income of \$58.3 million and 2) accumulated other comprehensive income of \$27.6 million, partially offset by: 1) the repurchase of 797,003 shares of our common stock for a total cost of \$22.8 million, under our stock repurchase program, and 2) cash dividends paid of \$25.7 million. During 2019 we repurchased approximately 2.8% of our common stock outstanding at December 31, 2018.

The decrease in shareholders' equity from December 31, 2017 to December 31, 2018 was primarily attributable to: 1) the repurchase of 1,155,157 shares of our common stock for a total cost of \$32.8 million, under our stock repurchase program, 2) cash dividends paid of \$24.1 million and 3) accumulated other comprehensive loss of \$13.1 million, partially offset by net income of \$59.5 million. During 2018 we repurchased approximately 3.8% of our common stock outstanding at December 31, 2017.

Our tangible common equity ratio was 8.79% at December 31, 2019, compared to 8.47% at December 31, 2018 and 8.86% at December 31, 2017. Our book value per share was \$18.68, \$16.97, and \$16.65 at year-end 2019, 2018 and 2017, respectively. The increase in our tangible common equity ratio in 2019 from 2018 was primarily attributable to the increase in common equity due to net income recorded in 2019, partially offset by the reduction in our common equity due to common stock repurchases, as well as the quarterly dividends paid in 2019. The increase in our book value per share from 2018 was primarily attributable to net income recorded in 2019 of \$58.3 million, combined with the reduction in common shares outstanding due to the aforementioned common stock repurchases completed in 2019.

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 19. Reconciliation to Tangible Common Equity Ratio**

	December 31,		
	2019	2018	2017
	(Dollars in thousands)		
Total shareholders' equity .....	\$ 528,520	\$ 491,725	\$ 500,011
Less:			
Other intangible assets (core deposit premium) .....	—	—	(2,006)
Tangible common equity .....	<u>\$ 528,520</u>	<u>\$ 491,725</u>	<u>\$ 498,005</u>
Total assets .....	\$ 6,012,672	\$ 5,807,026	\$ 5,623,708
Less: Other intangible assets (core deposit premium) .....	—	—	(2,006)
Tangible assets .....	<u>\$ 6,012,672</u>	<u>\$ 5,807,026</u>	<u>\$ 5,621,702</u>
Tangible common equity to tangible assets .....	<u>8.79%</u>	<u>8.47%</u>	<u>8.86%</u>

### ***Trust Preferred Securities***

As of December 31, 2019, we have two remaining statutory trusts, CPB Capital Trust IV ("Trust IV") and CPB Statutory Trust V ("Trust V"), which issued a total of \$50.0 million in floating rate 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 trusts' 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.

The Company determined that its investments in Trust IV and Trust V did not represent a variable interest and therefore the Company was not the primary beneficiary of each of the trusts. As a result, consolidation of the trusts by the Company were not required.

On December 17, 2018, the Company completed the redemption of \$20.0 million in floating rate trust preferred securities of Trust III bearing an interest rate of three-month LIBOR plus 2.85% and maturing on December 17, 2033. The redemption price was 100% of the aggregate liquidation amount of the securities plus accumulated but unpaid distributions up to but not including the redemption date. The Company also redeemed \$0.6 million of common securities issued by Trust III and held by

the Company, as a result of the concurrent redemption of 100% of the principal assets of Trust III, or \$20.6 million of the Company's junior subordinated debentures with an identical interest rate and maturity as the Trust III trust preferred securities. The redemption was pursuant to the optional prepayment provisions of the indenture. On January 9, 2019, Trust III was canceled with the state of Connecticut.

On January 7, 2019, the Company completed the redemption of \$20.0 million in floating rate trust preferred securities of Trust II bearing an interest rate of three-month LIBOR plus 2.85% and maturing on October 7, 2033. The redemption price was 100% of the aggregate liquidation amount of the securities plus accumulated but unpaid distributions up to but not including the redemption date. The Company also redeemed \$0.6 million of common securities issued by Trust II and held by the Company, as a result of the concurrent redemption of 100% of the principal assets of Trust II, or \$20.6 million of the Company's junior subordinated debentures with an identical interest rate and maturity as the Trust II trust preferred securities. The redemption was pursuant to the optional prepayment provisions of the indenture. On January 22, 2019, Trust II was canceled with the state of Delaware.

We also previously had CPB Capital Trust I ("Trust I"), which was canceled in August 2014.

### ***Holding Company Capital Resources***

CPF is required to act as a source of strength to the bank under the Dodd-Frank Act. CPF is obligated to pay its expenses and payments on its junior subordinated debentures which fund payments on the outstanding trust preferred securities.

CPF relies on the bank to pay dividends to it to fund its obligations. As of December 31, 2019, on a stand-alone basis, CPF had an available cash balance of approximately \$10.6 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, 2019, the bank had Statutory Retained Earnings of \$66.6 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 the "Dividends — Market for Registrant's Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities" section.

### ***Share Repurchases***

We repurchase shares of our common stock when we believe such repurchases are in the best interests of the Company and our shareholders. In January 2017, our Board of Directors authorized the repurchase of up to \$30.0 million of the Company's common stock from time to time on the open market or in privately negotiated transactions, pursuant to a newly authorized share repurchase program (the "2017 Repurchase Plan"). The 2017 Repurchase Plan replaced and superseded in its entirety the share repurchase plan previously approved by the Company's Board of Directors.

In November 2017, the Board of Directors authorized an increase in the 2017 Repurchase Plan authority by an additional \$50.0 million (known henceforth as the "Repurchase Plan"). In 2017, 864,483 shares of common stock, at a cost of \$26.6 million, were repurchased under the previous share repurchase plan and the Repurchase Plan combined.

In 2018, 1,155,157 shares of common stock, at a cost of \$32.8 million, were repurchased under the Repurchase Plan.

In June 2019, the Company's Board of Directors authorized the repurchase of up to \$30 million of its common stock from time to time in the open market or in privately negotiated transactions, pursuant to a newly authorized share repurchase program (the "2019 Repurchase Plan"). The 2019 Repurchase Plan replaces and supersedes in its entirety the Repurchase Plan, which had \$6.8 million in remaining repurchase authority.

In 2019, 797,003 shares of common stock, at a cost of \$22.8 million, were repurchased under the 2019 Repurchase Plan. A total of \$21.1 million remained available for repurchase under the 2019 Repurchase Plan at December 31, 2019.

In January 2020, the Company's Board of Directors authorized the repurchase of up to \$30 million of its common stock from time to time in the open market or in privately negotiated transactions, pursuant to a newly authorized share repurchase

program. The new repurchase plan replaces and supersedes in its entirety the 2019 Repurchase Plan. Our ability to repurchase shares is subject to the discretion of our Board of Directors and approval of our regulators, and there can be no assurance that the Board will repurchase shares of our common stock in the future.

## **Cybersecurity**

In recent years, cybersecurity has gained prominence within the financial services industry due to increases in the quantity and sophistication of cyber-attacks, which include significant distributed denial-of-service and credential validation attacks, malicious code and viruses and attempts to breach the security of systems, which, in certain instances, have resulted in unauthorized access to customer account data.

The bank has a number of complex information systems used for a variety of functions by customers, employees and vendors. In addition, third parties with which the bank does business or that facilitate business activities (e.g., vendors, exchanges, clearing houses, central depositories and financial intermediaries) could also be sources of cybersecurity risk to the bank, including with respect to breakdowns or failures of their systems, misconduct by the employees of such parties, or cyber-attacks which could affect their ability to deliver a product or service to the bank.

As a regulated financial institution, we must adhere to the security requirements and expectations of the applicable regulatory agencies, which include requirements related to data privacy, systems availability and business continuity planning, among others. The regulatory agencies have established guidelines for the responsibilities of the Board of Directors and senior management, which include establishing policy, appointing and training personnel, implementing review and testing functions and ensuring an appropriate frequency of updates.

The Board of Directors overall, and its Compliance Committee more specifically, oversees cybersecurity risk. The Executive Committee overall, and our Chief Legal Officer, our Risk Management Division Officer and our Chief Information Security Officer more specifically, manages the cybersecurity risk at the operational level. Various reports on cybersecurity are provided to our Executive Committee and a quarterly update is provided to the Compliance Committee and the Board of Directors.

As a complement to the overall cybersecurity infrastructure, the bank utilizes a number of internal training methods, both formally through mandatory courses and informally through written communications and other updates. Internal policies and procedures have been implemented to encourage the reporting of potential phishing attacks or other security risks. The bank also uses third party services as part of its cybersecurity framework, and any such third parties are required to comply with the bank's policies regarding information security and confidentiality. In addition, the bank retains third party groups to assess and supplement the bank's cybersecurity needs. These cyber-attacks have not, to date, resulted in any material disruption to the bank's operations or harm to its customers and have not had a material adverse effect on the bank's results of operations; however, there can be no assurance that a sophisticated cyber-attack can be detected or thwarted.

## **Transaction Risk**

Transaction risk is the risk to earnings or capital arising from problems in service, activity or product delivery. This risk is significant within any bank and is interconnected with other risk categories in most activities throughout the Company. Transaction risk is a function of internal controls, information systems, associate integrity, and operating processes. It arises daily throughout the Company as transactions are processed. It pervades all divisions, departments and centers and is inherent in all products and services we offer.

In general, transaction risk is defined as high, medium or low by the Company. The audit plan ensures that high risk areas are reviewed annually. We utilize internal auditors and independent audit firms to test key controls of operational processes and to audit information systems, compliance management programs, loan programs and trust services.

The key to managing transaction risk is in the design, documentation and implementation of well-defined procedures and controls. Any system of controls, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, but not absolute, assurances of the effectiveness of these systems and controls, and that the objectives of these controls have been met.

## **Compliance Risk**

Compliance risk is the risk to earnings or capital arising from violations of, or non-conformance with, laws, rules, regulations, prescribed practices, or ethical standards. Compliance risk also arises in situations where the laws or rules governing certain products or activities of the bank's customers may be ambiguous or untested. Compliance risk exposes us to fines, civil money

penalties, payment of damages, and the voiding of contracts. Compliance risk can also lead to a diminished reputation, reduced business value, limited business opportunities, lessened expansion potential, and lack of contract enforceability. The Company utilizes independent external firms to conduct compliance audits as a means of identifying weaknesses in the compliance program.

There is no single or primary source of compliance risk. It is inherent in every activity. Frequently, it blends into operational risk and transaction risk. A portion of this risk is sometimes referred to as legal risk. This is not limited solely to risk from failure to comply with consumer protection laws; it encompasses all laws, as well as prudent ethical standards and contractual obligations. It also includes the exposure to litigation from all aspects of banking, traditional and non-traditional.

Our risk management policies and codes of ethical conduct are cornerstones for controlling compliance risk. An integral part of controlling this risk is the proper training and development of employees. The Corporate Compliance Division Manager is responsible for developing and executing a comprehensive compliance training program. The Corporate Compliance Division Manager, in consultation with our internal and external legal counsel, seeks to provide our employees with adequate training commensurate to their job functions to ensure compliance with banking laws and regulations.

Our risk management policies and programs includes a risk-based audit program aimed at identifying internal control deficiencies and weaknesses. We have in-depth audits performed by an independent audit firm under the direction of the Director of Internal Audit and supplemented by independent external firms, and periodic monitoring performed by our risk management personnel. Annually, an Audit Plan for the Company is developed and presented for approval to the Audit Committee.

Our risk management team conducts periodic monitoring of our compliance efforts with a special focus on those areas that expose us to compliance risk. The purpose of the periodic monitoring is to verify whether our employees are adhering to established policies and procedures. Any material exceptions identified are brought forward to the appropriate department head, the Audit Committee and the Compliance Committee.

We recognize that customer complaints can often identify weaknesses in our compliance program which could expose us to risk. Therefore, we attempt to ensure that all complaints are given prompt attention. The Corporate Compliance Division Manager reviews formal complaints to determine if a significant compliance risk exists and communicates those findings to our Compliance Committee.

### **Strategic Risk**

Strategic risk is the risk to earnings or capital arising from adverse decisions or improper implementation of strategic decisions. This risk is a function of the compatibility between an organization's goals, the resources deployed against those goals and the quality of implementation.

Strategic risks are identified as part of the strategic planning process. Offsite strategic planning sessions, with members of the Board of Directors and Executive Committee, are held annually. The strategic review consists of an economic assessment, competitive analysis, industry outlook and legislative and regulatory review.

A primary measurement of strategic risk is peer group analysis. Key performance ratios are compared to peer groups consisting of U.S. banks of comparable size and complexity and banks in the Hawaii market to identify any sign of weakness and potential opportunities.

Another measure is the comparison of the actual results of previous strategic initiatives against the expected results established prior to implementation of each strategy.

### **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, 2019. 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 20.** Rate Sensitivity of Assets, Liabilities and Equity

	<b>Three Months or Less</b>	<b>Over Three Through Six Months</b>	<b>Over Six Through Twelve Months</b>	<b>Over One Through Three Years</b>	<b>Over Three Years</b>	<b>Non-Rate Sensitive</b>	<b>Total</b>
	(Dollars in thousands)						
<b>Assets</b>							
Interest-bearing deposits in other financial institutions .....	\$ 24,554	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 24,554
Investment securities .....	103,490	75,941	101,279	357,448	488,825	1,127	1,128,110
Loans held for sale .....	9,071	—	—	—	—	12	9,083
Loans and leases .....	1,036,397	295,631	544,018	1,386,181	1,184,468	2,845	4,449,540
FHLB stock .....	14,983	—	—	—	—	—	14,983
Other assets .....	—	—	—	—	—	386,402	386,402
Total assets .....	<u>\$ 1,188,495</u>	<u>\$ 371,572</u>	<u>\$ 645,297</u>	<u>\$ 1,743,629</u>	<u>\$ 1,673,293</u>	<u>\$ 390,386</u>	<u>\$ 6,012,672</u>
<b>Liabilities and Equity</b>							
Noninterest-bearing deposits .....	\$ 1,450,532	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 1,450,532
Interest-bearing deposits .....	3,041,493	287,600	262,156	56,044	22,198	—	3,669,491
FHLB advances and other short-term borrowings .....	150,000	—	—	—	—	—	150,000
Long-term debt .....	51,547	—	25,000	25,000	—	—	101,547
Lease liability .....	—	—	—	—	—	52,632	52,632
Other liabilities .....	—	—	—	—	—	59,950	59,950
Equity .....	—	—	—	—	—	528,520	528,520
Total liabilities and equity .....	<u>\$ 4,693,572</u>	<u>\$ 287,600</u>	<u>\$ 287,156</u>	<u>\$ 81,044</u>	<u>\$ 22,198</u>	<u>\$ 641,102</u>	<u>\$ 6,012,672</u>
Interest rate sensitivity gap .....	<u>\$(3,505,077)</u>	<u>\$ 83,972</u>	<u>\$ 358,141</u>	<u>\$ 1,662,585</u>	<u>\$ 1,651,095</u>	<u>\$ (250,716)</u>	<u>\$ —</u>
Cumulative interest rate sensitivity gap .....	<u>\$(3,505,077)</u>	<u>\$(3,421,105)</u>	<u>\$(3,062,964)</u>	<u>\$(1,400,379)</u>	<u>\$ 250,716</u>	<u>\$ —</u>	<u>\$ —</u>

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, 2019, over a one-year horizon, assuming no balance sheet growth and given both a 100 bp upward and 100 bp downward parallel shift in interest rates.

<b>Rate Change</b>	<b>Estimated Net Interest Income Sensitivity</b>
+100bp .....	2.45 %
-100bp .....	(5.01)%

The table below 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. This differs from the assumptions used in Table 10 - Maturity Distribution and Sensitivities of Loans to Changes in Interest Rates. See Note 25 - Fair Value of Financial Assets and Financial Liabilities 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.



**Table 21. Interest Rate Sensitivity**

	Expected Maturity Within						Total Book Value	Total Fair Value
	One Year	Two Years	Three Years	Four Years	Five Years	Thereafter		
	(Dollars in thousands)							
<b>Interest-sensitive assets</b>								
Interest-bearing deposits in other financial institutions .....	\$ 24,554	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 24,554	\$ 24,554
Weighted average yields .....	1.55%	0.00%	0.00%	0.00%	0.00%	0.00%	1.55%	
Fixed-rate investment securities .....	\$ 239,729	\$ 180,231	\$ 177,471	\$ 81,652	\$ 90,951	\$ 316,568	\$ 1,086,602	\$ 1,086,602
Weighted average yields .....	2.56%	2.64%	2.76%	2.57%	2.80%	2.82%	2.70%	
Variable-rate investment securities .....	\$ 3,634	\$ 3,307	\$ 3,010	\$ 2,739	\$ 4,012	\$ 23,679	\$ 40,381	\$ 40,381
Weighted average yields .....	2.98%	2.98%	2.98%	2.98%	3.08%	2.96%	2.98%	
Equity investment securities .....	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 1,127	\$ 1,127	\$ 1,127
Weighted average yields .....	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	
Fixed-rate loans and leases .....	\$ 671,390	\$ 528,489	\$ 392,882	\$ 270,393	\$ 199,572	\$ 481,084	\$ 2,543,810	\$ 2,512,865
Weighted average yields .....	4.39%	4.39%	4.21%	4.15%	4.10%	3.87%	4.22%	
Variable-rate loans and leases .....	\$ 737,445	\$ 389,019	\$ 285,417	\$ 208,022	\$ 126,566	\$ 165,487	\$ 1,911,956	\$ 1,888,695
Weighted average yields .....	4.36%	3.78%	3.77%	3.62%	3.62%	3.59%	3.96%	
Total - December 31, 2019 .....	<u>\$ 1,676,752</u>	<u>\$ 1,101,046</u>	<u>\$ 858,780</u>	<u>\$ 562,806</u>	<u>\$ 421,101</u>	<u>\$ 987,945</u>	<u>\$ 5,608,430</u>	<u>\$ 5,554,224</u>
Total - December 31, 2018 .....	<u>\$ 1,486,148</u>	<u>\$ 960,554</u>	<u>\$ 717,558</u>	<u>\$ 593,113</u>	<u>\$ 430,700</u>	<u>\$ 1,270,825</u>	<u>\$ 5,458,898</u>	<u>\$ 5,317,220</u>
<b>Interest-sensitive liabilities</b>								
Interest-bearing demand and savings deposits ...	\$ 2,643,038	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 2,643,038	\$ 2,643,038
Weighted average rates paid .....	0.21%	0.00%	0.00%	0.00%	0.00%	0.00%	0.21%	
Time deposits .....	\$ 946,738	\$ 35,469	\$ 21,690	\$ 9,956	\$ 12,239	\$ 361	\$ 1,026,453	\$ 1,023,362
Weighted average rates paid .....	1.41%	0.75%	0.89%	1.28%	1.07%	0.33%	1.37%	
FHLB advances and other short-term borrowings .....	\$ 150,000	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 150,000	\$ 150,000
Weighted average rates paid .....	1.81%	0.00%	0.00%	0.00%	0.00%	0.00%	1.81%	
Long-term debt .....	\$ 25,000	\$ 25,000	\$ —	\$ —	\$ —	\$ 51,547	\$ 101,547	\$ 97,827
Weighted average rates paid .....	3.17%	3.25%	0.00%	0.00%	0.00%	4.11%	3.67%	
Total - December 31, 2019 .....	<u>\$ 3,764,776</u>	<u>\$ 60,469</u>	<u>\$ 21,690</u>	<u>\$ 9,956</u>	<u>\$ 12,239</u>	<u>\$ 51,908</u>	<u>\$ 3,921,038</u>	<u>\$ 3,914,227</u>
Total - December 31, 2018 .....	<u>\$ 3,561,306</u>	<u>\$ 113,258</u>	<u>\$ 57,217</u>	<u>\$ 12,900</u>	<u>\$ 11,472</u>	<u>\$ 72,536</u>	<u>\$ 3,828,689</u>	<u>\$ 3,816,885</u>

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 cash flows and others.

## 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, 2019 was 86.9% compared to 82.4% at December 31, 2018. 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 \$72.2 million in 2019, \$103.5 million in 2018, and \$96.8 million in 2017. 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 \$129.0 million, \$211.1 million and \$296.1 million in 2019, 2018 and 2017, 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 2019, 2018 and 2017, net loan originations accounted for \$237.5 million, \$250.2 million and \$166.1 million, respectively, of cash used in investing activities. In addition, purchases of portfolio loans totaled \$140.1 million, \$58.6 million and \$83.8 million in 2019, 2018 and 2017, respectively. Net proceeds received from sales and maturities of investment securities totaled \$253.6 million and \$111.2 million in 2019 and 2018, respectively, compared to net purchases of investment securities of \$47.6 million in 2017. Investing activities included proceeds from sales of foreclosed loans and other real estate of \$140 thousand, \$46 thousand, and \$0.3 million in 2019, 2018 and 2017, respectively. We did not sell any loans originated for investment in 2019, 2018 and 2017.

Cash provided by financing activities totaled \$57.6 million, \$127.6 million, and \$197.3 million in 2019, 2018 and 2017, respectively. Deposit activities, borrowings and capital transactions represent the major components of financing activities. In 2019 and 2017, deposits increased by \$173.5 million and \$348.2 million, respectively, compared to a net decrease in deposits of \$9.9 million in 2018. Net cash outflows of short-term debt totaled \$47.0 million in 2019 and \$103.0 million in 2017, compared to net cash inflows from short-term debt of \$165.0 million in 2018. Repayments of long-term debt totaled \$20.6 million in 2019. Proceeds from and repayments of long-term debt totaled \$50.0 million and \$20.6 million in 2018, respectively. There were no net cash inflows or outflows from long-term debt in 2017. As with investment securities, the level of net borrowings is impacted by the levels of loan and deposit growth or contraction during the period. Capital transactions, primarily cash dividends and stock repurchases, totaled \$48.3 million, \$57.0 million and \$47.9 million of cash used in 2019, 2018 and 2017, respectively.

Core deposits have historically provided us with a sizable 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 \$1.84 billion line of credit with the FHLB as of December 31, 2019, of which \$1.57 billion remained available as of December 31, 2019. Short-term borrowings under this arrangement totaled \$150.0 million and \$197.0 million at December 31, 2019 and 2018, respectively. Long-term debt with the FHLB as of December 31, 2019 and 2018 totaled \$50.0 million. FHLB advances outstanding at December 31, 2019 were secured by certain real estate loans with a carrying value of \$2.48 billion in accordance with the collateral provisions of the Advances Pledge and Security Agreement with the FHLB.

The FHLB provides standby letters of credit on behalf of the bank to secure certain public deposits. If the FHLB is required to make a payment on a standby letter of credit, the payment amount is converted to an advance at the FHLB. The standby letters of credit issued on our behalf by the FHLB totaled \$78.9 million and \$4.6 million at December 31, 2019 and 2018, respectively.

The bank also maintained a line of credit with the Federal Reserve discount window of \$65.3 million and \$73.9 million as of December 31, 2019 and 2018, respectively. There were no advances outstanding under this arrangement at December 31, 2019 and 2018. Advances under this arrangement would have been secured by certain commercial and commercial real estate loans with a carrying value totaling \$126.1 million. The Federal Reserve does not have the right to sell or repledge these loans. See Note 11 - Short-Term Borrowings and Note 12 - Long-Term Debt to the Consolidated Financial Statements under "Part II, Item 8. Financial Statements and Supplementary Data" for additional information regarding our 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 2019, net cash provided by operating activities amounted to \$62.2 million. The primary source of funds in operating activities included dividends received from the bank of \$63.0 million. Net cash used in financing activities amounted to \$69.0 million. The primary use of funds in financing activities included the repurchases of common stock totaling \$22.8 million and cash dividends of \$25.7 million paid to our common shareholders. In addition, junior subordinated debentures issued by Trust II totaling \$20.6 million were repaid in 2019.

In 2018, net cash provided by operating activities amounted to \$79.8 million. The primary source of funds in operating activities included dividends received from the bank of \$82.0 million. Net cash used in financing activities amounted to \$77.6 million. The primary use of funds in financing activities included the repurchases of common stock totaling \$32.8 million and cash dividends of \$24.1 million paid to our common shareholders. In addition, junior subordinated debentures issued by Trust III totaling \$20.6 million were repaid in 2018.

In 2017, net cash provided by operating activities amounted to \$42.3 million. The primary source of funds in operating activities included dividends received from the bank of \$43.0 million. Net cash used in financing activities amounted to \$47.9 million. The primary use of funds in financing activities included the repurchases of common stock totaling \$26.6 million and cash dividends of \$21.3 million paid to our common shareholders.

### **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 24 - Financial Instruments With Off-Balance Sheet Risk 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.

**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 25 - Fair Value of Financial Assets and Financial Liabilities 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**

Shareholders and the Board of Directors of Central Pacific Financial Corp.  
Honolulu, Hawaii

#### **Opinions on the Financial Statements and Internal Control over Financial Reporting**

We have audited the accompanying consolidated balance sheets of Central Pacific Financial Corp. and subsidiaries (the "Company") as of December 31, 2019 and 2018, the related consolidated statements of income, comprehensive income, changes in equity, and cash flows for the years then ended, and the related notes (collectively referred to as the "financial statements"). We also have audited the Company's internal control over financial reporting as of December 31, 2019, based on criteria established in Internal Control - Integrated Framework: (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2019 and 2018, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2019, based on criteria established in Internal Control - Integrated Framework: (2013) issued by COSO.

We also have audited the adjustments to the 2017 consolidated financial statements to retrospectively apply the change in accounting principle related to Low Income Housing Tax Credit investments, as described in Note 1. In our opinion, such adjustments are appropriate and have been properly applied. We were not engaged to audit, review, or apply any procedures to the 2017 consolidated financial statements of the Company other than with respect to the adjustments and, accordingly, we do not express an opinion or any other form of assurance on the 2017 consolidated financial statements taken as a whole.

#### **Change in Accounting Principle**

As discussed above and in Note 1 to the financial statements, the Company changed the manner in which it accounts for Low Income Housing Tax Credit investments in 2018.

#### **Basis for Opinions**

The Company's management is responsible for these financial statements, 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 financial statements and an opinion on the Company's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the financial statements included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. Our audit of internal control over financial reporting 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 audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

## Definition and Limitations of Internal Control Over Financial Reporting

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.

## Critical Audit Matters

The critical audit matter communicated below is a matter arising from the current period audit of the financial statements that were communicated or required to be communicated to the audit committee and that: (1) relate to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of the critical audit matter does not alter in any way our opinion on the financial statements, taken as a whole, and we are not, by communicating the critical audit matter below, providing a separate opinion on the critical audit matter or on the accounts or disclosures to which it relates.

### *Allowance for Loan and Lease Losses - Qualitative Adjustments*

As described in Notes 1 and 5 to the consolidated financial statements, the Company's consolidated allowance for loan and lease losses balance was \$47,971,000 at December 31, 2019, which consists of three basic elements: specific reserves for individually impaired loans, a general allowance for loans other than those analyzed as individually impaired, and qualitative adjustments based on environmental and other factors which may be internal or external to the Company. The allowance for loan and lease losses is the estimate of incurred credit losses inherent in the loan and lease portfolio at the balance sheet date. The amount of the allowance for loan and lease losses is expected to be sufficient to absorb probable losses incurred in the loan and lease portfolio. The determination of the allowance for loan and lease losses involves significant assumptions which require a high degree of judgment relating to the Company's loan and lease portfolio and the evaluation of the general economic conditions and other qualitative factors and how those assumptions impact probable incurred losses inherent within the loan and lease portfolio. Changes in these assumptions could have a material effect on the Company's financial results.

Qualitative adjustments, which are added to the historical loss rates, are utilized to address changes in conditions, trends, and circumstances such as economic conditions and industry changes that could have a significant impact on the risk profile of the loan and lease portfolio, and provide for losses in the loan and lease portfolio that may not be reflected and/or captured in the historical loss data. The Company primarily bases qualitative adjustments on the following factors including: lending policies, economic conditions, loan profile, lending staff, problem loan trends, loan review, collateral, credit concentrations and other internal and external factors. The evaluation of these factors results in qualitative adjustments, which contribute significantly to the estimate of the allowance for loan and lease losses. We identified the estimate of the aggregate effect of the qualitative adjustments on the allowance for loan and lease losses as a critical audit matter as it involved especially subjective auditor judgement.

The primary procedures we performed to address this critical audit matter included:

- Testing the effectiveness of controls over the qualitative adjustments, including controls addressing:
  - The completeness and accuracy of the data used as the basis for the qualitative adjustments,
  - The mathematical accuracy of the qualitative adjustments calculation, and
  - Management's judgments related to the data and assumptions used in the determination of qualitative adjustments.
- Substantively testing management's process, including evaluating their judgments and assumptions, for determining the qualitative adjustments, including:
  - Evaluation of the completeness and accuracy of the data used as a basis for the qualitative adjustments,
  - Evaluation of the mathematical accuracy of the qualitative adjustments calculation,

- Evaluation of the reasonableness of management’s judgments related to the data and assumptions used in the determination of qualitative adjustments,
- Analytical evaluation of the directional consistency of the qualitative adjustments, with respect to the underlying trends, and
- Analytical evaluation of the overall adequacy of the allowance for loan and lease losses, including the qualitative adjustments.

/s/ Crowe LLP

We have served as the Company's auditor since 2018.

Sacramento, California  
February 25, 2020

## Report of Independent Registered Public Accounting Firm

To the Stockholders and Board of Directors  
Central Pacific Financial Corp.:

### *Opinion on the Consolidated Financial Statements*

We have audited, before the effects of the adjustments to retrospectively apply the change in accounting related to investments in low income housing tax credit partnerships described in Note 1, the consolidated statements of income, comprehensive income, changes in equity, and cash flows of Central Pacific Financial Corp. and subsidiaries (the Company) for the year ended December 31, 2017, and the related notes (collectively, the consolidated financial statements). The 2017 consolidated financial statements before the effects of the adjustments described in Note 1 are not presented herein. In our opinion, the consolidated financial statements, before the effects of the adjustments to retrospectively apply the change in accounting related to investments in low income housing tax credit partnerships described in Note 1, present fairly, in all material respects, the results of the Company's operations and its cash flows for the year ended December 31, 2017, in conformity with U.S. generally accepted accounting principles.

We were not engaged to audit, review, or apply any procedures to the adjustments to retrospectively apply the change in accounting related to investments in low income housing tax credit partnerships described in Note 1 and, accordingly, we do not express an opinion or any other form of assurance about whether such adjustments are appropriate and have been properly applied. Those adjustments were audited by other auditors.

### *Basis for Opinion*

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 audit. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. Our audit included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audit also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audit provides a reasonable basis for our opinion.

/s/ KPMG LLP

We or our predecessor firms served as the Company's auditor from 1975 to 2018.

Honolulu, Hawaii  
February 28, 2018



**CENTRAL PACIFIC FINANCIAL CORP. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**

	December 31,	
	2019	2018
	(Dollars in thousands)	
<b>Assets</b>		
Cash and due from financial institutions .....	\$ 78,418	\$ 80,569
Interest-bearing deposits in other financial institutions .....	24,554	21,617
Investment securities:		
Available-for-sale debt securities, at fair value .....	1,126,983	1,205,478
Held-to-maturity debt securities, fair value of: none at December 31, 2019 and \$144,272 at December 31, 2018 .....	—	148,508
Equity securities, at fair value .....	1,127	826
Total investment securities .....	<u>1,128,110</u>	<u>1,354,812</u>
Loans held for sale .....	9,083	6,647
Loans and leases .....	4,449,540	4,078,366
Allowance for loan and lease losses .....	(47,971)	(47,916)
Loans and leases, net of allowance for loan and lease losses .....	<u>4,401,569</u>	<u>4,030,450</u>
Premises and equipment, net .....	46,343	45,285
Accrued interest receivable .....	16,500	17,000
Investment in unconsolidated subsidiaries .....	17,115	14,008
Other real estate owned, net .....	164	414
Mortgage servicing rights .....	14,718	15,596
Bank-owned life insurance .....	159,656	157,440
Federal Home Loan Bank ("FHLB") stock .....	14,983	16,645
Right-of-use lease asset .....	52,348	—
Other assets .....	49,111	46,543
Total assets .....	<u>\$ 6,012,672</u>	<u>\$ 5,807,026</u>
<b>Liabilities and Equity</b>		
Deposits:		
Noninterest-bearing demand .....	\$ 1,450,532	\$ 1,436,967
Interest-bearing demand .....	1,043,010	954,011
Savings and money market .....	1,600,028	1,448,257
Time .....	1,026,453	1,107,255
Total deposits .....	<u>5,120,023</u>	<u>4,946,490</u>
FHLB advances and other short-term borrowings .....	150,000	197,000
Long-term debt .....	101,547	122,166
Lease liability .....	52,632	—
Other liabilities .....	59,950	49,645
Total liabilities .....	<u>5,484,152</u>	<u>5,315,301</u>
Contingent liabilities and other commitments (see Note 23)		
Equity:		
Preferred stock, no par value, authorized 1,000,000 shares; issued and outstanding none at: December 31, 2019, and December 31, 2018 .....	—	—
Common stock, no par value, authorized 185,000,000 shares; issued and outstanding: 28,289,257 at December 31, 2019 and 28,967,715 at December 31, 2018 .....	447,602	470,660
Additional paid-in capital .....	91,611	88,876
Accumulated deficit .....	(19,102)	(51,718)
Accumulated other comprehensive income (loss) .....	8,409	(16,093)
Total equity .....	<u>528,520</u>	<u>491,725</u>
Total liabilities and equity .....	<u>\$ 6,012,672</u>	<u>\$ 5,807,026</u>

*See accompanying notes to consolidated financial statements.*

**CENTRAL PACIFIC FINANCIAL CORP. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF INCOME**

	Year Ended December 31,		
	2019	2018	2017
	(Dollars in thousands, except per share data)		
Interest income:			
Interest and fees on loans and leases .....	\$ 182,657	\$ 159,456	\$ 144,224
Interest and dividends on investment securities:			
Taxable investment securities .....	29,454	34,501	33,933
Tax-exempt investment securities .....	3,044	3,696	3,874
Dividend income on investment securities .....	63	61	49
Interest on deposits in other financial institutions .....	201	365	356
Dividend income on FHLB stock .....	964	215	126
Total interest income .....	<u>216,383</u>	<u>198,294</u>	<u>182,562</u>
Interest expense:			
Interest on deposits:			
Demand .....	800	734	641
Savings and money market .....	5,100	2,000	1,099
Time .....	18,044	16,770	9,457
Interest on short-term borrowings .....	4,285	1,236	183
Interest on long-term debt .....	4,080	4,556	3,479
Total interest expense .....	<u>32,309</u>	<u>25,296</u>	<u>14,859</u>
Net interest income .....	184,074	172,998	167,703
Provision (credit) for loan and lease losses .....	6,317	(1,124)	(2,674)
Net interest income after provision for loan and lease losses .....	<u>177,757</u>	<u>174,122</u>	<u>170,377</u>
Other operating income:			
Mortgage banking income .....	5,983	7,315	6,962
Service charges on deposit accounts .....	8,406	8,406	8,468
Other service charges and fees .....	14,358	13,123	11,518
Income from fiduciary activities .....	4,395	4,245	3,674
Income from bank-owned life insurance .....	3,105	2,117	3,388
Net gain (loss) on sales of foreclosed assets .....	(145)	—	205
Equity in earnings of unconsolidated subsidiaries .....	257	233	602
Fees on foreign exchange .....	755	905	529
Loan placement fees .....	702	747	536
Net gains (losses) on sales of investment securities .....	36	(279)	(1,410)
Other .....	3,949	1,992	2,024
Total other operating income .....	<u>41,801</u>	<u>38,804</u>	<u>36,496</u>
Other operating expense:			
Salaries and employee benefits .....	82,290	75,352	72,286
Net occupancy .....	14,299	13,763	13,571
Legal and professional services .....	7,354	7,330	7,724
Computer software expense .....	10,812	9,841	9,192
Amortization of core deposit premium .....	—	2,006	2,674
Communication expense .....	3,551	3,410	3,659
Equipment .....	4,353	4,239	3,785
Advertising expense .....	2,661	2,675	2,408
Foreclosed asset expense .....	251	574	151
Other .....	16,060	15,492	15,623
Total other operating expense .....	<u>141,631</u>	<u>134,682</u>	<u>131,073</u>
Income before income taxes .....	77,927	78,244	75,800
Income tax expense .....	19,605	18,758	34,596
Net income .....	<u>\$ 58,322</u>	<u>\$ 59,486</u>	<u>\$ 41,204</u>
Per common share data:			
Basic earnings per share .....	\$ 2.05	\$ 2.02	\$ 1.36
Diluted earnings per share .....	2.03	2.01	1.34
Cash dividends declared .....	0.90	0.82	0.70

*See accompanying notes to consolidated financial statements.*

**CENTRAL PACIFIC FINANCIAL CORP. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

**Year Ended December 31,**

		<u>2019</u>		<u>2018</u>		<u>2017</u>
<b>(Dollars in thousands)</b>						
Net income.....	\$	58,322	\$	59,486	\$	41,204
Other comprehensive income (loss), net of tax:						
Net change in unrealized gain (loss) on investment securities .....		27,568		(14,122)		344
Defined benefit plans .....		34		1,043		138
Total other comprehensive income (loss), net of tax.....		<u>27,602</u>		<u>(13,079)</u>		<u>482</u>
Comprehensive income .....	\$	<u>85,924</u>	\$	<u>46,407</u>	\$	<u>41,686</u>

*See accompanying notes to consolidated financial statements.*

**CENTRAL PACIFIC FINANCIAL CORP. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY**

	Common Shares Outstanding	Preferred Stock	Common Stock	Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Non- Controlling Interest	Total
(Dollars in thousands, except per share data)								
<b>Balance at December 31, 2016</b> .....	30,796,243	\$ —	\$ 530,932	\$ 84,180	\$ (108,941)	\$ (1,521)	\$ 25	\$ 504,675
Net income .....	—	—	—	—	41,204	\$ —	—	41,204
Other comprehensive income.....	—	—	—	—	—	482	—	482
Cash dividends declared (\$0.70 per share) ..	—	—	—	—	(21,299)	—	—	(21,299)
12,020 net shares of common stock sold by directors' deferred compensation plan.....	—	—	(385)	—	—	—	—	(385)
864,483 shares of common stock repurchased and other related costs.....	(864,483)	—	(26,559)	—	—	—	—	(26,559)
Share-based compensation expense.....	92,462	—	—	1,918	—	—	—	1,918
Non-controlling interest expense .....	—	—	—	—	—	—	(1)	(1)
<b>Balance at December 31, 2017</b> .....	30,024,222	\$ —	\$ 503,988	\$ 86,098	\$ (89,036)	\$ (1,039)	\$ 24	\$ 500,035
Impact of the adoption of new accounting standards (1).....	—	—	—	—	139	(139)	—	—
<b>Adjusted balance at January 1, 2018</b> .....	30,024,222	—	503,988	86,098	(88,897)	(1,178)	24	500,035
Impact of the adoption of new accounting standards (2).....	—	—	—	—	1,836	(1,836)	—	—
Net income .....	—	—	—	—	59,486	—	—	59,486
Other comprehensive loss .....	—	—	—	—	—	(13,079)	—	(13,079)
Cash dividends declared (\$0.82 per share) ..	—	—	—	—	(24,143)	—	—	(24,143)
16,950 net shares of common stock sold by directors' deferred compensation plan.....	—	—	(504)	—	—	—	—	(504)
1,155,157 shares of common stock repurchased and other related costs.....	(1,155,157)	—	(32,824)	—	—	—	—	(32,824)
Share-based compensation expense.....	98,650	—	—	2,778	—	—	—	2,778
Non-controlling interest expense .....	—	—	—	—	—	—	(24)	(24)
<b>Balance at December 31, 2018</b> .....	28,967,715	\$ —	\$ 470,660	\$ 88,876	\$ (51,718)	\$ (16,093)	\$ —	\$ 491,725
Impact of the adoption of new accounting standards (3).....	—	—	—	—	—	(3,100)	—	(3,100)
<b>Adjusted balance at January 1, 2019</b> .....	28,967,715	—	470,660	88,876	(51,718)	(19,193)	—	488,625
Net income .....	—	—	—	—	58,322	—	—	58,322
Other comprehensive income.....	—	—	—	—	—	27,602	—	27,602
Cash dividends declared (\$0.90 per share) ..	—	—	—	—	(25,706)	—	—	(25,706)
14,600 net shares of common stock sold by directors' deferred compensation plan.....	—	—	(416)	—	—	—	—	(416)
797,003 shares of common stock repurchased and other related costs.....	(797,003)	—	(22,793)	—	—	—	—	(22,793)
Share-based compensation expense.....	118,545	—	151	2,735	—	—	—	2,886
<b>Balance at December 31, 2019</b> .....	28,289,257	\$ —	\$ 447,602	\$ 91,611	\$ (19,102)	\$ 8,409	\$ —	\$ 528,520

(1) Represents the impact of the adoption of Accounting Standards Update ("ASU") ASU 2016-01.

(2) Represents the impact of the adoption of ASU 2018-02.

(3) Represents the impact of the adoption of ASU 2017-12. See Note 1 to the consolidated financial statements for additional information

*See accompanying notes to consolidated financial statements.*

**CENTRAL PACIFIC FINANCIAL CORP. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	Year Ended December 31,		
	2019	2018	2017
	(Dollars in thousands)		
<b>Cash flows from operating activities:</b>			
Net income .....	\$ 58,322	\$ 59,486	\$ 41,204
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision (credit) for loan and lease losses .....	6,317	(1,124)	(2,674)
Depreciation and amortization of premises and equipment .....	6,139	6,288	6,441
Non-cash lease expense .....	284	—	—
Cash flows from operating leases .....	(6,230)	—	—
Amortization of mortgage servicing rights and core deposit premium .....	2,460	3,865	4,962
Write down of other real estate, net of loss (gain) on sale .....	252	431	(192)
Net amortization and accretion of premium/discounts on investment securities .....	9,271	10,907	11,674
Share-based compensation expense .....	2,735	2,778	1,918
Net loss (gain) on sales of investment securities .....	(36)	279	1,410
Net gain on sales of residential mortgage loans .....	(4,128)	(4,085)	(4,069)
Proceeds from sales of loans held for sale .....	207,686	240,137	319,556
Origination of loans held for sale .....	(205,994)	(226,363)	(299,942)
Equity in earnings of unconsolidated subsidiaries .....	(257)	(233)	(602)
Distributions from unconsolidated subsidiaries .....	246	685	—
Net increase in cash surrender value of bank-owned life insurance .....	(3,259)	(2,248)	(3,940)
Deferred income tax expense (benefit) .....	(3,965)	7,874	32,206
Net tax benefits from share-based compensation .....	253	144	544
Net change in other assets and liabilities .....	2,096	4,665	(11,712)
<b>Net cash provided by operating activities</b> .....	<b>72,192</b>	<b>103,486</b>	<b>96,784</b>
<b>Cash flows from investing activities:</b>			
Proceeds from maturities of and calls on available-for-sale investment securities .....	252,079	143,876	169,472
Proceeds from sales of available-for-sale investment securities .....	53,935	10,014	114,536
Purchases of available-for-sale investment securities .....	(55,011)	(85,366)	(356,887)
Redemption of MasterCard Class B common stock .....	2,555	—	—
Proceeds from maturities of and calls on held-to-maturity investment securities .....	—	42,722	25,237
Loan (originations) and payments, net .....	(237,493)	(250,188)	(166,051)
Purchases of loan portfolios .....	(140,085)	(58,564)	(83,784)
Proceeds from sales of foreclosed loans and other real estate .....	140	46	286
Proceeds from bank-owned life insurance death benefits .....	1,043	1,101	3,240
Purchases of premises and equipment .....	(7,197)	(3,225)	(6,531)
Distributions from unconsolidated subsidiaries .....	622	622	658
Contributions to unconsolidated subsidiaries .....	(1,222)	(3,297)	(114)
Proceeds from redemption (purchases) of FHLB stock .....	1,662	(8,884)	3,811
<b>Net cash used in investing activities</b> .....	<b>(128,972)</b>	<b>(211,143)</b>	<b>(296,127)</b>
<b>Cash flows from financing activities:</b>			
Net increase (decrease) in deposits .....	173,533	(9,864)	348,153
Proceeds from long-term debt .....	—	50,000	—
Repayments of long-term debt .....	(20,619)	(20,619)	—
Net (decrease) increase in FHLB advances and other short-term borrowings .....	(47,000)	165,000	(103,000)
Cash dividends paid on common stock .....	(25,706)	(24,143)	(21,299)
Repurchases of common stock .....	(22,793)	(32,824)	(26,559)
Net proceeds from issuance of common stock and stock option exercises .....	151	—	—
<b>Net cash provided by financing activities</b> .....	<b>57,566</b>	<b>127,550</b>	<b>197,295</b>

	Year Ended December 31,		
	2019	2018	2017
	(Dollars in thousands)		
Net increase (decrease) in cash and cash equivalents .....	786	19,893	(2,048)
Cash and cash equivalents at beginning of year .....	102,186	82,293	84,341
<b>Cash and cash equivalents at end of year .....</b>	<b>\$ 102,972</b>	<b>\$ 102,186</b>	<b>\$ 82,293</b>

**Supplemental disclosure of cash flow information:**

Cash paid during the year for:

Interest .....	\$ 33,072	\$ 23,943	\$ 12,717
Income taxes .....	24,101	23	8,401

**Supplemental non-cash disclosures:**

Net change in common stock held by directors' deferred compensation plan .....	\$ 416	\$ 504	\$ 385
Net reclassification of loans to foreclosed loans and other real estate .....	142	40	154
Net transfer of investment securities from held-to-maturity to available-for-sale .....	(149,042)	—	—
Right-of-use lease assets obtained in exchange for lease liabilities .....	56,779	—	—

*See accompanying notes to consolidated financial statements.*

**CENTRAL PACIFIC FINANCIAL CORP. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**Years Ended December 31, 2019, 2018, and 2017**

**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 35 branches and 77 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, home equity 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, mobile banking, cash management services, safe deposit boxes, international banking services, night depository facilities, foreign exchange 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. and Subsidiaries (consolidated). When we refer to "Central Pacific Financial Corp." or to the holding company, we are referring to the parent company on a standalone basis. 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 26 - Segment Information.

**Accounting Policy Change and Reclassification**

During the fourth quarter of 2018, we voluntarily changed our accounting policy for investments in low income housing tax credit ("LIHTC") partnerships from the cost method to the proportional amortization method using the practical expedient available under Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 323, *"Investments - Equity Method and Joint Ventures"*, which permits an investor to amortize the initial cost of the investment in proportion to only the tax credits allocated to the investor. We believe the proportional amortization method is preferable because it better reflects the economics of an investment that is made for the primary purpose of receiving tax credits and other tax benefits. In addition to a change in the timing of the recognition of amortization expense on LIHTC investments, amortization expense on LIHTC investments is now reflected in the income tax expense line, which provides users a better understanding of the nature of the returns of such investments, instead of in other operating expenses on the consolidated statements of income. The change did not impact net income, the consolidated balance sheets and the consolidated statements of cash flows.

As a result of this accounting policy change, the following presents the effect of the change on our consolidated statements of income for periods prior to the fourth quarter of 2018 that were retrospectively adjusted:

	December 31, 2018			December 31, 2017		
	Unadjusted	Adjusted	Impact of Change	Unadjusted	Adjusted	Impact of Change
(dollars in thousands)						
Other operating expense .....	\$ 135,687	\$ 134,682	\$ (1,005)	\$ 131,817	\$ 131,073	\$ (744)
Income tax expense .....	17,753	18,758	1,005	33,852	34,596	744
Net income .....	59,486	59,486	—	41,204	41,204	—

## 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.

In December 2015, we acquired a 50% ownership interest in a mortgage loan origination and brokerage company, One Hawaii HomeLoans, LLC. The bank concluded that the investment met the consolidation requirements under Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 810, "Consolidation". The bank also concluded that the entity met the definition of a variable interest entity and that we were the primary beneficiary of the variable interest entity. Accordingly, the investment was consolidated into our financial statements as of December 31, 2017. One Hawaii HomeLoans, LLC was terminated in 2017, and final payment of taxes and distributions to members was made in March 2018.

We have 50% ownership interests in three other mortgage loan origination and brokerage companies which are accounted for using the equity method and are included in investment in unconsolidated subsidiaries: Gentry HomeLoans, LLC, Haseko HomeLoans, LLC and Island Pacific HomeLoans, LLC. We also had a 50% ownership in Pacific Access Mortgage, LLC, which was terminated in 2017, and final payment of taxes and distributions to members was made in March 2018.

As previously discussed we have LIHTC investments that are now accounted for under the proportional amortization 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 also included in investment in unconsolidated subsidiaries.

Our investments in unconsolidated subsidiaries accounted for under the equity, proportional amortization and cost methods were \$0.2 million, \$15.3 million and \$1.6 million, respectively, at December 31, 2019 and \$0.2 million, \$11.6 million and \$2.2 million, respectively, at December 31, 2018. 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, deferred income tax assets and income tax expense, valuation of investment securities, mortgage servicing rights and the related amortization thereon, pension liability and the fair value of certain financial instruments.



## Cash and Cash Equivalents

Cash and cash equivalents include cash and due from financial institutions, interest-bearing deposits in other financial institutions, federal funds sold and all highly liquid investments with maturities of three months or less at the time of purchase. Net cash flows are reported for customer loan and deposit transactions, interest-bearing deposits in other financial institutions, and federal funds purchased and repurchase agreements.

## Investment Securities

Investments in debt securities are designated as trading, available-for-sale ("AFS"), or held-to-maturity ("HTM"). Investments in debt securities are designated as HTM only if we have the positive intent and ability to hold these securities to maturity. HTM securities are reported at amortized cost. Trading securities are reported at fair value, with changes in fair value included in net income. Debt securities not classified as HTM or trading are classified as AFS and are reported at fair value, with net unrealized gains and losses, net of applicable taxes, included in accumulated other comprehensive income (loss) ("AOCI").

Equity securities with readily determinable fair values are carried at fair value, with changes in fair value included in net income. Equity securities without readily determinable fair values are carried at cost, minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment.

The Company classifies its investment securities portfolio into the following major security types: mortgage-backed securities ("MBS") and other debt securities. The Company's MBS portfolio is comprised of primarily of residential MBS issued by United States of America ("U.S.") government entities and agencies. These securities are either explicitly or implicitly guaranteed by an agency of the U.S. government, are highly rated by major rating agencies and have a long history of no credit losses. The remainder of the MBS portfolio are commercial MBS issued by U.S government entities and agencies (which shall have a minimum credit rating of BBB) and non-agency residential and commercial MBS (which shall meet minimum internal credit guidelines).

The Company's other debt securities portfolio is comprised of obligations issued by U.S. government entities and agencies, obligations issued by states and political subdivisions (which shall have a minimum credit rating of BBB), and corporate bonds (which shall have a minimum credit rating of BBB-).

Interest income on investment securities includes amortization of premiums and accretion of discounts. We amortize premiums to the earliest call date. We accrete discounts associated with investment securities using the interest method over the life of the respective security instrument. Gains and losses on the sale of investment securities are recorded on the trade date and determined using the specific identification method.

Management evaluates investment securities for other-than-temporary impairment ("OTTI") on at least a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation, to determine whether the unrealized losses on investment securities, or the decline in their value below amortized cost is "other-than-temporary." The term other-than-temporary is not intended to indicate that the decline is permanent, but indicates that the prospects for a near-term recovery of value are not necessarily favorable, or that there is a general lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. In conducting this assessment, for debt securities in an unrealized loss position we evaluate a number of factors including, but not limited to:

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

Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the decline in value is determined to be other-than-temporary, the value of the security is reduced and a corresponding impairment charge to earnings is recognized for anticipated credit losses.

For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: 1) OTTI related to credit loss, which must be recognized in the income statement and 2) OTTI related to other factors,

which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis. For equity securities, the entire amount of impairment is recognized through earnings.

The declines in market value of investment securities at December 31, 2019 and 2018 were primarily attributable to changes in interest rates and volatility in the credit and financial markets. Because we have no intent to sell securities in an unrealized loss position and it is not more likely than not that we will be required to sell such securities before recovery of its amortized cost basis, we do not consider our investments to be other-than-temporarily impaired.

### **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. Net fees and costs associated with originating and acquiring the Hawaii residential mortgage loans held for sale are deferred and included in the basis for determining the gain or loss on sales of loans held for sale. 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.

Loans originated with the intent to be held in our portfolio are subsequently transferred to held for sale when our intent to hold for the foreseeable future has changed. At the time of a loan's transfer to the held for sale account, 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 for loan and lease losses.

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. Collateral values are determined based on appraisals received from qualified valuation professionals and are obtained periodically or when indicators that property values may be impaired are present.

We sell residential mortgage loans 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. Our repurchase risk generally relates to early payment defaults and borrower fraud. We establish residential mortgage repurchase reserves to reflect this risk based on our estimate of losses after considering a combination of factors, including our estimate of future repurchase activity and our projection of incurred credit losses resulting from repurchased loans.

### **Loans**

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are stated at the principal amount outstanding, net of unamortized deferred loan origination fees and costs and unamortized purchase premiums and discounts. Net deferred loan origination fees and costs are recognized over the life of the related loan as an adjustment to yield and are amortized using the interest method over the contractual terms of the underlying loan, adjusted for actual prepayments. Unamortized loan origination fees and costs on loans paid in full are recognized as a component of interest income on loans. Purchase premiums and discounts are generally amortized into interest income using the interest method over the contractual terms of the underlying loans.

Interest income on loans is accrued at the contractual rate of interest on the unpaid principal balance. Accrued interest receivable on loans is reported together with accrued interest on investments in AFS debt securities on the consolidated balance sheets.

## Nonaccrual Loans

The Company determines delinquency status by considering the number of days full payments required by the contractual terms of the loan are past due. Loans are placed on nonaccrual status when interest payments are 90 days past due, or earlier should management determine that the borrowers will be unable to meet contractual principal and/or interest obligations, unless the loans are well-secured and in the process of collection. When a loan is placed on nonaccrual status, all interest previously accrued but not collected is reversed against current period interest income should management determine that the collectibility of such accrued interest is doubtful. All subsequent receipts are applied to principal outstanding and no interest income is recognized unless the financial condition and payment record of the borrowers warrant such recognition and the loan is restored to accrual status. A nonaccrual loan may be restored to an accrual basis when principal and interest payments are current and full payment of principal and interest is reasonably assured.

## Troubled Debt Restructuring ("TDR")

A loan is accounted for and reported as a TDR when, for economic or legal reasons, the Company grants a concession to a borrower experiencing financial difficulty that it would not otherwise consider. A restructuring that results in only an insignificant delay in payment is not considered a concession. A delay may be considered insignificant if the payments subject to the delay are insignificant relative to the unpaid principal or collateral value and the contractual amount due, or the delay in timing of the restructured payment period is insignificant relative to the frequency of payments, the debt's original contractual maturity or original expected duration.

TDRs that are performing and on accrual status as of the date of the modification remain on accrual status. TDRs that are nonperforming as of the date of modification generally remain as nonaccrual until the prospect of future payments in accordance with the modified loan agreement is reasonably assured, generally demonstrated when the borrower maintains compliance with the restructured terms for a predetermined period, normally at least six months. TDRs with temporary below-market concessions remain designated as a TDR regardless of the accrual or performance status until the loan is paid off. However, if the TDR loan has been modified in a subsequent restructure with market terms and the borrower is not currently experiencing financial difficulty, then the loan may be de-designated as a TDR.

## **Allowance for Loan and Lease Losses**

The allowance for loan and lease losses (the "Allowance") is a valuation allowance established through provisions for loan and lease losses (the "Provision") charged against income. Our policy is to charge a loan off in the period in which the loan is deemed to be uncollectible and all interest previously accrued but not collected is reversed against current period interest income. We consider a loan to be uncollectible when it is probable that a loss has been incurred and the Company can make a reasonable estimate of the loss. In these instances, the likelihood of and/or timeframe for recovery of the amount due is uncertain, weak, or protracted. Subsequent receipts, if any, are credited first to the remaining principal, then to the Allowance as recoveries, and finally to unaccrued interest.

The Allowance is management's estimate of incurred credit losses inherent in our loan and lease portfolio at the balance sheet date. In determining the amount of our Allowance, we rely on an analysis of our loan portfolio, our experience and our evaluation of general economic conditions, as well as regulatory requirements. We maintain our Allowance at an amount we expect to be sufficient to absorb probable losses inherent in our loan and lease portfolio based on a projection of probable net loan charge-offs.

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 qualitative adjustments based on environmental and other factors which may be internal or external to the Company. These three elements 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.

## General Allowance

In determining the general allowance component of the Allowance, the Company utilizes a comprehensive approach to segment the loan portfolio into homogeneous groups. The Company's methodology segments the portfolio generally by FDIC Call Report codes in eleven segments, and is consistent with general industry practice. For the purpose of determining general allowance loss factors, loss experience is derived from a migration analysis, with the exception of national syndicated loans and auto dealer purchased loans where an average historical loss rate is applied due to limited historical loss experience. The key inputs to run a migration analysis are the length of the migration period, the dates for the migration periods to start and the number of migration periods used for the analysis. For each migration period, the analysis will determine the outstanding balance in each segment and/or sub-segment at the start of each period. These loans will then be followed for the length of the migration period to identify the amount of associated charge-offs and recoveries. A loss rate for each migration period is calculated using the formula 'net charge-offs over the period divided by beginning loan balance'. The Allowance methodology applies a look back period to January 1, 2010. The Company extends its look back period with each additional quarter passing. As of December 31, 2019, the look back period was ten years.

## Qualitative Adjustments

Our Allowance methodology uses qualitative adjustments to address changes in conditions, trends, and circumstances such as economic conditions and industry changes that could have a significant impact on the risk profile of the loan portfolio, and provide for losses in the loan portfolio that may not be reflected and/or captured in the historical loss data. In order to ensure that the qualitative adjustments are in compliance with current regulatory standards and U.S. GAAP, the Company is primarily basing adjustments on the nine standard factors outlined in the 2006 Interagency Policy Statement on the Allowance for Loan and Lease Losses. These factors include: lending policies, economic conditions, loan profile, lending staff, problem loan trends, loan review, collateral, credit concentrations and other internal and external factors.

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 adjustments are applied to factor in current loan portfolio and market intelligence. These adjustments, which are added to the historical loss rate, consider the nature of the Company's primary markets and are reasonable, consistently determined and appropriately documented. Management reviews the results of the qualitative adjustment quarterly to ensure it is consistent with the trends in the overall economy, and from time to time may make adjustments, if necessary, to ensure directional consistency.

## **Reserve for Unfunded Commitments**

Our process for determining the reserve for unfunded loan commitments utilizes historical loss rates 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.

## **Premises and Equipment**

Premises and equipment are stated at cost, net of accumulated depreciation and amortization. Depreciation and amortization are included in other operating expense and are computed using the straight-line method over the shorter of the estimated useful lives of the assets or the applicable leases. Useful lives generally range from five to thirty-nine years for premises and improvements, and one to seven years for equipment. Major improvements and betterments are capitalized, while recurring maintenance and repairs are charged to operating expense. Net gains or losses on dispositions of premises and equipment are included in other operating income and operating expense.

## **Other Real Estate**

Other real estate is composed of properties acquired through foreclosure proceedings and is initially recorded at fair value less estimated costs to sell the property, thereby establishing the new cost basis of other real estate. Losses arising at the time of acquisition of such properties are charged against the Allowance. Subsequent to acquisition, such properties are carried at the lower of cost or fair value less estimated selling expenses, determined on an individual asset basis. Any deficiency resulting from the excess of cost over fair value less estimated selling expenses is recognized as a valuation allowance. Any subsequent increase in fair value up to its cost basis is recorded as a reduction of the valuation allowance. Increases or decreases in the valuation allowance are included in other operating expense. Net gains or losses recognized on the sale of these properties are included in other operating income.

## **Core Deposit Premium and Mortgage Servicing Rights**

Our core deposit premium was amortized over 14 years which approximated the estimated life of the purchased deposits. 2018 was the final year of amortization. The carrying value of our core deposit premium was periodically evaluated to estimate the remaining periods of benefit. If these periods of benefit were determined to be less than the remaining amortizable life, an adjustment to reflect such shorter life would have been made.

Mortgage servicing rights are recorded when loans are sold to third-parties with servicing of those loans retained and we classify and pool our mortgage servicing rights into buckets of homogeneous characteristics. 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 and is a component of mortgage banking income in the other operating income section of our consolidated statements of income. Amortization of the servicing rights is also reported as a component of mortgage banking income. Ancillary income is recorded in other income.

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, servicing cost and ancillary income. Many of these assumptions are subjective and require a high level of management judgment. Our mortgage servicing rights portfolio and valuation assumptions are periodically reviewed by management.

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

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

## **Federal Home Loan Bank Stock**

We are a member of the Federal Home Loan Bank of Des Moines (the "FHLB"). The bank is required to obtain and hold a specific number of shares of capital stock of the FHLB equal to the sum of a membership investment requirement and an activity-based investment requirement. The securities are reported at cost and are presented separately in the consolidated balance sheets.

## **Non-Controlling Interest**

Non-controlling interest was comprised of capital and undistributed profits of the member of One Hawaii HomeLoans, LLC, other than the bank. One Hawaii HomeLoans, LLC was terminated in 2017, and final payment of taxes and distributions to members was made in March 2018. As a result, non-controlling interest on our consolidated balance sheet totaled \$0 at December 31, 2019 and December 31, 2018.

## **Share-Based Compensation**

Share-based compensation cost is measured at the grant date, based on the estimated fair value of the award. We use the Black-Scholes option-pricing model to determine the fair-value of stock options, and the market price of the Company's common stock at the grant date for restricted stock awards. Share-based compensation is recognized as expense over the employee's requisite service period, generally defined as the vesting period. For awards with graded vesting, we recognize compensation expense on a straight-line basis over their respective vesting period. The Company's accounting policy is to recognize forfeitures as they occur. See Note 16 - Share-Based Compensation for further discussion of our stock-based compensation.

## **Income Taxes**

Deferred tax assets and liabilities are recognized for the estimated future tax effects attributable to temporary differences and carryforwards. A valuation allowance may be required if, based on the weight of available evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized. In determining whether a valuation allowance is necessary, we consider the level of taxable income in prior years, to the extent that carrybacks are permitted under current tax laws, as well as estimates of future taxable income and tax planning strategies that could be implemented to accelerate taxable income, if necessary. If our estimates of future taxable income were materially overstated or if our assumptions regarding the tax consequences of tax planning strategies were inaccurate, some or all of our deferred tax assets may not be realized, which would result in a charge to earnings. We recognize interest and penalties related to income tax matters in other expense.

We establish 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.

## **Earnings per Share**

Basic earnings per share is computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding during the period, excluding unvested restricted stock awards. Diluted earnings per share is computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding during the period, increased by the dilutive effect of stock options and stock awards, less shares held in a Rabbi trust pursuant to a deferred compensation plan for directors.

## **Forward Foreign Exchange Contracts**

We are periodically a party to a limited amount of forward foreign exchange contracts to satisfy customer needs for foreign currencies. These contracts are not utilized for trading purposes and are carried at market value, with realized gains and losses included in fees on foreign exchange.

## Derivatives and Hedging Activities

We recognize all derivatives on the balance sheet at fair value. On the date that we enter into a derivative contract, we designate the derivative as (1) a hedge of the fair value of an identified asset or liability ("fair value hedge"), (2) a hedge of a forecasted transaction or of the variability of cash flows to be received or paid related to an identified asset or liability ("cash flow hedge") or (3) a transaction not qualifying for hedge accounting ("free standing derivative"). For a fair value hedge, changes in the fair value of the derivative and, to the extent that it is effective, changes in the fair value of the hedged asset or liability, attributable to the hedged risk, are recorded in current period net income in the same financial statement category as the hedged item. For a cash flow hedge, changes in the fair value of the derivative, to the extent that it is effective, is recorded in other comprehensive income (loss) ("OCI"). These changes in fair value are subsequently reclassified to net income in the same period(s) that the hedged transaction affects net income in the same financial statement category as the hedged item. For free standing derivatives, changes in fair values are reported in current period other operating income.

## Accounting Standards Adopted in 2019

In February 2016, the FASB issued ASU 2016-02, *"Leases (Topic 842)." ASU 2016-02 increases transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The ASU establishes a right-of-use ("ROU") model that requires a lessee to recognize a ROU lease asset and lease liability on the balance sheet for all leases with a term of longer than 12 months. The FASB has also made available several practical expedients to assist entities with the adoption of ASU 2016-02. Among other things, these practical expedients require no reassessment of whether existing contracts are or contain leases as well as no reassessment of lease classification for current leases. In July 2018, the FASB released ASU 2018-11, "Leases (Topic 842): Targeted Improvements," which adds an additional practical expedient that allows entities to elect not to recast comparative periods presented when transitioning to Topic 842. The Company elected to adopt the practical expedient allowed under ASU 2018-11. During the year ended December 31, 2018, the Company engaged a software vendor to assist in the implementation of ASU 2016-02. The Company adopted ASU 2016-02 effective January 1, 2019 using the modified retrospective approach and recorded a ROU lease asset and corresponding lease liability on the Company's consolidated balance sheet of \$55.9 million for its operating leases where it is a lessee. There was no impact to the Company's financial statements for its leases where it is a lessor. As of December 31, 2019, the ROU lease asset and lease liability was \$52.3 million and \$52.6 million, respectively. See Note 19 - Operating Leases for required disclosures on this new standard.*

In August 2017, the FASB issued ASU 2017-12, *"Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities."* ASU 2017-12 was issued to better align an entity's risk management activities and financial reporting for hedging relationships through changes to both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results. The FASB believes that such amendments will: 1) improve the transparency of information about an entity's risk management activities and 2) simplify the application of hedge accounting. The ASU allows an entity that qualifies for the last-of-layer method a one-time opportunity to reclassify securities from the held-to-maturity category to the available-for-sale category. The Company adopted ASU 2017-12 effective January 1, 2019 and transferred its entire held-to-maturity investment securities portfolio with a fair value of \$144.3 million at January 1, 2019 to the available-for-sale portfolio. On the date of adoption, the Company recorded a cumulative effect adjustment related to the unrealized loss on the investment securities transferred, which decreased available-for-sale investments by \$4.2 million, increased deferred tax assets by \$1.1 million, and decreased opening accumulated other comprehensive income (loss) ("AOCI") by \$3.1 million. The ASU did not have a material impact on our current derivative activities.

In August 2018, the FASB issued ASU 2018-15, *"Intangibles—Goodwill and Other— Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract,"* which requires an entity in a cloud computing arrangement (i.e., hosting arrangement) that is a service contract to follow the internal-use software guidance in ASC 350-40 to determine which implementation costs to capitalize as assets or expense as incurred. Capitalized implementation costs should be presented in the same line item on the balance sheet as amounts prepaid for the hosted service, if any (generally as an "other asset"). The capitalized costs will be amortized over the term of the hosting arrangement, with the amortization expense being presented in the same income statement line item as the fees paid for the hosted service. ASU 2018-15 is effective for the Company's reporting period beginning January 1, 2020 and early adoption is permitted. The Company early adopted ASU 2018-15 during the second quarter of 2019. The adoption of the ASU did not have a material impact on our consolidated financial statements.

## Impact of Other Recently Issued Accounting Pronouncements on Future Filings

In June 2016, the FASB issued ASU 2016-13, *"Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments,"* and subsequent amendments to the guidance, ASU 2019-04 in April 2019 and ASU 2019-05 in May 2019. The standard significantly changes how entities will measure credit losses for most financial assets and certain other instruments that aren't measured at fair value through net income. In issuing the standard, the FASB is responding to criticism that today's "incurred loss" guidance delays the recognition of credit losses on loans, leases, held-to-maturity debt securities, loan commitments, and financial guarantees, and instead provides for a current expected credit loss ("CECL") approach to determine the allowance for credit losses. CECL requires an organization to measure all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. In addition, this guidance modifies the accounting treatment for other-than-temporary impairment for available-for-sale debt securities. Organizations will continue to use judgment to determine which loss estimation methods are appropriate for their circumstances. This guidance requires entities to record a cumulative effect adjustment to the consolidated balance sheet as of the beginning of the first reporting period in which the guidance is effective. However, an organization may elect to phase in the regulatory capital impact over a three-year transition period if adoption of the new standard results in a reduction of retained earnings. This update is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019, with earlier adoption permitted. As such, the Company will implement CECL for the reporting period beginning January 1, 2020 and intends to elect to phase in the regulatory capital impact over a three-year transition period. The new guidance will require significant operational changes, particularly in existing processes, data collection and analysis.

The Company has formed a steering committee that is responsible for oversight of the Company's implementation strategy for compliance with provisions of the new standard. The Company has also established a project management governance process to manage the implementation across affected disciplines. To date, the Company has established appropriate loan pools by segment and sub-segment, developed internal loss driver models, and has leveraged a third-party software solution to measure expected losses under CECL. As part of this process, the Company has also engaged an additional third party specializing in economic forecasting to enable it to incorporate reasonable and supportable forecasts in its process. Finally, the Company has developed and enhanced internal controls, had its CECL framework independently validated by a third-party expert, and has performed parallel runs. While the CECL implementation effort is near completion, the Company is unable to determine the final adoption impact on our consolidated financial statements as certain internal controls over the calculation and inputs have not yet fully operated. Additional work will be completed on internal controls over significant assumptions utilized. However, based on preliminary analyses completed thus far, management estimates its allowance for credit losses, including reserves for unfunded commitments, to increase by roughly 0%-15%. The foregoing range is based on the Company's calculation models and the underlying assumptions embedded in its methodology, including economic forecasts and sensitivity analyses. The final calculation, including assumptions, economic forecasts and inputs are subject to change based on the final completion of all internal controls and related testing.

In August 2018, the FASB issued ASU 2018-13, *"Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement."* The ASU is part of the FASB's disclosure framework project to improve the effectiveness of disclosures in the notes to financial statements by facilitating clear communication of the information required by generally accepted accounting principles. The ASU modifies disclosure requirements on fair value measurements in Topic 820 and is effective for the Company's reporting period beginning January 1, 2020. Early adoption is permitted. Based on preliminary evaluation, the ASU will not have a material impact on disclosures in our consolidated financial statements.

In August 2018, the FASB issued ASU 2018-14, *"Compensation—Retirement Benefits—Defined Benefit Plans—General (Subtopic 715-20): Disclosure Framework—Changes to the Disclosure Requirements for Defined Benefit Plans."* Like ASU 2018-13, this ASU is part of the FASB's disclosure framework project. This ASU modifies disclosure requirements for employers that sponsor defined benefit pension or other postretirement plans. The ASU is effective for the Company's reporting period beginning January 1, 2021. Early adoption is permitted. Based on preliminary evaluation, the ASU will not have a material impact on disclosures in our consolidated financial statements.

## 2. RESERVE REQUIREMENTS

The bank is required by the Federal Reserve Bank of San Francisco to maintain reserves based on the amount of deposits held. The amount held as a reserve by our bank at December 31, 2019 and 2018 was \$58.7 million and \$62.9 million, respectively.



### 3. INVESTMENT SECURITIES

A summary of our available-for-sale investment securities as of December 31, 2019 and 2018 are as follows:

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
	(Dollars in thousands)			
<b>December 31, 2019</b>				
Available-for-Sale:				
Debt securities:				
States and political subdivisions.....	\$ 119,755	\$ 2,303	\$ (40)	\$ 122,018
Corporate securities.....	30,277	252	—	30,529
U.S. Treasury obligations and direct obligations of U.S Government agencies.....	40,769	10	(398)	40,381
Mortgage-backed securities:				
Residential - U.S. GSEs.....	673,918	6,003	(2,099)	677,822
Residential - Non-government sponsored entities ("Non-GSEs").....	36,377	830	(16)	37,191
Commercial - U.S. GSEs and agencies.....	80,773	1,198	(746)	81,225
Commercial - Non-GSEs.....	134,676	3,141	—	137,817
Total available-for-sale investment securities.....	<u>\$ 1,116,545</u>	<u>\$ 13,737</u>	<u>\$ (3,299)</u>	<u>\$ 1,126,983</u>
	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
	(Dollars in thousands)			
<b>December 31, 2018</b>				
Held-to-Maturity:				
Mortgage-backed securities:				
Residential - U.S. Government-sponsored entities ("GSEs").....	\$ 83,436	\$ 19	\$ (3,174)	\$ 80,281
Commercial - U.S. GSEs.....	65,072	—	(1,081)	63,991
Total held-to-maturity investment securities.....	<u>\$ 148,508</u>	<u>\$ 19</u>	<u>\$ (4,255)</u>	<u>\$ 144,272</u>
Available-for-Sale:				
Debt securities:				
States and political subdivisions.....	\$ 174,114	\$ 1,035	\$ (1,475)	\$ 173,674
Corporate securities.....	55,259	—	(410)	54,849
U.S. Treasury obligations and direct obligations of U.S Government agencies.....	33,257	—	(683)	32,574
Mortgage-backed securities:				
Residential - U.S. GSEs.....	736,175	369	(19,492)	717,052
Residential - Non-government sponsored entities ("Non-GSEs").....	41,245	337	(464)	41,118
Commercial - U.S. GSEs and agencies.....	53,014	—	(1,531)	51,483
Commercial - Non-GSEs.....	134,867	1,013	(1,152)	134,728
Total available-for-sale investment securities.....	<u>\$ 1,227,931</u>	<u>\$ 2,754</u>	<u>\$ (25,207)</u>	<u>\$ 1,205,478</u>

The amortized cost and fair value of our equity investment securities is as follows:

(dollars in thousands)	<u>Amortized Cost</u>	<u>Fair Value</u>
<b>December 31, 2019</b>		
Equity securities .....	935	1,127
<b>December 31, 2018</b>		
Equity securities .....	826	826

As discussed in Note 1 - Summary of Significant Accounting Policies, on January 1, 2019 in conjunction with the adoption of ASU 2017-12, the Company transferred all of its held-to-maturity investment securities with an amortized cost of \$148.5 million and fair value of \$144.3 million to its available-for-sale investment securities portfolio.

The amortized cost and estimated fair value of our investment securities at December 31, 2019 by contractual maturity are shown below. Actual maturities may differ from contractual maturities as issuers have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity date are shown separately.

	<u>December 31, 2019</u>	
	<u>Amortized Cost</u>	<u>Fair Value</u>
	(Dollars in thousands)	
Available-for-Sale:		
Due in one year or less .....	\$ 50,356	\$ 50,681
Due after one year through five years .....	46,846	47,258
Due after five years through ten years .....	62,562	63,695
Due after ten years.....	31,037	31,294
Mortgage-backed securities		
Residential - U.S. GSEs .....	673,918	677,822
Residential - Non-government sponsored entities ("Non-GSEs").....	36,377	37,191
Commercial - U.S. GSEs and agencies.....	80,773	81,225
Commercial - Non-GSEs .....	134,676	137,817
Total available-for-sale investment securities .....	<u>\$ 1,116,545</u>	<u>\$ 1,126,983</u>

In the third quarter of 2019, we sold six available-for-sale securities totaling \$53.9 million at a net realized gain on sale of \$36 thousand.

In the fourth quarter of 2018, we sold two available-for-sale corporate securities totaling \$10.0 million at a net realized loss on sale of \$0.3 million.

Investment securities of \$0.72 billion and \$0.98 billion at December 31, 2019 and 2018, respectively, were pledged to secure public funds on deposit and other long-term and short-term borrowings.

At December 31, 2019 and 2018, there were no holdings of securities of any one issuer, other than the U.S. Government and its agencies, in an amount greater than 10% of shareholders' equity.

There were a total of 81 and 336 securities in an unrealized or unrecognized loss position at December 31, 2019 and 2018, respectively. The following table summarizes securities which were in an unrealized or unrecognized loss position at December 31, 2019 and 2018, aggregated by major security type and length of time in a continuous unrealized or unrecognized loss position:

Description of Securities	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
(Dollars in thousands)						
<b>December 31, 2019</b>						
Debt securities:						
States and political subdivisions .....	\$ 1,754	\$ (9)	\$ 801	\$ (31)	\$ 2,555	\$ (40)
Corporate securities .....	—	—	—	—	—	—
U.S. Treasury obligations and direct obligations of U.S Government agencies .....	18,882	(143)	19,031	(255)	37,913	(398)
Mortgage-backed securities:						
Residential - U.S. Government-sponsored entities ("GSEs") .....	54,335	(283)	214,295	(1,816)	268,630	(2,099)
Residential - Non-government sponsored entities ("Non-GSEs") .....	8,206	(16)	—	—	8,206	(16)
Commercial - U.S. GSEs and agencies.....	32,067	(746)	—	—	32,067	(746)
Total temporarily impaired securities.....	<u>\$ 115,244</u>	<u>\$ (1,197)</u>	<u>\$ 234,127</u>	<u>\$ (2,102)</u>	<u>\$ 349,371</u>	<u>\$ (3,299)</u>

Description of Securities	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
(Dollars in thousands)						
<b>December 31, 2018</b>						
Debt securities:						
States and political subdivisions .....	\$ 38,099	\$ (157)	\$ 49,505	\$ (1,318)	\$ 87,604	\$ (1,475)
Corporate securities .....	49,729	(250)	5,120	(160)	54,849	(410)
U.S. Treasury obligations and direct obligations of U.S Government agencies .....	30,029	(613)	2,545	(70)	32,574	(683)
Mortgage-backed securities:						
Residential - U.S. Government-sponsored entities ("GSEs") .....	88,957	(1,229)	666,685	(21,437)	755,642	(22,666)
Residential - Non-government sponsored entities ("Non-GSEs") .....	—	—	24,515	(464)	24,515	(464)
Commercial - U.S. GSEs and agencies.....	13,973	(247)	101,500	(2,365)	115,473	(2,612)
Commercial - Non-GSEs .....	33,847	(233)	46,680	(919)	80,527	(1,152)
Total temporarily impaired securities.....	<u>\$ 254,634</u>	<u>\$ (2,729)</u>	<u>\$ 896,550</u>	<u>\$ (26,733)</u>	<u>\$ 1,151,184</u>	<u>\$ (29,462)</u>

The unrealized losses on the Company's investment securities are primarily attributable to changes in interest rates and volatility in the credit and financial markets. Investment securities are evaluated on at least a quarterly basis, and include evaluating the changes in the investment securities' ratings issued by rating agencies and changes in the financial condition of the issuer, and for mortgage related securities, delinquency and loss information with respect to the underlying collateral, changes in levels of subordination for the Company's particular position within the repayment structure, and remaining credit enhancement as compared to projected credit losses of the security. All of these investment securities continue to be investment

grade rated by one or more major rating agencies. Because we have no intent to sell securities in an unrealized loss position and it is not more likely than not that we will be required to sell such securities before recovery of its amortized cost basis, we do not consider our investments to be other-than-temporarily impaired.

#### Visa and MasterCard Class B Common Stock

As of December 31, 2019, the Company owns 34,631 shares of Class B common stock of Visa, Inc. ("Visa"). These shares were received in 2008 as part of Visa's initial public offering ("IPO"). These shares are transferable only under limited circumstances until they can be converted into shares of the publicly traded Class A common stock. This conversion will not occur until the resolution of certain litigation, which is indemnified by Visa members. Since its IPO, Visa has funded a litigation reserve to settle these litigation claims. At its discretion, Visa may continue to increase the litigation reserve based upon a change in the conversion ratio of each member bank's restricted Class B common stock to unrestricted Class A common stock. Due to the existing transfer restriction and the uncertainty of the outcome of the Visa litigation, the Company has determined that the Visa Class B common stock does not have a readily determinable fair value and chooses to carry the shares on the Company's consolidated balance sheets at zero cost basis.

During the first quarter of 2019, the Company converted the 11,170 shares of Class B common stock of MasterCard, Inc. ("MasterCard") it received during their initial public offering to an equal number of Class A common stock and sold the shares for \$2.6 million. The shares were carried on the Company's consolidated balance sheets at zero cost basis and the proceeds received were recorded as a gain in other operating income - other in the Company's consolidated statements of income. The Company no longer owns any shares of MasterCard Class B common stock.

#### 4. LOANS AND LEASES

Loans and leases, excluding loans held for sale, consisted of the following as of December 31, 2019 and 2018:

	December 31,	
	2019	2018
	(Dollars in thousands)	
Commercial, financial and agricultural .....	\$ 570,089	\$ 581,177
Real estate:		
Construction .....	96,139	67,269
Residential mortgage .....	1,595,801	1,424,384
Home equity .....	490,239	468,966
Commercial mortgage .....	1,124,911	1,041,685
Consumer .....	569,516	492,268
Leases .....	—	124
Subtotal .....	4,446,695	4,075,873
Net deferred costs .....	2,845	2,493
Total loans and leases .....	\$ 4,449,540	\$ 4,078,366

There are different types of risk characteristics for the loans in each portfolio segment. The construction and real estate segment's predominant risk characteristics are the collateral and the geographic location of the property collateralizing the loan, as well as the operating cash flow for the commercial real estate properties. The commercial, financial and agricultural (and leases) segment's predominant risk characteristics are the cash flows of the business we lend to, the global cash flows and liquidity of the guarantors of such losses, as well as economic and market conditions. The consumer segment's predominant risk characteristics are employment and income levels as they relate to the consumer.

During the year ended December 31, 2019, we foreclosed on one portfolio loan with a carrying value of \$142 thousand, and recorded a gain on the transfer of \$22 thousand. We did not transfer any loans to the held-for-sale category during the year ended December 31, 2019. In addition, we did not sell any other portfolio loans during the year ended December 31, 2019.

In 2019, we purchased an auto loan portfolio totaling \$30.2 million which included a \$0.6 million premium over the \$29.6 million outstanding balance. At the time of purchase, the auto loans had a weighted average remaining term of 56 months and a weighted average yield, net of servicing costs, of 6.15%. In 2019, we also purchased unsecured consumer loan portfolios

totaling \$109.9 million which included a \$2.3 million discount to the \$112.2 million outstanding balance. At the time of purchase, the unsecured consumer loan portfolios had a weighted average remaining term of 76 months and a weighted average yield, net of servicing costs, of 6.24%.

In 2018, we purchased an auto loan portfolio totaling \$20.6 million which included a \$0.1 million premium over the \$20.5 million outstanding balance. At the time of purchase, the auto loans had a weighted average remaining term of 63 months and a weighted average yield, net of the premium paid and servicing costs, of 3.89%. In 2018, we also purchased an unsecured consumer loan portfolio totaling \$38.0 million, which represented the outstanding balance at the time of purchase. At the time of purchase, the unsecured consumer loans had a weighted average remaining term of 41 months and a weighted average yield, net of servicing costs, of 6.99%.

During the year ended December 31, 2018, we foreclosed on one portfolio loan with a carrying value of \$40 thousand. We did not transfer any loans to the held-for-sale category during the year ended December 31, 2018. In addition, we did not sell any portfolio loans during the year ended December 31, 2018.

In the normal course of business, our bank makes loans to certain directors, executive officers and their affiliates. These loans are made in the ordinary course of business at normal credit terms. As of December 31, 2019 and December 31, 2018, related party loan balances were \$36.3 million and \$34.0 million, respectively.

### Impaired Loans

The following tables present by class, the balance in the Allowance and the recorded investment in loans and leases based on the Company's impairment method as of December 31, 2019 and 2018:

	Real Estate					Consumer	Leases	Total
	Comml., Fin. & Ag.	Constr.	Resi. Mortgage	Home Equity	Comml. Mortgage			
	(Dollars in thousands)							
<b>December 31, 2019</b>								
Allowance:								
Individually evaluated for impairment...	\$ 218	\$ —	\$ —	\$ —	\$ —	\$ 17	\$ —	\$ 235
Collectively evaluated for impairment...	7,918	1,792	13,327	4,206	11,113	9,380	—	47,736
Total ending balance .....	<u>\$ 8,136</u>	<u>\$ 1,792</u>	<u>\$ 13,327</u>	<u>\$ 4,206</u>	<u>\$ 11,113</u>	<u>\$ 9,397</u>	<u>\$ —</u>	<u>\$ 47,971</u>
Loans and leases:								
Individually evaluated for impairment...	\$ 602	\$ —	\$ 6,516	\$ 92	\$ 1,839	\$ 17	\$ —	\$ 9,066
Collectively evaluated for impairment...	569,487	96,139	1,589,285	490,147	1,123,072	569,499	—	4,437,629
Subtotal .....	570,089	96,139	1,595,801	490,239	1,124,911	569,516	—	4,446,695
Net deferred costs (income) .....	215	(285)	4,000	495	(1,496)	(84)	—	2,845
Total ending balance .....	<u>\$ 570,304</u>	<u>\$ 95,854</u>	<u>\$ 1,599,801</u>	<u>\$ 490,734</u>	<u>\$ 1,123,415</u>	<u>\$ 569,432</u>	<u>\$ —</u>	<u>\$ 4,449,540</u>

	Real Estate							Consumer	Leases	Total
	Comml., Fin. & Ag.	Constr.	Resi. Mortgage	Home Equity	Comml. Mortgage					
	(Dollars in thousands)									
<b>December 31, 2018</b>										
Allowance:										
Individually evaluated for impairment...	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Collectively evaluated for impairment...	8,027	1,202	14,349	3,788	13,358	7,192	—	—	47,916	
Total ending balance .....	<u>\$ 8,027</u>	<u>\$ 1,202</u>	<u>\$ 14,349</u>	<u>\$ 3,788</u>	<u>\$ 13,358</u>	<u>\$ 7,192</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 47,916</u>	
Loans and leases:										
Individually evaluated for impairment...	\$ 220	\$ 2,273	\$ 10,075	\$ 275	\$ 2,348	\$ —	\$ —	\$ —	\$ 15,191	
Collectively evaluated for impairment...	580,957	64,996	1,414,309	468,691	1,039,337	492,268	124	—	4,060,682	
Subtotal .....	581,177	67,269	1,424,384	468,966	1,041,685	492,268	124	—	4,075,873	
Net deferred costs (income) .....	483	(342)	3,821	—	(1,407)	(62)	—	—	2,493	
Total ending balance .....	<u>\$ 581,660</u>	<u>\$ 66,927</u>	<u>\$ 1,428,205</u>	<u>\$ 468,966</u>	<u>\$ 1,040,278</u>	<u>\$ 492,206</u>	<u>\$ 124</u>	<u>\$ —</u>	<u>\$ 4,078,366</u>	

The following table presents by class, impaired loans as of December 31, 2019 and 2018:

	December 31, 2019			December 31, 2018		
	Unpaid Principal Balance	Recorded Investment	Allowance Allocated	Unpaid Principal Balance	Recorded Investment	Allowance Allocated
	(Dollars in thousands)					
Impaired loans with no related Allowance recorded:						
Commercial, financial and agricultural.....	\$ 246	\$ 135	\$ —	\$ 330	\$ 220	\$ —
Real estate:						
Construction .....	—	—	—	3,076	2,273	—
Residential mortgage .....	7,230	6,516	—	11,019	10,075	—
Home equity .....	92	92	—	275	275	—
Commercial mortgage.....	1,839	1,839	—	2,348	2,348	—
Total impaired loans with no related Allowance recorded.....	<u>9,407</u>	<u>8,582</u>	<u>—</u>	<u>17,048</u>	<u>15,191</u>	<u>—</u>
Impaired loans with an Allowance recorded:						
Commercial, financial and agricultural.....	467	467	218	—	—	—
Consumer .....	17	17	17	—	—	—
Total impaired loans with an Allowance recorded.....	<u>484</u>	<u>484</u>	<u>235</u>	<u>—</u>	<u>—</u>	<u>—</u>
Total impaired loans.....	<u>\$ 9,891</u>	<u>\$ 9,066</u>	<u>\$ 235</u>	<u>\$ 17,048</u>	<u>\$ 15,191</u>	<u>\$ —</u>

The following table presents by class, the average recorded investment and interest income recognized on impaired loans during the years ended December 31, 2019, 2018 and 2017:

	Year Ended December 31, 2019		Year Ended December 31, 2018		Year Ended December 31, 2017	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
	(Dollars in thousands)					
Commercial, financial and agricultural .....	\$ 214	\$ 9	\$ 435	\$ 24	\$ 1,272	\$ 24
Real estate:						
Construction .....	1,018	62	2,436	111	2,760	99
Residential mortgage .....	8,322	905	12,681	662	17,122	1,843
Home equity .....	277	13	482	—	1,213	69
Commercial mortgage .....	2,098	86	3,368	179	4,893	313
Consumer .....	3	—	—	—	—	—
Total .....	<u>\$ 11,932</u>	<u>\$ 1,075</u>	<u>\$ 19,402</u>	<u>\$ 976</u>	<u>\$ 27,260</u>	<u>\$ 2,348</u>

For the years ended December 31, 2019, 2018 and 2017, the amount of interest income recognized on impaired loans within the period that the loans were impaired were primarily related to loans modified in a troubled debt restructuring ("TDR") that were on accrual status. For the years ended December 31, 2019, 2018 and 2017, the amount of interest income recognized using a cash-based method of accounting during the period that the loans were impaired was not material.

#### Foreclosure Proceedings

The Company had \$0.6 million and \$0.7 million of residential mortgage loans collateralized by residential real estate property that were in the process of foreclosure at December 31, 2019 and 2018, respectively.

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

For all loan types, the Company determines delinquency status by considering the number of days full payments required by the contractual terms of the loan are past due. The following tables present by class, the aging of the recorded investment in past due loans and leases as of December 31, 2019 and 2018:

	Accruing Loans 30 - 59 Days Past Due	Accruing Loans 60 - 89 Days Past Due	Accruing Loans 90+ Days Past Due	Nonaccrual Loans	Total Past Due and Nonaccrual	Loans and Leases Not Past Due	Total
		(Dollars in thousands)					
<b>December 31, 2019</b>							
Commercial, financial and agricultural....	\$ 476	\$ 865	\$ —	\$ 467	\$ 1,808	\$ 568,496	\$ 570,304
Real estate:							
Construction .....	643	—	—	—	643	95,211	95,854
Residential mortgage .....	1,830	589	724	979	4,122	1,595,679	1,599,801
Home equity .....	759	207	—	92	1,058	489,676	490,734
Commercial mortgage .....	—	397	—	—	397	1,123,018	1,123,415
Consumer .....	3,223	943	286	17	4,469	564,963	569,432
Total .....	<u>\$ 6,931</u>	<u>\$ 3,001</u>	<u>\$ 1,010</u>	<u>\$ 1,555</u>	<u>\$ 12,497</u>	<u>\$ 4,437,043</u>	<u>\$ 4,449,540</u>

	Accruing Loans 30 - 59 Days Past Due	Accruing Loans 60 - 89 Days Past Due	Accruing Loans 90+ Days Past Due	Nonaccrual Loans	Total Past Due and Nonaccrual	Loans and Leases Not Past Due	Total
(Dollars in thousands)							
<b>December 31, 2018</b>							
Commercial, financial and agricultural....	\$ 1,348	\$ 162	\$ —	\$ —	\$ 1,510	\$ 580,150	\$ 581,660
Real estate:							
Construction .....	—	—	—	—	—	66,927	66,927
Residential mortgage .....	3,966	157	—	2,048	6,171	1,422,034	1,428,205
Home equity .....	433	104	298	275	1,110	467,856	468,966
Commercial mortgage .....	—	—	—	—	—	1,040,278	1,040,278
Consumer .....	2,340	872	238	—	3,450	488,756	492,206
Leases .....	—	—	—	—	—	124	124
Total .....	<u>\$ 8,087</u>	<u>\$ 1,295</u>	<u>\$ 536</u>	<u>\$ 2,323</u>	<u>\$ 12,241</u>	<u>\$ 4,066,125</u>	<u>\$ 4,078,366</u>

Interest income totaling \$3.1 million, \$1.2 million, and \$2.6 million was recognized on nonaccrual loans, including loans held for sale, in 2019, 2018 and 2017, respectively. Additional interest income of \$0.3 million, \$0.4 million, and \$0.4 million would have been recognized in 2019, 2018 and 2017, respectively, had these loans been accruing interest throughout those periods. Additionally, interest income of \$0.3 million, \$0.7 million, and \$0.8 million was collected and recognized on charged-off loans in 2019, 2018 and 2017, respectively.

### Modifications

TDRs included in nonperforming assets at December 31, 2019 consisted of one Hawaii residential mortgage loan with a principal balance of \$0.3 million. Concessions made to the original contractual terms of these loans consisted primarily of the deferral of interest and/or principal payments due to deterioration in the borrowers' financial condition. The principal balances on these TDRs had matured and/or were in default at the time of restructure and we have no commitments to lend additional funds to any of these borrowers. At December 31, 2018, TDRs included in nonperforming assets consisted of three loans with a combined principal balance of \$0.4 million.

There were \$7.5 million of TDRs still accruing interest at December 31, 2019, none of which were more than 90 days delinquent. At December 31, 2018, there were \$12.9 million of TDRs still accruing interest, none of which were more than 90 days delinquent.

Some loans modified in a TDR may already be on nonaccrual status and partial charge-offs may have already been taken against the outstanding loan balance. Thus, these loans have already been identified as impaired and have already been evaluated under the Company's Allowance methodology. As a result, some loans modified in a TDR may have the financial effect of increasing the specific allowance associated with the loan. The loans modified in a TDR did not have a material effect on our Provision and Allowance during the years ended December 31, 2019 and 2018.



The following table presents by class, information related to loans modified in a TDR during the years ended December 31, 2019, 2018 and 2017:

<b>Year Ended December 31, 2019</b>			
	<b>Number of Loans</b>	<b>Recorded Investment (as of period end)</b>	<b>Increase in the Allowance</b>
<b>(Dollars in thousands)</b>			
Real estate: Residential mortgage.....	1	\$ 104	\$ —
Total.....	1	\$ 104	\$ —

<b>Year Ended December 31, 2018</b>			
	<b>Number of Loans</b>	<b>Recorded Investment (as of period end)</b>	<b>Increase in the Allowance</b>
<b>(Dollars in thousands)</b>			
Real estate: Residential mortgage.....	3	\$ 575	\$ —
Total.....	3	\$ 575	\$ —

<b>Year Ended December 31, 2017</b>			
	<b>Number of Loans</b>	<b>Recorded Investment (as of period end)</b>	<b>Increase in the Allowance</b>
<b>(Dollars in thousands)</b>			
Real estate: Residential mortgage.....	3	\$ 104	\$ —
Total.....	3	\$ 104	\$ —

No loans were modified as a TDR within the previous twelve months that subsequently defaulted during the years ended December 31, 2019, 2018 and 2017.

### Credit Quality Indicators

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

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

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

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

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

Loans and leases not meeting the criteria above are considered to be pass rated loans and leases. The following tables present by class and credit indicator, the recorded investment in the Company's loans and leases as of December 31, 2019 and 2018:

	Pass	Special Mention	Substandard	Loss	Subtotal	Net Deferred Costs (Income)	Total
(Dollars in thousands)							
<b>December 31, 2019</b>							
Commercial, financial and agricultural .....	\$ 523,342	\$ 20,677	\$ 26,070	\$ —	\$ 570,089	\$ 215	\$ 570,304
Real estate:							
Construction .....	96,139	—	—	—	96,139	(285)	95,854
Residential mortgage .....	1,593,072	840	1,889	—	1,595,801	4,000	1,599,801
Home equity .....	490,147	—	92	—	490,239	495	490,734
Commercial mortgage .....	1,094,364	17,440	13,107	—	1,124,911	(1,496)	1,123,415
Consumer .....	569,212	—	193	111	569,516	(84)	569,432
Total .....	<u>\$ 4,366,276</u>	<u>\$ 38,957</u>	<u>\$ 41,351</u>	<u>\$ 111</u>	<u>\$ 4,446,695</u>	<u>\$ 2,845</u>	<u>\$ 4,449,540</u>

	Pass	Special Mention	Substandard	Loss	Subtotal	Net Deferred Costs (Income)	Total
(Dollars in thousands)							
<b>December 31, 2018</b>							
Commercial, financial and agricultural .....	\$ 552,706	\$ 7,961	\$ 20,510	\$ —	\$ 581,177	\$ 483	\$ 581,660
Real estate:							
Construction .....	67,269	—	—	—	67,269	(342)	66,927
Residential mortgage .....	1,422,240	—	2,144	—	1,424,384	3,821	1,428,205
Home equity .....	468,394	—	572	—	468,966	—	468,966
Commercial mortgage .....	1,029,581	10,412	1,692	—	1,041,685	(1,407)	1,040,278
Consumer .....	492,030	—	80	158	492,268	(62)	492,206
Leases .....	124	—	—	—	124	—	124
Total .....	<u>\$ 4,032,344</u>	<u>\$ 18,373</u>	<u>\$ 24,998</u>	<u>\$ 158</u>	<u>\$ 4,075,873</u>	<u>\$ 2,493</u>	<u>\$ 4,078,366</u>

## 5. ALLOWANCE FOR LOAN AND LEASE LOSSES

The following tables present by class, the activity in the Allowance for the periods indicated:

	Real Estate							Total
	Commercial, Financial & Agricultural	Construction	Residential Mortgage	Home Equity	Commercial Mortgage	Consumer	Leases	
(Dollars in thousands)								
<b>Year ended December 31, 2019</b>								
Beginning balance .....	\$ 8,027	\$ 1,202	\$ 14,349	\$ 3,788	\$ 13,358	\$ 7,192	\$ —	\$ 47,916
Provision (credit) for loan and lease losses .....	1,413	(20)	(1,546)	381	(2,270)	8,359	—	6,317
	<u>9,440</u>	<u>1,182</u>	<u>12,803</u>	<u>4,169</u>	<u>11,088</u>	<u>15,551</u>	<u>—</u>	<u>54,233</u>
Charge-offs .....	2,478	—	—	5	—	8,265	—	10,748
Recoveries .....	1,174	610	524	42	25	2,111	—	4,486
Net charge-offs (recoveries) .....	<u>1,304</u>	<u>(610)</u>	<u>(524)</u>	<u>(37)</u>	<u>(25)</u>	<u>6,154</u>	<u>—</u>	<u>6,262</u>
Ending balance .....	<u>\$ 8,136</u>	<u>\$ 1,792</u>	<u>\$ 13,327</u>	<u>\$ 4,206</u>	<u>\$ 11,113</u>	<u>\$ 9,397</u>	<u>\$ —</u>	<u>\$ 47,971</u>

	Commercial, Financial & Agricultural	Real Estate				Consumer	Leases	Total
		Construction	Residential Mortgage	Home Equity	Commercial Mortgage			
(Dollars in thousands)								
<b>Year ended December 31, 2018</b>								
Beginning balance.....	\$ 7,594	\$ 1,835	\$ 14,328	\$ 3,317	\$ 16,801	\$ 6,126	\$ —	\$ 50,001
Provision (credit) for loan and lease losses	2,082	(6,392)	(183)	444	(3,495)	6,420	—	(1,124)
	<u>9,676</u>	<u>(4,557)</u>	<u>14,145</u>	<u>3,761</u>	<u>13,306</u>	<u>12,546</u>	<u>—</u>	<u>48,877</u>
Charge-offs.....	2,852	—	—	—	—	7,323	—	10,175
Recoveries.....	1,203	5,759	204	27	52	1,969	—	9,214
Net charge-offs (recoveries).....	1,649	(5,759)	(204)	(27)	(52)	5,354	—	961
Ending balance.....	<u>\$ 8,027</u>	<u>\$ 1,202</u>	<u>\$ 14,349</u>	<u>\$ 3,788</u>	<u>\$ 13,358</u>	<u>\$ 7,192</u>	<u>\$ —</u>	<u>\$ 47,916</u>

	Commercial, Financial & Agricultural	Real Estate				Consumer	Leases	Total
		Construction	Residential Mortgage	Home Equity	Commercial Mortgage			
(Dollars in thousands)								
<b>Year ended December 31, 2017</b>								
Beginning balance.....	\$ 8,637	\$ 4,224	\$ 15,055	\$ 3,502	\$ 19,104	\$ 6,109	\$ —	\$ 56,631
Provision (credit) for loan and lease losses	(705)	(2,558)	(1,533)	(229)	(2,460)	4,811	—	(2,674)
	<u>7,932</u>	<u>1,666</u>	<u>13,522</u>	<u>3,273</u>	<u>16,644</u>	<u>10,920</u>	<u>—</u>	<u>53,957</u>
Charge-offs.....	1,704	—	73	—	—	6,294	—	8,071
Recoveries.....	1,366	169	879	44	157	1,500	—	4,115
Net charge-offs.....	338	(169)	(806)	(44)	(157)	4,794	—	3,956
Ending balance.....	<u>\$ 7,594</u>	<u>\$ 1,835</u>	<u>\$ 14,328</u>	<u>\$ 3,317</u>	<u>\$ 16,801</u>	<u>\$ 6,126</u>	<u>\$ —</u>	<u>\$ 50,001</u>

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

Changes in the allowance for loan and lease losses for impaired loans (included in the above amounts) were as follows:

	Year Ended December 31,		
	2019	2018	2017
(Dollars in thousands)			
Balance, beginning of year.....	\$ —	\$ —	\$ —
Provision for loan and lease losses.....	235	—	—
Balance, end of year.....	<u>\$ 235</u>	<u>\$ —</u>	<u>\$ —</u>

At December 31, 2019 and 2018, all impaired loans were measured based on the fair value of the underlying collateral for collateral-dependent loans, at the loan's observable market price, or the net present value of future cash flows, as appropriate.

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

## 6. PREMISES AND EQUIPMENT

Premises and equipment consisted of the following as of December 31, 2019 and 2018:

	December 31,	
	2019	2018
	(Dollars in thousands)	
Land.....	\$ 8,309	\$ 8,309
Office buildings and improvements .....	107,840	102,398
Furniture, fixtures and equipment .....	39,066	37,586
Gross premises and equipment .....	155,215	148,293
Accumulated depreciation and amortization .....	(108,872)	(103,008)
Net premises and equipment.....	<u>\$ 46,343</u>	<u>\$ 45,285</u>

Depreciation and amortization of premises and equipment were charged to the following operating expenses:

	Year Ended December 31,		
	2019	2018	2017
	(Dollars in thousands)		
Net occupancy .....	\$ 3,401	\$ 3,527	\$ 3,880
Equipment .....	2,738	2,761	2,561
Total .....	<u>\$ 6,139</u>	<u>\$ 6,288</u>	<u>\$ 6,441</u>

## 7. INVESTMENTS IN UNCONSOLIDATED SUBSIDIARIES

Investments in unconsolidated subsidiaries as of December 31, 2019 and 2018 consisted of the following components:

	December 31,	
	2019	2018
	(Dollars in thousands)	
Investments in low income housing tax credit partnerships.....	\$ 15,322	\$ 11,603
Investments in common securities of statutory trusts .....	1,547	2,169
Investments in affiliates.....	192	182
Other .....	54	54
Total .....	<u>\$ 17,115</u>	<u>\$ 14,008</u>

The Company invests in low income housing tax credit ("LIHTC") partnerships. As of December 31, 2019 and 2018, the Company had \$11.5 million and \$8.3 million, respectively, in unfunded commitments related to the LIHTC partnerships, which is recorded in other liabilities in the Company's consolidated balance sheets. The expected payments for the unfunded commitments as of December 31, 2019 are as follows (dollars in thousands):

Year Ending December 31:	
2020 .....	\$ 6,873
2021 .....	1,494
2022 .....	3,010
2023 .....	10
2024 .....	26
Thereafter .....	49
Total commitments .....	<u>\$ 11,462</u>

Prior to 2018, the Company's investments in LIHTC partnerships were accounted for using the cost method. In 2018, the Company voluntarily changed its accounting policy for LIHTC partnerships from the cost method to the proportional amortization method using the practical expedient available under ASC 323, "Investments - Equity Method and Joint Ventures", which permits an investor to amortize the initial cost of the investment in proportion to only the tax credits allocated to the investor. The Company believes the proportional amortization method is preferable because it better reflects the economics of an investment that is made for the primary purpose of receiving tax credits and other tax benefits. In addition to a change in the timing of the recognition of amortization expense on LIHTC investments, amortization expense on LIHTC investments is now reflected in the income tax expense line, which provides users a better understanding of the nature of the returns of such investments, instead of in other operating expenses on the consolidated statements of income.

The following table presents amortization expense and tax credits recognized associated with our investments in LIHTC partnerships for the periods presented:

	Year Ended December 31,		
	2019	2018	2017
	(Dollars in thousands)		
Proportional amortization method:			
Amortization expense recognized in income tax expense.....	\$ 681	\$ 1,005	\$ 744
Federal and state tax credits recognized in income tax expense .....	803	759	919

## 8. CORE DEPOSIT PREMIUM AND MORTGAGE SERVICING RIGHTS

The following table presents changes in our core deposit premium and mortgage servicing rights for the periods presented:

	Core Deposit Premium	Mortgage Servicing Rights	Total
	(Dollars in thousands)		
<b>Balance as of December 31, 2016</b> .....	\$ 4,680	\$ 15,779	\$ 20,459
Additions .....	—	2,352	2,352
Amortization .....	(2,674)	(2,288)	(4,962)
<b>Balance as of December 31, 2017</b> .....	\$ 2,006	\$ 15,843	\$ 17,849
Additions .....	—	1,612	1,612
Amortization .....	(2,006)	(1,859)	(3,865)
<b>Balance as of December 31, 2018</b> .....	\$ —	\$ 15,596	\$ 15,596
Additions .....	—	1,582	1,582
Amortization .....	—	(2,460)	(2,460)
<b>Balance as of December 31, 2019</b> .....	\$ —	\$ 14,718	\$ 14,718

The gross carrying value, accumulated amortization, and net carrying value related to our core deposit premium and mortgage servicing rights as of December 31, 2019 and 2018 are presented below:

	December 31, 2019			December 31, 2018		
	Gross Carrying Value	Accumulated Amortization	Net Carrying Value	Gross Carrying Value	Accumulated Amortization	Net Carrying Value
	(Dollars in thousands)					
Core deposit premium .....	\$ 44,642	\$ (44,642)	\$ —	\$ 44,642	\$ (44,642)	\$ —
Mortgage servicing rights .....	67,595	(52,877)	14,718	66,013	(50,417)	15,596
Total .....	\$ 112,237	\$ (97,519)	\$ 14,718	\$ 110,655	\$ (95,059)	\$ 15,596

Our core deposit premium was fully amortized as of December 31, 2018. Based on our mortgage servicing rights held as of December 31, 2019, estimated amortization expense for the next five succeeding fiscal years and all years thereafter are as follows (dollars in thousands):

**Year Ending December 31:**

2020.....	\$	2,407
2021.....		1,964
2022.....		1,635
2023.....		1,382
2024.....		1,154
Thereafter.....		6,176
Total.....	\$	<u>14,718</u>

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 a component of mortgage banking income and totaled \$1.6 million, \$1.6 million, and \$2.4 million in 2019, 2018 and 2017, respectively. Amortization of the servicing rights is reported as a component of mortgage banking income 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 and pool our mortgage servicing rights into buckets of homogeneous characteristics.

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, servicing costs and ancillary income. Many of these assumptions are subjective and require a high level of management judgment. Our mortgage servicing rights portfolio and valuation assumptions are periodically reviewed by management.

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

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

	<b>Year Ended December 31,</b>	
	<b>2019</b>	<b>2018</b>
	<b>(Dollars in thousands)</b>	
Fair market value, beginning of period.....	\$ 17,696	\$ 17,161
Fair market value, end of period.....	15,820	17,696
Weighted average discount rate.....	9.5%	9.5%
Weighted average prepayment speed assumption.....	14.2%	14.5%

Loans serviced for others as of December 31, 2019 and 2018 totaled \$1.89 billion and \$2.01 billion, respectively. Loans serviced for others are not reported as assets on the Company's consolidated balance sheets.

## 9. DERIVATIVES

We utilize various designated and undesignated derivative financial instruments to reduce our exposure to movements in interest rates including interest rate swaps, interest rate lock commitments and forward sale commitments. We measure all derivatives at fair value on our consolidated balance sheet. At each reporting period, we record the derivative instruments in other assets or other liabilities depending on whether the derivatives are in an asset or liability position. For derivative instruments that are designated as hedging instruments, we record the effective portion of the changes in the fair value of the derivative in AOCI, net of tax, until earnings are affected by the variability of cash flows of the hedged transaction. We immediately recognize the portion of the gain or loss in the fair value of the derivative that represents hedge ineffectiveness in current period earnings. For derivative instruments that are not designated as hedging instruments, changes in the fair value of the derivative are included in current period earnings. We had no derivative instruments designated as hedging instruments as of December 31, 2019 and December 31, 2018.

### Interest Rate Lock and Forward Sale Commitments

We enter into interest rate lock commitments on certain mortgage loans that are intended to be sold. To manage interest rate risk on interest rate lock commitments, we also enter into forward loan sale commitments. The interest rate lock and forward loan sale commitments are accounted for as undesignated derivatives and are recorded at their respective fair values in other assets or other liabilities, with changes in fair value recorded in current period earnings. These instruments serve to reduce our exposure to movements in interest rates. At December 31, 2019, we were a party to interest rate lock and forward sale commitments on \$0.6 million and \$9.0 million of mortgage loans, respectively. At December 31, 2018, we were a party to interest rate lock and forward sale commitments on \$2.2 million and \$8.5 million of mortgage loans, respectively.

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

Derivatives not designated as hedging instruments	Balance Sheet Location	Asset Derivatives		Liability Derivatives	
		Fair Value at	Fair Value at	Fair Value at	Fair Value at
		December 31, 2019	December 31, 2018	December 31, 2019	December 31, 2018
(Dollars in thousands)					
Interest rate lock and forward sale commitments.....	Other assets / other liabilities	\$ 8	\$ 11	\$ 28	\$ 95

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

Derivatives not in Cash Flow Hedging Relationship	Location of Gain (Loss) Recognized in Earnings on Derivatives	Amount of Gain (Loss) Recognized in Earnings on Derivatives
(Dollars in thousands)		
<b>Year ended December 31, 2019</b>		
Interest rate lock and forward sale commitments .....	Mortgage banking income	\$ 63
<b>Year ended December 31, 2018</b>		
Interest rate lock and forward sale commitments .....	Mortgage banking income	(70)
<b>Year ended December 31, 2017</b>		
Interest rate lock and forward sale commitments .....	Mortgage banking income	(156)

## 10. DEPOSITS

The Company had \$1.03 billion and \$1.11 billion of total time deposits as of December 31, 2019 and 2018, respectively. Contractual maturities of total time deposits as of December 31, 2019 were as follows (dollars in thousands):

### Year Ending December 31:

2020 .....	\$	946,738
2021 .....		35,469
2022 .....		21,690
2023 .....		9,956
2024 .....		12,239
Thereafter .....		361
Total .....	\$	<u>1,026,453</u>

Time deposits that meet or exceed the FDIC insurance limit of \$250,000 totaled \$766.4 million and \$832.3 million at December 31, 2019 and 2018, respectively.

Contractual maturities of time deposits of \$250,000 or more as of December 31, 2019 were as follows:

### (Dollars in thousands)

Three months or less .....	\$	336,195
Over three months through six months .....		232,713
Over six months through twelve months .....		177,173
2021 .....		13,415
2022 .....		3,713
2023 .....		2,033
2024 .....		1,156
Thereafter .....		—
Total .....	\$	<u>766,398</u>

At December 31, 2019 and 2018, overdrawn deposit accounts totaling \$0.9 million and \$0.9 million have been reclassified as loans on the consolidated balance sheets.

## 11. SHORT-TERM BORROWINGS

The bank is a member of the FHLB and maintained a \$1.84 billion line of credit, of which \$1.57 billion remained available as of December 31, 2019. At December 31, 2019, short-term borrowings under this arrangement totaled \$150.0 million. At December 31, 2018, short-term borrowings under this arrangement totaled \$197.0 million.

The FHLB provides standby letters of credit on behalf of the bank to secure certain public deposits. If the FHLB is required to make a payment on a standby letter of credit, the payment amount is converted to an advance at the FHLB. The standby letters of credit issued on our behalf by the FHLB totaled \$78.9 million and \$4.6 million at December 31, 2019 and 2018, respectively.

At December 31, 2019 and 2018, our bank had additional unused borrowings available at the Federal Reserve discount window of \$65.3 million and \$73.9 million, respectively. As of December 31, 2019 and 2018, certain commercial real estate and commercial loans with a carrying value totaling \$126.1 million and \$123.3 million, respectively, were pledged as collateral on our line of credit with the Federal Reserve discount window. The Federal Reserve does not have the right to sell or repledge these loans.

Interest expense on short-term borrowings totaled \$4.3 million, \$1.2 million and \$0.2 million in 2019, 2018 and 2017, respectively.



A summary of our short-term borrowings as of December 31, 2019, 2018 and 2017 is as follows:

	<b>Year Ended December 31,</b>		
	<b>2019</b>	<b>2018</b>	<b>2017</b>
	<b>(Dollars in thousands)</b>		
Amount outstanding at December 31 .....	\$ 150,000	\$ 197,000	\$ 32,000
Average amount outstanding during year .....	185,909	50,630	15,531
Highest month-end balance during year .....	334,500	197,000	69,000
Weighted average interest rate on balances outstanding at December 31 .....	1.81%	2.59%	1.63%
Weighted average interest rate during year .....	2.31%	2.44%	1.18%

## 12. LONG-TERM DEBT

Long-term debt, which is based on original maturity, consisted of FHLB advances and subordinated debentures totaling \$101.5 million and \$122.2 million at December 31, 2019 and 2018, respectively.

	<b>December 31,</b>	
	<b>2019</b>	<b>2018</b>
	<b>(Dollars in thousands)</b>	
FHLB advances .....	\$ 50,000	\$ 50,000
Subordinated debentures .....	51,547	72,166
Total .....	<u>\$ 101,547</u>	<u>\$ 122,166</u>

At December 31, 2019, future principal payments on long-term debt based on redemption date or final maturity are as follows (dollars in thousands):

<b>Year Ending December 31:</b>	
2020 .....	\$ 25,000
2021 .....	25,000
2022 .....	—
2023 .....	—
2024 .....	—
Thereafter .....	51,547
Total .....	<u>\$ 101,547</u>

### FHLB Advances

FHLB long-term advances outstanding totaled \$50.0 million as of December 31, 2019 and \$50.0 million as of December 31, 2018. At December 31, 2019, our bank had FHLB advances available of approximately \$1.57 billion, which was secured by certain real estate loans with a carrying value of \$2.48 billion in accordance with the collateral provisions of the Advances, Pledge and Security Agreement with the FHLB. Interest expense on FHLB long-term advances was \$1.6 million and \$0.2 million in 2019 and 2018, respectively. There was no interest expense on long-term FHLB advances in 2017.

### Subordinated Debentures

As of December 31, 2019 and December 31, 2018, the Company had the following junior subordinated debentures outstanding:

(dollars in thousands)

December 31, 2019

Name of Trust	Amount of Subordinated Debentures	Interest Rate
Trust IV .....	\$ 30,928	Three month LIBOR + 2.45%
Trust V .....	20,619	Three month LIBOR + 1.87%
Total .....	<u>\$ 51,547</u>	

December 31, 2018

Name of Trust	Amount of Subordinated Debentures	Interest Rate
Trust II .....	\$ 20,619	Three month LIBOR + 2.85%
Trust IV .....	30,928	Three month LIBOR + 2.45%
Trust V .....	20,619	Three month LIBOR + 1.87%
Total .....	<u>\$ 72,166</u>	

In October 2003, we created two wholly-owned statutory trusts, CPB Capital Trust II, a Delaware statutory trust ("Trust II") and CPB Statutory Trust III, a Delaware statutory trust ("Trust III"). Trust II issued \$20.0 million in floating rate trust preferred securities bearing an interest rate of three-month London Interbank Offered Rate ("LIBOR") plus 2.85% and maturing on October 7, 2033. The principal assets of Trust II are \$20.6 million of the Company's junior subordinated debentures with an identical interest rate and maturity as the Trust II trust preferred securities. Trust II issued \$0.6 million of common securities to the Company.

On November 13, 2018, the Company submitted a notice to the trustee and security holder to redeem, in whole and at par, the \$20.0 million of trust preferred securities issued by Trust II. The trust preferred securities were redeemed, along with the \$0.6 million in common securities issued by Trust II and held by the Company, as a result of the concurrent redemption of 100% of the Company's outstanding floating rate junior subordinated debentures held by Trust II, which underlay the trust preferred securities. The redemption was pursuant to the optional prepayment provisions of the indenture and occurred on January 7, 2019. The redemption price for the floating rate junior subordinated debentures was equal to 100% of the principal amount plus accrued interest, up to, but not including, the redemption date. The proceeds from the redemption of the floating rate junior subordinated debentures was simultaneously applied to redeem all of the outstanding floating rate trust preferred securities at a price of 100% of the aggregate liquidation amount of the securities plus accumulated but unpaid distributions up to but not including the redemption date. The Company received all necessary regulatory approvals for the redemption. The redemption was funded with excess cash currently available to the Company.

On December 17, 2018, the Company completed the redemption of \$20.0 million in floating rate trust preferred securities of Trust III bearing an interest rate of three-month LIBOR plus 2.85% and maturing on December 17, 2033. The redemption price was price was 100% of the aggregate liquidation amount of the securities plus accumulated but unpaid distributions up to but not including the redemption date. The Company also redeemed \$0.6 million of common securities issued by Trust III and held by the Company, as a result of the concurrent redemption of 100% of the principal assets of Trust III, or \$20.6 million of the Company's junior subordinated debentures with an identical interest rate and maturity as the Trust III trust preferred securities. The redemption was pursuant to the optional prepayment provisions of the indenture.

On January 7, 2019, the Company completed the redemption of \$20.0 million in floating rate trust preferred securities of Trust II bearing an interest rate of three-month LIBOR plus 2.85% and maturing on October 7, 2033. The redemption price was price was 100% of the aggregate liquidation amount of the securities plus accumulated but unpaid distributions up to but not including the redemption date. The Company also redeemed \$0.6 million of common securities issued by Trust II and held by the Company, as a result of the concurrent redemption of 100% of the principal assets of Trust II, or \$20.6 million of the Company's junior subordinated debentures with an identical interest rate and maturity as the Trust II trust preferred securities. The redemption was pursuant to the optional prepayment provisions of the indenture. On January 22, 2019, Trust II was canceled with the state of Delaware.

In September 2004, we created a wholly-owned statutory trust, CPB Capital Trust IV ("Trust IV"). Trust IV issued \$30.0 million in floating rate trust preferred securities bearing an interest rate of three-month LIBOR plus 2.45% and maturing on

December 15, 2034. The principal assets of Trust IV are \$30.9 million of the Company's junior subordinated debentures with an identical interest rate and maturity as the Trust IV trust preferred securities. Trust IV issued \$0.9 million of common securities to the Company.

In December 2004, we created a wholly-owned statutory trust, CPB Statutory Trust V ("Trust V"). Trust V issued \$20.0 million in floating rate trust preferred securities bearing an interest rate of three-month LIBOR plus 1.87% and maturing on December 15, 2034. The principal assets of Trust V are \$20.6 million of the Company's junior subordinated debentures with an identical interest rate and maturity as the Trust V trust preferred securities. Trust V issued \$0.6 million of common securities to the Company.

The Company is not considered the primary beneficiary of Trusts II, III, IV and V, therefore the trusts are not considered a variable interest entity and are not consolidated in the Company's financial statements. Rather the subordinated debentures are shown as a liability on the Company's consolidated balance sheets. The Company's investment in the common securities of the trusts are included in investment in unconsolidated subsidiaries in the Company's consolidated balance sheets.

The floating rate trust preferred securities, the junior subordinated debentures that are the assets of Trusts IV and V and the common securities issued by Trusts IV and V are redeemable in whole or in part on any interest payment date on or after December 15, 2009 for Trust IV and V, or at any time in whole but not in part within 90 days following the occurrence of certain events. Our obligations with respect to the issuance of the trust preferred securities constitute a full and unconditional guarantee by the Company of each trust's obligations with respect to its trust preferred securities. Subject to certain exceptions and limitations, we may elect from time to time to defer interest payments on the subordinated debentures, which would result in a deferral of distribution payments on the related trust preferred securities, for up to 20 consecutive quarterly periods without default or penalty.

The subordinated debentures may be included in Tier 1 capital, with certain limitations applicable, under current regulatory guidelines and interpretations.

### **13. EQUITY**

As a Hawaii state-chartered bank, Central Pacific Bank may only pay dividends to the extent it has retained earnings as defined under Hawaii banking law ("Statutory Retained Earnings"), which differs from GAAP retained earnings. As of December 31, 2019, the bank had Statutory Retained Earnings of \$66.6 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.

We repurchase shares of our common stock when we believe such repurchases are in the best interests of the Company. In January 2017, the Board of Directors authorized the repurchase of up to \$30.0 million of the Company's common stock from time to time in the open market or in privately negotiated transactions, pursuant to a newly authorized share repurchase program (the "2017 Repurchase Plan"). The 2017 Repurchase Plan replaced and superseded in its entirety the share repurchase plan previously approved by the Company's Board of Directors. In January 2017, prior to the 2017 Repurchase Plan being approved, 1,750 shares of common stock, at a cost of \$0.1 million, were repurchased under the previous share repurchase plan.

In November 2017, the Board of Directors authorized an increase in the share repurchase program authority by an additional \$50.0 million (known henceforth as the "Repurchase Plan"). In the year ended December 31, 2017, 862,733 shares of common stock, at a cost of \$26.5 million, were repurchased under the Repurchase Plan.

In the year ended December 31, 2018, 1,155,157 shares of common stock, at a cost of \$32.8 million, were repurchased under the Repurchase Plan.

In June 2019, the Company's Board of Directors authorized the repurchase of up to \$30.0 million of its common stock from time to time in the open market or in privately negotiated transactions, pursuant to a newly authorized share repurchase program (the "2019 Repurchase Plan"). The 2019 Repurchase Plan replaced and superseded in its entirety the Repurchase Plan previously approved by the Company's Board of Directors, which had \$6.8 million in remaining repurchase authority.

In the year ended December 31, 2019, a total of 797,003 shares of common stock, at a cost of \$22.8 million, were repurchased under the Company's existing share repurchase plans. A total of 488,700 shares of common stock, at a cost of \$13.9 million, were repurchased under the Repurchase Plan and a total of 308,303 shares of common stock, at a cost of \$8.9 million, were repurchased under the 2019 Repurchase Plan.

A total of \$21.1 million remained available for repurchase under the 2019 Repurchase Plan at December 31, 2019.

## **14. REVENUE FROM CONTRACTS WITH CUSTOMERS**

### **Revenue Recognition**

Accounting Standards Codification ("ASC") 606, "*Revenue from Contracts with Customers*", establishes principles for reporting information about the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts to provide goods or services to its customers. The core principle requires an entity to recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration that it expects to be entitled to receive in exchange for those goods or services. Revenue is recognized as performance obligations are satisfied.

The Company recognizes revenues as they are earned based on contractual terms, as transactions occur, or as services are provided and collectability is reasonably assured. Our principal source of revenue is derived from interest income on financial instruments, such as our loan and investment securities portfolios, as well as revenue related to our mortgage banking activities. These revenue-generating transactions are out of scope of ASC 606, but are subject to other GAAP and discussed elsewhere within our disclosures.

We also generate other revenue in connection with our broad range of banking products and financial services. Descriptions of our other revenue-generating activities that are within the scope of ASC 606, which are presented in our consolidated statements of income as components of other operating income are as follows:

#### *Service charges on deposit accounts*

Revenue from service charges on deposit accounts includes general service fees for monthly account maintenance and activity- or transaction-based fees and consist of transaction-based revenue, time-based revenue (service period), item-based revenue or some other individual attribute-based revenue. Revenue is recognized when our performance obligation is completed which is generally monthly for account maintenance services or when a transaction has been completed (such as stop payment fees). Payment for such performance obligations are generally received at the time the performance obligations are satisfied.

#### *Other Service Charges and Fees*

Revenue from other service charges and fees includes cards and payments income, safe deposit rental income and other service charges, commissions and fees.

Cards and payments income includes interchange fees from debit cards processed through card association networks, merchant services, and other card related services. Interchange rates are generally set by the credit card associations and based on purchase volumes and other factors. Interchange fees are recognized as transactions occur. Interchange expenses related to cards and payments income are presented gross in other operating expense. Merchant services income represents account management fees and transaction fees charged to merchants for the processing of card association network transactions. Merchant services revenue is recognized as transactions occur, or as services are performed.

Other service charges, commissions and fees include automated teller machines ("ATM") surcharge and interchange fees, bill payment fees, cashier's check and money order fees, wire transfer fees, loan brokerage fees, and commissions on sales of insurance, broker-dealer products, letters of credit, and travelers' checks. Revenue from these fees and commissions is recorded in a manner that reflects the timing of when transactions occur, and as services are provided.

Based on the nature of the commission agreement with the broker-dealer and each insurance provider, we may recognize revenue from broker-dealer and insurance commissions over time or at a point-in-time as our performance obligation is satisfied.

### *Income from Fiduciary Activities*

Income from fiduciary activities includes fees from wealth management, trust, custodial and escrow services provided to individual and institutional customers. Revenue is generally recognized monthly based on a minimum annual fee and/or the market value of assets in custody. Additional fees are recognized for transactional activity.

Revenue from trade execution and brokerage services is earned through commissions from trade execution on behalf of clients. Revenue from these transactions is recognized at the trade date. Any ongoing service fees are recognized on a monthly basis as services are performed.

### *Net Gain (Loss) on Sales of Foreclosed Assets*

The Company records a gain or loss on the sale of a foreclosed property when control of the property transfers to the Company, which typically occurs at the time the deed is executed. The Company does not finance the sale of the foreclosed property.

### *Fees on Foreign Exchange*

The Company provides foreign currency exchange services to customers, whereby cash can be converted to different foreign currencies, and vice versa. As a result of the services, a gain or loss is recognized on foreign currency transactions, as well as income related to commissions and fees earned on each transaction.

Revenue from the commissions and fees earned on the transactions fall within the scope of ASC 606, and is recorded in a manner that reflects the timing of when transactions occur, and as services are provided. Realized and unrealized gains or losses related to foreign currency are out of scope of ASC 606.

### *Loan Placement Fees*

Loan placement fees primarily represent revenues earned by the Company for loan placement and underwriting. Revenues for these services are recorded at a point-in-time, upon completion of a contractually identified transaction, or when an advisory opinion is provided.

The following presents the Company's other operating income, segregated by revenue streams that are in-scope and out-of-scope of ASC 606 for the periods presented:

(dollars in thousands)	Year Ended December 31,	
	2019	2018
Other operating income:		
In-scope of ASC 606		
Service charges on deposit accounts.....	\$ 8,406	\$ 8,406
Other service charges and fees.....	12,435	11,078
Income on fiduciary activities .....	4,395	4,245
Net gain (loss) on sales of foreclosed assets.....	(145)	—
Fees on foreign exchange .....	101	110
Loan placement fees .....	702	747
In-scope other operating income .....	25,894	24,586
Out-of-scope other operating income .....	15,907	14,218
Total other operating income .....	<u>\$ 41,801</u>	<u>\$ 38,804</u>

## 15. MORTGAGE BANKING INCOME

Noninterest income from the Company's mortgage banking activities includes the following components for the periods presented:

	Year Ended December 31,		
	2019	2018	2017
	(Dollars in thousands)		
Mortgage banking income:			
Net loan servicing fees .....	\$ 4,252	\$ 5,159	\$ 5,337
Amortization of mortgage servicing rights.....	(2,460)	(1,859)	(2,288)
Net gain on sale of residential mortgage loans.....	4,128	4,085	4,069
Unrealized gain (loss) on interest rate locks.....	63	(70)	(156)
Total mortgage banking income.....	<u>\$ 5,983</u>	<u>\$ 7,315</u>	<u>\$ 6,962</u>

## 16. SHARE-BASED COMPENSATION

In accordance with ASC 718, compensation expense is recognized only for those shares expected to vest, based on the Company's historical experience and future expectations. The following table summarizes the effects of share-based compensation for options and awards granted under the Company's equity incentive plans for each of the periods presented:

	Year Ended December 31,		
	2019	2018	2017
	(Dollars in thousands)		
Salaries and employee benefits .....	\$ 4,289	\$ 3,787	\$ 3,266
Directors stock awards .....	96	255	150
Income tax benefit.....	(1,427)	(1,227)	(1,903)
Net share-based compensation effect.....	<u>\$ 2,958</u>	<u>\$ 2,815</u>	<u>\$ 1,513</u>

Upon exercise or vesting of a share-based award, if the tax deduction exceeds the compensation cost that was previously recorded for financial statement purposes, this will result in an excess tax benefit. Effective January 1, 2017, ASU 2016-09, "Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting" requires the Company to recognize all excess tax benefits or tax deficiencies through the income statement as income tax expense/benefit. Under previous GAAP, any excess tax benefits were recognized in additional-paid-in-capital to offset current-period and subsequent-period tax deficiencies. During 2019, 2018 and 2017, the Company recorded an income tax benefit of \$0.3 million, \$0.1 million and \$0.5 million, respectively, as a result of restricted stock units vesting during the year.

The Company's share-based compensation arrangements are described below:

### Equity Incentive Plans

We have adopted equity incentive plans for the purpose of granting options, restricted stock and other equity based awards for the Company's common stock to directors, officers and other key individuals. Option awards are generally granted with an exercise price equal to the market price of the Company's common stock at the date of grant; those option awards generally vest based on three or five years of continuous service and have 10-year contractual terms. Certain option and share awards provide for accelerated vesting if there is a change in control (as defined in the stock option plans below). We have historically issued new shares of common stock upon exercises of stock options and purchases of restricted awards.

In September 2004, we adopted and our shareholders approved the 2004 Stock Compensation Plan ("2004 Plan") making available 1,500,000 shares for grants to employees and directors. Upon adoption of the 2004 Plan, all unissued shares from the previous 1997 Plan were frozen and no new options were granted under the 1997 Plan. In May 2007, the 2004 Plan was amended to increase the number of shares available for grant by an additional 1,000,000 shares. In April 2011, the 2004 Plan was amended to increase the number of shares authorized from 1,402,589 to 4,944,831.

In April 2013, we adopted and our shareholders approved the 2013 Stock Compensation Plan ("2013 Plan") making available 2,200,000 shares for grants to employees and directors. Upon adoption of the 2013 Plan, all unissued shares from the 2004 Plan were frozen and no new grants will be granted under the 2004 Plan. Shares may continue to be settled under the 2004 Plan pursuant to previously outstanding awards. New shares are issued from the 2013 Plan.

As of December 31, 2019, 2018 and 2017, a total of 1,304,773, 1,468,137 and 1,567,912 shares, respectively, were available for future grants under our 2013 Plan.

## Stock Options

The fair value of each option award is estimated on the date of grant based on the following:

*Valuation and amortization method*—We estimate the fair value of stock options granted using the Black-Scholes option pricing formula and a single option award approach. We use historical data to estimate option exercise and employee termination activity within the valuation model; separate groups of employees that have similar historical exercise behavior are considered separately for valuation purposes. This fair value is then amortized on a straight-line basis over the requisite service periods of the awards, which is generally the vesting period.

*Expected life*—The expected life of options represents the period of time that options granted are expected to be outstanding.

*Expected volatility*—Expected volatilities are based on the historical volatility of the Company's common stock.

*Risk-free interest rate*—The risk-free interest rate for periods within the contractual life of the option is based on the Treasury yield curve in effect at the time of grant.

*Expected dividend*—The expected dividend assumption is based on our current expectations about our anticipated dividend policy.

The following is a summary of option activity for our stock option plans for the year ended December 31, 2019:

	Number of Units	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in thousands)
Stock options outstanding as of January 1, 2019 .....	147,644	\$ 15.77		
Changes during the year:				
Granted .....	—	—		
Exercised.....	(10,553)	14.31		
Expired.....	(3,278)	80.08		
Forfeited.....	—	—		
Stock options outstanding as of December 31, 2019 .....	<u>133,813</u>	14.31	2.3	\$ 2,043
Vested and exercisable as of December 31, 2019 .....	<u>133,813</u>	14.31	3.3	2,043

The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying option awards and the quoted price of the Company's common stock for the options that were in-the-money as of December 31, 2019.

During the years ended December 31, 2019 and 2018, the aggregate intrinsic value of options exercised under our stock option plan determined as of the date of exercise was \$0.2 million and \$0.2 million, respectively. There were no options exercised during the year ended December 31, 2017.

As of December 31, 2019, all compensation costs related to stock options granted to employees under our stock option plans have been recognized.

As of December 31, 2019, all shares have been vested. There were no shares that vested in 2019 and 2018. The total fair value of options vested during the year ended December 31, 2017 was \$0.5 million.

No stock options were granted during the years ended December 31, 2019, 2018 and 2017.

### Restricted Stock Awards and Units

Under the 1997, 2004 and 2013 Plans, we awarded restricted stock awards and units to our non-officer directors and certain senior management personnel. The awards typically vest over a three or five year period from the date of grant and are subject to forfeiture until performance and employment targets are achieved. Compensation expense is measured as the market price of the stock awards on the grant date, and is recognized over the specified vesting periods.

As of December 31, 2019, there was \$6.5 million of total unrecognized compensation cost related to restricted stock awards and units that is expected to be recognized over a weighted-average period of 2.0 years.

The table below presents the activity of restricted stock awards and units for each of the periods presented:

	Number of Units	Weighted Average Grant Date Fair Value	Fair Value of Restricted Stock Awards and Units That Vested During The Year (in thousands)
Unvested as of December 31, 2016 .....	437,697	\$ 22.01	
Changes during the year:			
Granted .....	126,204	31.35	
Forfeited .....	(31,570)	24.89	
Vested .....	(134,780)	19.81	\$ 4,224
Unvested as of December 31, 2017 .....	397,551	25.49	
Changes during the year:			
Granted .....	118,846	29.47	
Forfeited .....	(25,481)	27.39	
Vested .....	(128,191)	24.59	3,763
Unvested as of December 31, 2018 .....	362,725	26.98	
Changes during the year:			
Granted .....	181,431	28.89	
Forfeited .....	(17,689)	29.10	
Vested .....	(160,000)	24.55	3,927
Unvested as of December 31, 2019 .....	366,467	28.89	

## 17. PENSION PLANS

### Defined Benefit Retirement Plan

The bank has a defined benefit retirement plan that covered substantially all of its employees who were employed during the period that the plan was in effect. The plan was initially curtailed in 1986, and accordingly, plan benefits were fixed as of that date. Effective January 1, 1991, the bank reactivated its defined benefit retirement plan. As a result of the reactivation, employees for whom benefits were fixed in 1986 began to accrue additional benefits under a new formula that became effective January 1, 1991. Employees who were not participants at curtailment, but who were subsequently eligible to join, became participants effective January 1, 1991. Under the reactivated plan, benefits are based upon the employees' years of service and their highest average annual salaries in a 60-consecutive-month period of service, reduced by benefits provided from the bank's terminated money purchase pension plan. The reactivation of the defined benefit retirement plan resulted in an increase of \$5.9 million in the unrecognized prior service cost, which was amortized over a period of 13 years. Effective December 31, 2002, the bank curtailed its defined benefit retirement plan, and accordingly, plan benefits were fixed as of that date.



The following tables set forth information pertaining to the defined benefit retirement plan:

	<b>Year Ended December 31,</b>	
	<b>2019</b>	<b>2018</b>
<b>(Dollars in thousands)</b>		
<b>Change in benefit obligation:</b>		
Benefit obligation at beginning of year .....	\$ 20,746	\$ 23,471
Interest cost .....	828	796
Actuarial (gains) losses .....	1,677	(1,714)
Benefits paid .....	(1,648)	(1,807)
Benefit obligation at end of the year .....	<u>21,603</u>	<u>20,746</u>
<b>Change in plan assets, at fair value:</b>		
Fair value of plan assets at beginning of year .....	19,874	22,832
Actual return on plan assets .....	3,083	(1,151)
Benefits paid .....	(1,648)	(1,807)
Fair value of plan assets at end of year .....	<u>21,309</u>	<u>19,874</u>
Funded status at end of year .....	<u>\$ (294)</u>	<u>\$ (872)</u>
<b>Amounts recognized in AOCI:</b>		
Net actuarial losses .....	<u>\$ (6,625)</u>	<u>\$ (8,137)</u>
<b>Benefit obligation actuarial assumptions:</b>		
Weighted average discount rate .....	3.1%	4.2%

	<b>Year Ended December 31,</b>		
	<b>2019</b>	<b>2018</b>	<b>2017</b>
<b>(Dollars in thousands)</b>			
<b>Components of net periodic benefit cost:</b>			
Interest cost .....	\$ 828	\$ 796	\$ 926
Expected return on plan assets .....	(996)	(1,206)	(1,036)
Amortization of net actuarial losses .....	1,101	979	1,191
Net periodic benefit cost .....	<u>\$ 933</u>	<u>\$ 569</u>	<u>\$ 1,081</u>
<b>Net periodic cost actuarial assumptions:</b>			
Weighted average discount rate .....	4.2%	3.6%	4.1%
Expected long-term rate of return on plan assets .....	5.3%	5.5%	5.5%

The unrecognized net actuarial losses included in AOCI expected to be recognized in net periodic benefit cost during 2020 is approximately \$0.8 million.

The long-term rate of return on plan assets reflects the weighted-average long-term rates of return for the various categories of investments held in the plan. The expected long-term rate of return is adjusted when there are fundamental changes in expected returns on the plan investments.

The defined benefit retirement plan assets consist primarily of equity and debt securities. Our asset allocations by asset category were as follows:

	December 31,	
	2019	2018
Equity securities .....	39.1%	48.4%
Debt securities .....	57.5	46.9
Other .....	3.4	4.7
Total .....	100.0%	100.0%

Equity securities included the Company's common stock in the amount of \$0.1 million at December 31, 2019 and 2018.

Our investment strategy for the defined benefit retirement plan is to maximize the long-term rate of return on plan assets while maintaining an acceptable level of risk. The investment policy establishes a target allocation for each asset class that is reviewed periodically and rebalanced when considered appropriate.

The fair values of the defined benefit retirement plan as of December 31, 2019 and 2018 by asset category were as follows:

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
	(Dollars in thousands)			
<b>December 31, 2019</b>				
Money market accounts .....	\$ 727	\$ —	\$ —	\$ 727
Mutual funds .....	13,434	—	—	13,434
Government obligations .....	—	2,587	—	2,587
Common stocks .....	2,475	—	—	2,475
Preferred stocks .....	173	—	—	173
Corporate bonds and debentures .....	—	1,913	—	1,913
Total .....	\$ 16,809	\$ 4,500	\$ —	\$ 21,309

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
	(Dollars in thousands)			
<b>December 31, 2018</b>				
Money market accounts .....	\$ 931	\$ —	\$ —	\$ 931
Mutual funds .....	10,537	—	—	10,537
Government obligations .....	—	2,192	—	2,192
Common stocks .....	4,122	—	—	4,122
Preferred stocks .....	146	—	—	146
Corporate bonds and debentures .....	—	1,946	—	1,946
Total .....	\$ 15,736	\$ 4,138	\$ —	\$ 19,874

We are not required by funding regulations or laws to make any contributions to our defined benefit retirement plan in 2020.

Estimated future benefit payments in each of the next five years and in the aggregate for the five years thereafter are as follows (dollars in thousands):

**Year Ending December 31:**

2020.....	\$	1,769
2021.....		1,718
2022.....		1,652
2023.....		1,606
2024.....		1,541
2025-2029.....		6,617
Total.....	\$	<u>14,903</u>

**Supplemental Executive Retirement Plans**

In 1995, 2001, 2004 and 2006, our bank established Supplemental Executive Retirement Plans ("SERP") that provide certain officers of the Company with supplemental retirement benefits. On December 31, 2002, the 1995 and 2001 SERP were curtailed. In conjunction with the merger with CB Bancshares, Inc. ("CBBI"), we assumed CBBI's SERP obligation.

The following tables set forth information pertaining to the SERP:

	<u>Year Ended December 31,</u>	
	<u>2019</u>	<u>2018</u>
	(Dollars in thousands)	
<b>Change in benefit obligation</b>		
Benefit obligation at beginning of year.....	\$ 10,355	\$ 11,219
Interest cost.....	430	389
Actuarial (gains) losses.....	1,517	(907)
Benefits paid.....	(331)	(346)
Benefit obligation at end of year.....	<u>11,971</u>	<u>10,355</u>
<b>Change in plan assets</b>		
Fair value of plan assets at beginning of year.....	—	—
Employer contributions.....	331	346
Benefits paid.....	(331)	(346)
Fair value of plan assets at end of year.....	<u>—</u>	<u>—</u>
Funded status at end of year.....	<u>\$ (11,971)</u>	<u>\$ (10,355)</u>
<b>Amounts recognized in AOCI</b>		
Net transition obligation.....	\$ (64)	\$ (82)
Prior service cost.....	(14)	(31)
Net actuarial losses.....	(2,583)	(1,082)
Total amounts recognized in AOCI.....	<u>\$ (2,661)</u>	<u>\$ (1,195)</u>
<b>Benefit obligation actuarial assumptions</b>		
Weighted average discount rate.....	3.0%	4.2%

**Year Ended December 31,**

	<b>2019</b>	<b>2018</b>	<b>2017</b>
<b>(Dollars in thousands)</b>			
<b>Components of net periodic benefit cost</b>			
Interest cost .....	\$ 430	\$ 389	\$ 429
Amortization of net actuarial (gains) losses .....	16	174	102
Amortization of net transition obligation .....	18	18	18
Amortization of prior service cost .....	18	18	18
Settlement .....	—	—	138
Net periodic benefit cost .....	<u>\$ 482</u>	<u>\$ 599</u>	<u>\$ 705</u>

**Net periodic cost actuarial assumptions**

Weighted average discount rate .....	4.2%	3.5%	4.1%
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The estimated amortization of components included in AOCI that will be recognized into net periodic benefit cost for 2020 is as follows (dollars in thousands):

Amortization of net actuarial losses .....	\$ 16
Amortization of net transition obligation .....	18
Amortization of prior service cost .....	18

The SERP holds no plan assets other than employer contributions that are paid as benefits during the year. We expect to contribute \$0.3 million to the SERP in 2020.

Estimated future benefit payments reflecting expected future service for the SERP in each of the next five years and in the aggregate for the five years thereafter are as follows (dollars in thousands):

**Year Ending December 31:**

2020 .....	\$ 329
2021 .....	320
2022 .....	490
2023 .....	661
2024 .....	653
2025-2029 .....	4,051
Total .....	<u>\$ 6,504</u>

**18. 401(K) RETIREMENT SAVINGS PLAN**

We maintain a 401(k) Retirement Savings Plan ("Retirement Savings Plan") that covers substantially all employees of the Company. The Retirement Savings Plan allows employees to direct their own investments among a selection of investment alternatives and is funded by employee elective deferrals, employer matching contributions and employer profit sharing contributions.

We match 100% of an employee's elective deferrals, up to 4% of the employee's pay each pay period. Our employer matching contributions to the Retirement Savings Plan totaled \$2.3 million, \$2.1 million and \$2.1 million in 2019, 2018 and 2017, respectively.

We also have the option of making discretionary profit sharing contributions into the Retirement Savings Plan. Our Board of Directors has sole discretion in determining the annual profit sharing contribution, subject to limitations of the Internal Revenue Code. We did not make any profit sharing contributions in 2019, 2018 and 2017.

## 19. OPERATING LEASES

As discussed in Note 1 - Summary of Significant Accounting Policies, we adopted ASU 2016-02 effective January 1, 2019 using the modified retrospective approach and recorded a right-of-use ("ROU") lease asset and corresponding lease liability on the Company's consolidated balance sheet of \$55.9 million for operating leases where we are a lessee. We lease certain property and equipment with lease terms expiring through 2045. In some instances, a lease may contain renewal options for periods ranging from five to 15 years. All renewal options are likely to be exercised and therefore have been recognized as part of our right-of-use assets and lease liabilities in accordance with ASC 842, "Leases". Certain leases also contain variable payments that are primarily determined based on common area maintenance costs and Hawaii state tax rates. All leases are operating leases and we do not include any short-term leases in the calculation of the right-of-use assets and lease liabilities. The most significant assumption related to the Company's application of ASC 842 was the discount rate assumption. As most of the Company's lease agreements do not provide for an implicit interest rate, the Company uses the collateralized interest rate that the Company would have to pay to borrow over a similar term to estimate the Company's lease liability.

Total lease cost, cash flow information, weighted-average remaining lease term and weighted-average discount rate is summarized below for the period indicated:

(dollars in thousands)	<b>Year Ended December 31,</b>	
	<b>2019</b>	
Lease cost:		
Operating lease cost.....	\$	6,514
Variable lease cost .....		2,637
Less: sublease income .....		(44)
Total lease cost .....	\$	<u>9,107</u>
Other information:		
Operating cash flows from operating leases.....	\$	(6,230)
Weighted-average remaining lease term - operating leases.....		13.51 years
Weighted-average discount rate - operating leases.....		3.92%

The following is a schedule of annual undiscounted cash flows for our operating leases and a reconciliation of those cash flows to the operating lease liabilities for the next five succeeding fiscal years and all years thereafter (dollars in thousands):

<b>Year Ending December 31,</b>	<b>Undiscounted Cash Flows</b>		<b>Lease Liability Expense</b>		<b>Lease Liability Reduction</b>	
2020 .....	\$	6,216	\$	1,965	\$	4,251
2021 .....		5,907		1,808		4,099
2022 .....		5,472		1,659		3,813
2023 .....		5,175		1,519		3,656
2024 .....		4,947		1,385		3,562
Thereafter .....		40,920		7,669		33,251
Total.....	\$	<u>68,637</u>	\$	<u>16,005</u>	\$	<u>52,632</u>

In addition, the Company, as lessor, leases certain properties that it owns. All of these leases are operating leases. The following represents lease income related to these leases that was recognized for the period indicated:

(dollars in thousands)	<b>Year Ended December 31,</b>	
	<b>2019</b>	
Total rental income recognized .....	\$	2,098

Based on the Company's leases as lessor as of December 31, 2019, estimated lease payments for the next five succeeding fiscal years and all years thereafter are as follows (dollars in thousands):

<b>Year Ending December 31,</b>	
2020 .....	\$ 2,133
2021 .....	2,137
2022 .....	1,614
2023 .....	641
2024 .....	165
Thereafter .....	262
<b>Total .....</b>	<b>\$ 6,952</b>

Net rent expense for all operating leases for the years ended December 31, 2018 and 2017 is summarized as follows:

(dollars in thousands)	<b>Year Ended December 31,</b>	
	<b>2018</b>	<b>2017</b>
Rent expense charged to net occupancy .....	\$ 8,578	\$ 8,318
Less: sublease income .....	(41)	(43)
Net rent expense charged to net occupancy .....	8,537	8,275
Add: rent expense charged to equipment expense .....	12	15
<b>Total net rent expense .....</b>	<b>\$ 8,549</b>	<b>\$ 8,290</b>

## 20. INCOME TAXES

Components of income tax expense (benefit) for the years ended December 31, 2019, 2018 and 2017 were as follows:

	<b>Year Ended December 31,</b>		
	<b>2019</b>	<b>2018</b>	<b>2017</b>
	<b>(Dollars in thousands)</b>		
Current expense:			
Federal .....	\$ 23,359	\$ 10,812	\$ 2,471
State .....	211	72	(81)
Total current .....	23,570	10,884	2,390
Deferred expense:			
Federal .....	(8,970)	2,137	27,263
State .....	5,005	5,737	4,943
Total deferred .....	(3,965)	7,874	32,206
<b>Provision for income taxes .....</b>	<b>\$ 19,605</b>	<b>\$ 18,758</b>	<b>\$ 34,596</b>

On December 22, 2017, H.R. 1, commonly referred to as the Tax Cuts and Jobs Act ("Tax Reform") was signed into law making significant changes to the U.S. federal tax code. The most impactful, as related to the Company, included a decrease in the current U.S. federal corporate tax rate from 35% to 21% for the year beginning January 1, 2018. In the year ended December 31, 2017, the Company recorded additional income tax expense of \$7.4 million related to the estimated impact of Tax Reform on the Company's net deferred tax assets ("DTA"). In 2018, the Company recorded an income tax benefit of \$1.5 million related to the finalization of the impact of Tax Reform, which also included the impact of a tax method change for software development and prepaid expenses that was filed in 2018.

Income tax expense (benefit) for the periods presented differed from the "expected" tax expense (computed by applying the U.S. federal corporate tax rate of 21% for the years ended December 31, 2019 and December 31, 2018 and 35% for the year ended December 31, 2017, to income (loss) before income taxes) for the following reasons:

	<b>Year Ended December 31,</b>		
	<b>2019</b>	<b>2018</b>	<b>2017</b>
	<b>(Dollars in thousands)</b>		
Computed "expected" tax expense (benefit) .....	\$ 16,365	\$ 16,430	\$ 26,270
Increase (decrease) in taxes resulting from:			
Tax-exempt interest income .....	(675)	(808)	(1,387)
Other tax-exempt income .....	(652)	(445)	(1,186)
Low-income housing and energy tax credits .....	(182)	35	(594)
State income taxes, net of Federal income tax effect, excluding impact of deferred tax valuation allowance .....	4,345	4,756	3,348
Change in the beginning-of-the-year balance of the valuation allowance for deferred tax assets allocated to income tax expense .....	(41)	140	570
Impact of Tax Reform on net deferred tax assets .....	—	(1,542)	7,440
Other, net .....	445	192	135
<b>Total .....</b>	<b>\$ 19,605</b>	<b>\$ 18,758</b>	<b>\$ 34,596</b>

See Note 1 - Summary of Significant Accounting Policies for discussion of the accounting policy change in 2018 from the cost method to the proportional amortization method for our LIHTC investments, the effects of which are now reported on the income tax expense line in the consolidated statements of income and are included in the low-income housing and energy tax credits line above.

The tax effects of temporary differences that gave rise to significant portions of the deferred tax assets and deferred tax liabilities were as follows:

	December 31,	
	2019	2018
	(Dollars in thousands)	
<b>Deferred tax assets</b>		
Lease liability.....	\$ 14,095	\$ —
Allowance for loan and lease losses .....	10,136	10,112
Accrued expenses .....	1,795	1,517
Employee retirement benefits .....	2,847	2,595
Federal and state tax credit carryforwards.....	1,821	7,728
State net operating loss carryforwards.....	3,181	3,291
Restricted stock and non-qualified stock options .....	954	1,001
Premises and equipment .....	3,365	3,157
Other .....	2,488	3,485
Total deferred tax assets.....	<u>40,682</u>	<u>32,886</u>
<b>Deferred tax liabilities</b>		
Right-of-use lease asset .....	14,019	—
Intangible assets.....	3,941	4,189
Other .....	2,761	3,698
Total deferred tax liabilities.....	<u>20,721</u>	<u>7,887</u>
<b>Less: Deferred tax valuation allowance.....</b>	<u>3,420</u>	<u>3,461</u>
Net deferred tax assets .....	<u>\$ 16,541</u>	<u>\$ 21,538</u>

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

As of December 31, 2019, the valuation allowance on our net DTA totaled \$3.4 million, of which \$3.2 million related to our DTA from net apportioned net operating loss ("NOL") carryforwards for California state income tax purposes as we do not expect to generate sufficient income in California to utilize the DTA. The remaining \$0.2 million relates to a valuation allowance on a Hawaii capital loss carry forward balance of \$6.2 million that we do not expect to be able to utilize. The net change in the valuation allowance was a decrease of \$41 thousand in 2019, compared to an increase of \$0.1 million in 2018.

Net of this valuation allowance, the Company's net DTA totaled \$16.5 million as of December 31, 2019, compared to a net DTA of \$21.5 million as of December 31, 2018.

At December 31, 2019, the Company had NOL carryforwards for California state income tax purposes of \$37.1 million, which are available to offset future state taxable income. California NOL carryforwards will expire if not utilized beginning in 2028. The Company does not have any NOL carryforwards for U.S. federal or Hawaii state income tax purposes. In addition, we have gross Hawaii state tax credit carryforwards of \$2.5 million that do not expire. In 2018, we utilized the remainder of our federal tax credit carryforwards.

At December 31, 2019, we have no material unrecognized tax benefits that, if recognized would favorably affect the effective income tax rate in future periods. We do not expect our unrecognized tax benefits to change significantly over the next 12 months.



We are subject to U.S. federal income tax as well as income tax of multiple state jurisdictions. Taxable years through 2015 are closed.

## 21. ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The following table presents the components of other comprehensive income (loss) for the years ended December 31, 2019, 2018 and 2017, by component:

	<u>Before Tax</u>	<u>Tax Effect</u>	<u>Net of Tax</u>
	<u>(Dollars in thousands)</u>		
<b>Year ended December 31, 2019</b>			
Net unrealized gains on investment securities:			
Net unrealized gains arising during the period .....	\$ 37,696	\$ 10,102	\$ 27,594
Less: Reclassification adjustment for losses realized in net income .....	(36)	(10)	(26)
Net unrealized gains on investment securities .....	<u>37,660</u>	<u>10,092</u>	<u>27,568</u>
Defined benefit plans:			
Net actuarial losses arising during the period .....	(1,106)	(296)	(810)
Amortization of net actuarial losses .....	1,117	299	818
Amortization of net transition obligation .....	18	5	13
Amortization of prior service cost .....	18	5	13
Defined benefit plans, net .....	<u>47</u>	<u>13</u>	<u>34</u>
Other comprehensive income .....	<u>\$ 37,707</u>	<u>\$ 10,105</u>	<u>\$ 27,602</u>
	<u>Before Tax</u>	<u>Tax Effect</u>	<u>Net of Tax</u>
	<u>(Dollars in thousands)</u>		
<b>Year ended December 31, 2018</b>			
Net unrealized losses on investment securities:			
Net unrealized losses arising during the period .....	\$ (19,063)	\$ (5,145)	\$ (13,918)
Less: Reclassification adjustment for losses realized in net income .....	(279)	(75)	(204)
Net unrealized losses on investment securities .....	<u>(19,342)</u>	<u>(5,220)</u>	<u>(14,122)</u>
Defined benefit plans:			
Net actuarial gains arising during the period .....	264	71	193
Amortization of net actuarial losses .....	1,153	329	824
Amortization of net transition obligation .....	18	5	13
Amortization of prior service cost .....	18	5	13
Defined benefit plans, net .....	<u>1,453</u>	<u>410</u>	<u>1,043</u>
Other comprehensive loss .....	<u>\$ (17,889)</u>	<u>\$ (4,810)</u>	<u>\$ (13,079)</u>

	Before Tax	Tax Effect	Net of Tax
	(Dollars in thousands)		
<b>Year ended December 31, 2017</b>			
Net unrealized gains on investment securities:			
Net unrealized losses arising during the period .....	\$ (838)	\$ (333)	\$ (505)
Less: Reclassification adjustment for gains realized in net income .....	1,410	561	849
Net unrealized gains on investment securities .....	<u>572</u>	<u>228</u>	<u>344</u>
Defined benefit plans:			
Net actuarial losses arising during the period .....	(1,318)	(518)	(800)
Amortization of net actuarial losses .....	1,293	460	833
Amortization of net transition obligation .....	18	7	11
Amortization of prior service cost .....	18	7	11
Settlement .....	138	55	83
Defined benefit plans, net .....	<u>149</u>	<u>11</u>	<u>138</u>
Other comprehensive income .....	<u>\$ 721</u>	<u>\$ 239</u>	<u>\$ 482</u>

The following table presents the changes in each component of AOCI, net of tax, for the years ended December 31, 2019, 2018 and 2017:

	Investment Securities	Defined Benefit Plans	Accumulated Other Comprehensive Income (Loss)
	(Dollars in thousands)		
<b>Year ended December 31, 2019</b>			
Balance at beginning of period .....	\$ (9,643)	\$ (6,450)	\$ (16,093)
Impact of adoption of new accounting standards .....	(3,100)	—	(3,100)
Adjusted balance at beginning of period .....	<u>(12,743)</u>	<u>(6,450)</u>	<u>(19,193)</u>
Other comprehensive income (loss) before reclassifications .....	27,594	(810)	26,784
Amounts reclassified from AOCI .....	(26)	844	818
Net other comprehensive income (loss) .....	<u>27,568</u>	<u>34</u>	<u>27,602</u>
Balance at end of period .....	<u>\$ 14,825</u>	<u>\$ (6,416)</u>	<u>\$ 8,409</u>

	<b>Investment Securities</b>	<b>Defined Benefit Plans</b>	<b>Accumulated Other Comprehensive Income (Loss)</b>
	<b>(Dollars in thousands)</b>		
<b>Year ended December 31, 2018</b>			
Balance at beginning of period.....	\$ 5,073	\$ (6,112)	\$ (1,039)
Impact of adoption of new accounting standards	(139)	—	(139)
Adjusted balance at beginning of period	<u>4,934</u>	<u>(6,112)</u>	<u>(1,178)</u>
Impact of adoption of new accounting standards	(455)	(1,381)	(1,836)
Other comprehensive income (loss) before reclassifications.....	(13,918)	193	(13,725)
Amounts reclassified from AOCI .....	(204)	850	646
Net other comprehensive income (loss).....	<u>(14,122)</u>	<u>1,043</u>	<u>(13,079)</u>
Balance at end of period .....	<u>\$ (9,643)</u>	<u>\$ (6,450)</u>	<u>\$ (16,093)</u>

	<b>Investment Securities</b>	<b>Defined Benefit Plans</b>	<b>Accumulated Other Comprehensive Income (Loss)</b>
	<b>(Dollars in thousands)</b>		
<b>Year ended December 31, 2017</b>			
Balance at beginning of period.....	\$ 4,729	\$ (6,250)	\$ (1,521)
Other comprehensive income (loss) before reclassifications.....	(505)	(800)	(1,305)
Amounts reclassified from AOCI .....	849	938	1,787
Total other comprehensive income (loss) .....	<u>344</u>	<u>138</u>	<u>482</u>
Balance at end of period .....	<u>\$ 5,073</u>	<u>\$ (6,112)</u>	<u>\$ (1,039)</u>

The following table presents the amounts reclassified out of each component of AOCI for the years ended December 31, 2019, 2018 and 2017:

Details about AOCI Components	Amount Reclassified from AOCI			Affected Line Item in the Statement Where Net Income is Presented
	Year ended December 31,			
	2019	2018	2017	
(Dollars in thousands)				
Sale of available-for-sale investment securities:				
Realized gains (losses) on available-for-sale investment securities .....	\$ 36	\$ 279	\$ (1,410)	Net gains (losses) on sales of investment securities
Tax effect .....	(10)	(75)	561	Income tax benefit (expense)
Net of tax .....	<u>\$ 26</u>	<u>\$ 204</u>	<u>\$ (849)</u>	
Defined benefit plan items:				
Amortization of net actuarial losses .....	\$ (1,117)	\$ (1,153)	\$ (1,293)	Salaries and employee benefits (1)
Amortization of net transition obligation .....	(18)	(18)	(18)	Salaries and employee benefits (1)
Amortization of prior service cost .....	(18)	(18)	(18)	Salaries and employee benefits (1)
Settlement .....	—	—	(138)	Salaries and employee benefits (1)
Total before tax .....	<u>(1,153)</u>	<u>(1,189)</u>	<u>(1,467)</u>	
Tax effect .....	309	339	529	Income tax expense
Net of tax .....	<u>\$ (844)</u>	<u>\$ (850)</u>	<u>\$ (938)</u>	
Total reclassifications, net of tax .....	<u><u>\$ (818)</u></u>	<u><u>\$ (646)</u></u>	<u><u>\$ (1,787)</u></u>	

(1) These accumulated other comprehensive income components are included in the computation of net periodic pension cost (see Note 17 - Pension Plans for additional details).

## 22. EARNINGS PER SHARE

The table below presents the information used to compute basic and diluted earnings per share for the years ended December 31, 2019, 2018 and 2017:

	Year Ended December 31,		
	2019	2018	2017
	(In thousands, except per share data)		
Net income .....	<u>\$ 58,322</u>	<u>\$ 59,486</u>	<u>\$ 41,204</u>
Weighted average shares outstanding for basic earnings per share.....	28,495,699	29,409,683	30,400,511
Add: Dilutive effect of employee stock options and awards .....	181,401	200,224	237,629
Weighted average shares outstanding for diluted earnings per share.....	<u>28,677,100</u>	<u>29,609,907</u>	<u>30,638,140</u>
Basic earnings per share .....	<u>\$ 2.05</u>	<u>\$ 2.02</u>	<u>\$ 1.36</u>
Diluted earnings per share .....	<u>\$ 2.03</u>	<u>\$ 2.01</u>	<u>\$ 1.34</u>

There were no potentially dilutive securities that have been excluded from the dilutive share calculation for the years ended December 31, 2019, 2018, and 2017.

## **23. CONTINGENT LIABILITIES AND OTHER COMMITMENTS**

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

In the normal course of business there are outstanding contingent liabilities and other commitments such as unused letters of credit and items held for collections, which are not reflected in the accompanying consolidated financial statements. Management does not anticipate any material losses as a result of these transactions.

## **24. FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK**

We are a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of our customers. These financial instruments include commitments to extend credit, standby letters of credit and financial guarantees written, forward foreign exchange contracts, and interest rate contracts. Those instruments involve, to varying degrees, elements of credit, interest rate and foreign exchange risk in excess of the amounts recognized in the consolidated balance sheets. The contract or notional amounts of those instruments reflect the extent of involvement we have in particular classes of financial instruments.

Our exposure to credit loss in the event of nonperformance by the counter-party to the financial instrument for commitments to extend credit and standby letters of credit and financial guarantees written is represented by the contractual amount of those instruments. For forward foreign exchange contracts and interest rate contracts, the contract amounts do not represent exposure to credit loss. We control the credit risk of these contracts through credit approvals, limits and monitoring procedures. We use the same credit policies in making commitments and conditional obligations as we do for on-balance sheet instruments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. These derivatives are carried at fair value with changes in fair value recorded as a component of other operating income in the consolidated statements of income. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. We evaluate each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary, is based on management's credit evaluation of the counter-party. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment, and income-producing commercial properties.

Standby letters of credit and financial guarantees written are conditional commitments issued by us to guarantee the performance of a customer to a third-party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. We hold collateral supporting those commitments for which collateral is deemed necessary.

Interest rate options issued on residential mortgage loans expose us to interest rate risk, which is economically hedged with forward interest rate contracts. These derivatives are carried at fair value with changes in fair value recorded as a component of other operating income in the consolidated statements of income. The amount of interest rate options fluctuates based on residential mortgage volume.

Forward interest rate contracts represent commitments to purchase or sell loans at a future date at a specified price. We enter into forward interest rate contracts on our residential mortgage held for sale loans. These derivatives are carried at fair value with changes in fair value recorded as a component of other operating income in the consolidated statements of income. Risks arise from the possible inability of counter-parties to meet the terms of their contracts and from movements in market rates. Management reviews and approves the creditworthiness of the counter-parties to its forward interest rate contracts.

Forward foreign exchange contracts represent commitments to purchase or sell foreign currencies at a future date at a specified price. These derivatives are carried at fair value with changes in fair value recorded as a component of other operating income in the consolidated statements of income. Risks arise from the possible inability of counter-parties to meet the terms of their contracts and from movements in foreign currency exchange rates. Management reviews and approves the creditworthiness of its forward foreign exchange counter-parties. At December 31, 2019 and 2018, we did not have any forward foreign exchange contracts.

At December 31, 2019 and 2018, financial instruments with off-balance sheet risk were as follows:

	December 31,	
	2019	2018
(Dollars in thousands)		
Notional amount of:		
Financial instruments whose contract amounts represent credit risk:		
Commitments to extend credit.....	\$ 1,089,135	\$ 1,030,322
Standby letters of credit and financial guarantees written.....	10,526	13,377
Notional amount of:		
Financial instruments whose contract amounts exceed the amount of credit risk:		
Interest rate options .....	625	2,158
Forward interest rate contracts .....	8,968	8,530

## 25. FAIR VALUE OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

### Disclosures about Fair Value of Financial Instruments

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

#### Short-Term Financial Instruments

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

#### Investment Securities

The fair value of investment securities is based on market price quotations received from third-party pricing services. The third-party pricing services utilize pricing models supported with timely market data information. Where quoted market prices are not available, fair values are based on quoted market prices of comparable securities.

#### Loans

Fair values of loans are estimated based on discounted cash flows of portfolios of loans with similar financial characteristics including the type of loan, interest terms and repayment history. Fair values are calculated by discounting scheduled cash flows through estimated maturities using estimated market discount rates. Estimated market discount rates are reflective of credit and interest rate risks inherent in the Company's various loan types and are derived from available market information, as well as specific borrower information. In accordance with ASU 2016-01, the fair value of loans as of December 31, 2019 and 2018 are based on the notion of exit price. The fair value of loans as of December 31, 2017 was measured based on the notion of entry price.

#### Loans Held for Sale

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

#### FHLB Stock

It is not practical to determine the fair value of FHLB stock due to the restrictions placed on its transferability.

### Deposit Liabilities

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

### Long-Term Debt

The fair value of our long-term debt is estimated by discounting scheduled cash flows over the contractual borrowing period at the estimated market rate for similar borrowing arrangements.

### Derivatives

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

### Off-Balance Sheet Financial Instruments

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

### Limitations

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

Fair value estimates are based on existing on- and off-balance sheet financial instruments without attempting to estimate the value of future business and the value of assets and liabilities that are not considered financial instruments. For example, significant assets and liabilities that are not considered financial assets or liabilities include deferred tax assets and liabilities and premises and equipment.

**Fair Value Measurement Using**

	<b>Carrying Amount</b>	<b>Estimated Fair Value</b>	<b>Quoted Prices in Active Markets for Identical Assets (Level 1)</b>	<b>Significant Other Observable Inputs (Level 2)</b>	<b>Significant Unobservable Inputs (Level 3)</b>
<b>(Dollars in thousands)</b>					
<b>December 31, 2019</b>					
Financial assets:					
Cash and due from financial institutions .....	\$ 78,418	\$ 78,418	\$ 78,418	\$ —	\$ —
Interest-bearing deposits in other financial institutions .....	24,554	24,554	24,554	—	—
Investment securities .....	1,128,110	1,128,110	1,127	1,115,728	11,255
Loans held for sale .....	9,083	9,083	—	9,083	—
Loans and leases, net of Allowance .....	4,401,569	4,392,477	—	—	4,392,477
FHLB stock .....	14,983	N/A	N/A	N/A	N/A
Accrued interest receivable .....	16,500	16,500	16,500	—	—
Financial liabilities:					
Deposits:					
Noninterest-bearing deposits .....	1,450,532	1,450,532	1,450,532	—	—
Interest-bearing demand and savings deposits .....	2,643,038	2,643,038	2,643,038	—	—
Time deposits .....	1,026,453	1,023,362	—	—	1,023,362
FHLB advances and other short-term borrowings .....	150,000	150,000	—	150,000	—
Long-term debt .....	101,547	97,827	—	97,827	—
Accrued interest payable (included in other liabilities) .....	4,288	4,288	4,288	—	—

**Fair Value Measurement Using**

	<b>Notional Amount</b>	<b>Carrying Amount</b>	<b>Estimated Fair Value</b>	<b>Quoted Prices in Active Markets for Identical Assets (Level 1)</b>	<b>Significant Other Observable Inputs (Level 2)</b>	<b>Significant Unobservable Inputs (Level 3)</b>
<b>(Dollars in thousands)</b>						
<b>December 31, 2019</b>						
Off-balance sheet financial instruments:						
Commitments to extend credit .....	\$ 1,089,135	\$ 1,230	\$ 1,230	\$ —	\$ 1,230	\$ —
Standby letters of credit and financial guarantees written .....	10,526	158	158	—	158	—
Derivatives:						
Interest rate lock commitments .....	625	8	8	—	8	—
Forward sale commitments .....	8,968	(28)	(28)	—	(28)	—



	Carrying Amount	Estimated Fair Value	Fair Value Measurement Using		
			Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(Dollars in thousands)					
<b>December 31, 2018</b>					
Financial assets:					
Cash and due from financial institutions .....	\$ 80,569	\$ 80,569	\$ 80,569	\$ —	\$ —
Interest-bearing deposits in other financial institutions .....	21,617	21,617	21,617	—	—
Investment securities.....	1,354,812	1,350,576	826	1,338,581	11,169
Loans held for sale .....	6,647	6,647	—	6,647	—
Loans and leases, net of Allowance .....	4,030,450	3,938,380	—	—	3,938,380
FHLB stock.....	16,645	N/A	N/A	N/A	N/A
Accrued interest receivable.....	17,000	17,000	17,000	—	—
Financial liabilities:					
Deposits:					
Noninterest-bearing deposits .....	1,436,967	1,436,967	1,436,967	—	—
Interest-bearing demand and savings deposits.....	2,402,268	2,402,268	2,402,268	—	—
Time deposits .....	1,107,255	1,099,560	—	—	1,099,560
FHLB advances and other short-term borrowings.....	197,000	197,000	—	197,000	—
Long-term debt.....	122,166	118,057	—	118,057	—
Accrued interest payable (included in other liabilities) .....	5,051	5,051	5,051	—	—

	Notional Amount	Carrying Amount	Estimated Fair Value	Fair Value Measurement Using		
				Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(Dollars in thousands)						
<b>December 31, 2018</b>						
Off-balance sheet financial instruments:						
Commitments to extend credit.....	\$ 1,030,322	\$ 1,205	\$ 1,205	\$ —	\$ 1,205	\$ —
Standby letters of credit and financial guarantees written .....	13,377	201	201	—	201	—
Derivatives:						
Interest rate lock commitments.....	2,158	11	11	—	11	—
Forward sale commitments .....	8,530	(95)	(95)	—	(95)	—

## Fair Value Measurements

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

- Level 1 — Valuation is based upon quoted prices (unadjusted) for identical assets or liabilities traded in active markets. A quoted price in an active market provides the most reliable evidence of fair value and shall be used to measure fair value whenever available.
- Level 2 — Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

- Level 3 — Valuation is generated from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect our own estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of discounted cash flow models and similar techniques that requires the use of significant judgment or estimation.

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

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

There were no transfers of financial assets and liabilities between Level 1 and Level 2 of the fair value hierarchy during the year ended December 31, 2019.

The following table below presents the fair value of assets and liabilities measured on a recurring basis:

	<b>Fair Value at Reporting Date Using</b>			
	<b>Fair Value</b>	<b>Quoted Prices in Active Markets for Identical Assets (Level 1)</b>	<b>Significant Other Observable Inputs (Level 2)</b>	<b>Significant Unobservable Inputs (Level 3)</b>
<b>(Dollars in thousands)</b>				
<b>December 31, 2019</b>				
Available-for-sale investment securities:				
Debt securities:				
States and political subdivisions.....	\$ 122,018	\$ —	\$ 110,763	\$ 11,255
Corporate securities .....	30,529	—	30,529	—
U.S. Treasury obligations and direct obligations of U.S. Government agencies.....	40,381	—	40,381	—
Mortgage-backed securities:				
Residential - U.S. Government-sponsored entities ("GSEs") .....	677,822	—	677,822	—
Residential - Non-government sponsored entities ("Non-GSEs") .....	37,191	—	37,191	—
Commercial - U.S. GSEs and agencies .....	81,225	—	81,225	—
Commercial - Non-GSEs .....	137,817	—	137,817	—
Equity securities .....	1,127	1,127	—	—
Derivatives: Interest rate lock and forward sale commitments .....	(20)	—	(20)	—
<b>Total .....</b>	<b>\$ 1,128,090</b>	<b>\$ 1,127</b>	<b>\$ 1,115,708</b>	<b>\$ 11,255</b>

**Fair Value at Reporting Date Using**

Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>December 31, 2018</b>			
Available-for-sale investment securities:			
Debt securities:			
States and political subdivisions .....	\$ 173,674	\$ —	\$ 162,505
Corporate securities .....	54,849	—	54,849
U.S. Treasury obligations and direct obligations of U.S. Government agencies .....	32,574	—	32,574
Mortgage-backed securities:			
Residential - U.S. Government-sponsored entities ("GSEs") .....	717,052	—	717,052
Residential - Non-government sponsored entities ("Non-GSEs") .....	41,118	—	41,118
Commercial - U.S. GSEs and agencies .....	51,483	—	51,483
Commercial - Non-GSEs .....	134,728	—	134,728
Equity securities .....	826	826	—
Derivatives: Interest rate lock and forward sale commitments .....	(84)	—	(84)
<b>Total .....</b>	<b>\$ 1,206,220</b>	<b>\$ 826</b>	<b>\$ 1,194,225</b>

The changes in Level 3 assets and liabilities measured at fair value on a recurring basis are summarized as follows:

	<b>Available-for-Sale Debt Securities - States and Political Subdivisions</b>
	<b>(Dollars in thousands)</b>
<b>Balance as of December 31, 2017</b> .....	\$ 11,794
Principal payments received .....	(373)
Purchases .....	—
Unrealized net loss included in other comprehensive loss .....	(252)
<b>Balance as of December 31, 2018</b> .....	\$ 11,169
Principal payments received .....	(400)
Purchases .....	—
Unrealized net gain included in other comprehensive loss .....	486
<b>Balance as of December 31, 2019</b> .....	<b>\$ 11,255</b>

Within the state and political subdivisions debt securities category, the Company holds four mortgage revenue bonds issued by the City and County of Honolulu with an aggregate fair value of \$11.3 million and \$11.2 million at December 31, 2019 and 2018, respectively. The Company estimates the fair value of its mortgage revenue bonds by using a discounted cash flow model to calculate the present value of estimated future principal and interest payments.

The significant unobservable input used in the fair value measurement of the Company's mortgage revenue bonds is the weighted average discount rate. As of December 31, 2019, the weighted average discount rate utilized was 4.08%, which was derived by incorporating a credit spread over the FHLB Fixed-Rate Advance curve. Significant increases (decreases) in the weighted average discount rate could result in a significantly lower (higher) fair value measurement.

The following table presents the fair value of assets measured on a nonrecurring basis and the level of valuation assumptions used to determine the respective fair values:

	Fair Value Measurements Using				Total Losses
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
(Dollars in thousands)					
<b>December 31, 2019</b>					
Other real estate <sup>(1)</sup> .....	\$ 164	\$ —	\$ 164	\$ —	\$ —
Total .....					\$ —
<b>December 31, 2018</b>					
Other real estate <sup>(1)</sup> .....	\$ 414	\$ —	\$ 414	\$ —	\$ —
Total .....					\$ —

<sup>(1)</sup> Represents other real estate that is carried at fair value less costs to sell. Fair value is generally based upon independent market prices or appraised values of the collateral.

## 26. SEGMENT INFORMATION

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

The Banking Operations segment includes construction and real estate development lending, commercial lending, residential mortgage lending, 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 includes activities not captured by the Banking Operations or Treasury segments described above and includes activities such as electronic banking, data processing and management of bank owned properties.

The accounting policies of the segments are consistent with those described in Note 1 - Summary of Significant Accounting Policies. The majority of the Company's net income is derived from net interest income. Accordingly, management focuses primarily on net interest income, rather than gross interest income and expense amounts, in evaluating segment profitability.

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

Segment net income (loss) and total assets are provided in the following table for the periods indicated:

	<b>Banking Operations</b>	<b>Treasury</b>	<b>All Others</b>	<b>Total</b>
	<b>(Dollars in thousands)</b>			
<b>Year ended December 31, 2019</b>				
Net interest income.....	\$ 171,716	\$ 12,358	\$ —	\$ 184,074
Intersegment net interest income (expense).....	22,907	(11,448)	(11,459)	—
Credit (provision) for loan and lease losses .....	(6,317)	—	—	(6,317)
Other Operating income:.....				
Mortgage banking income.....	4,191	—	1,792	5,983
Service charges on deposit accounts .....	8,406	—	—	8,406
Other service charges and fees .....	5,685	—	8,673	14,358
Income from fiduciary activities.....	4,395	—	—	4,395
Equity in earnings of unconsolidated subsidiaries .....	257	—	—	257
Fees on foreign exchange .....	91	664	—	755
Investments securities gains (losses) .....	—	36	—	36
Income from bank-owned life insurance .....	—	3,105	—	3,105
Loan placement fees .....	702	—	—	702
Net gain (loss) sale of foreclosed assets .....	—	—	(145)	(145)
Other .....	632	2,585	732	3,949
Total other operating income.....	<u>24,359</u>	<u>6,390</u>	<u>11,052</u>	<u>41,801</u>
Total other operating expense .....	(64,940)	(1,487)	(75,204)	(141,631)
Administrative and overhead expense allocation.....	(69,039)	(841)	69,880	—
Income before taxes.....	78,686	4,972	(5,731)	77,927
Income tax (expense) benefit .....	(19,796)	(1,251)	1,442	(19,605)
Net income (loss).....	<u>\$ 58,890</u>	<u>\$ 3,721</u>	<u>\$ (4,289)</u>	<u>\$ 58,322</u>

	<b>Banking Operations</b>	<b>Treasury</b>	<b>All Others</b>	<b>Total</b>
	<b>(Dollars in thousands)</b>			
<b>Balance as of December 31, 2019</b>				
Investment securities.....	\$ —	\$ 1,128,110	\$ —	\$ 1,128,110
Loans and leases (including loans held for sale).....	4,458,623	—	—	4,458,623
Other.....	24,813	251,151	149,975	425,939
Total assets.....	<u>\$ 4,483,436</u>	<u>\$ 1,379,261</u>	<u>\$ 149,975</u>	<u>\$ 6,012,672</u>

	<b>Banking Operations</b>	<b>Treasury</b>	<b>All Others</b>	<b>Total</b>
	<b>(Dollars in thousands)</b>			
<b>Year ended December 31, 2018</b>				
Net interest income .....	\$ 153,314	\$ 19,684	\$ —	\$ 172,998
Intersegment net interest income (expense) .....	28,691	(18,284)	(10,407)	—
Credit (provision) for loan and lease losses .....	1,124	—	—	1,124
Other operating income: .....				
Mortgage banking income .....	4,015	—	3,300	7,315
Service charges on deposit accounts .....	8,406	—	—	8,406
Other service charges and fees .....	5,154	23	7,946	13,123
Income from fiduciary activities .....	4,245	—	—	4,245
Equity in earnings of unconsolidated subsidiaries .....	233	—	—	233
Fees on foreign exchange .....	98	807	—	905
Investments securities gains (losses) .....	—	(279)	—	(279)
Income from bank-owned life insurance .....	—	2,117	—	2,117
Loan placement fees .....	747	—	—	747
Other .....	981	65	946	1,992
Total other operating income .....	23,879	2,733	12,192	38,804
Total other operating expense .....	(63,649)	(1,472)	(69,561)	(134,682)
Administrative and overhead expense allocation .....	(60,636)	(874)	61,510	—
Income before taxes .....	82,723	1,787	(6,266)	78,244
Income tax (expense) benefit .....	(19,832)	(428)	1,502	(18,758)
Net income (loss) .....	\$ 62,891	\$ 1,359	\$ (4,764)	\$ 59,486

	<b>Banking Operations</b>	<b>Treasury</b>	<b>All Others</b>	<b>Total</b>
	<b>(Dollars in thousands)</b>			
<b>Balance as of December 31, 2018</b>				
Investment securities .....	\$ —	\$ 1,354,812	\$ —	\$ 1,354,812
Loans and leases (including loans held for sale) .....	4,085,013	—	—	4,085,013
Other .....	36,905	256,652	73,644	367,201
Total assets .....	\$ 4,121,918	\$ 1,611,464	\$ 73,644	\$ 5,807,026

	<b>Banking Operations</b>	<b>Treasury</b>	<b>All Others</b>	<b>Total</b>
	<b>(Dollars in thousands)</b>			
<b>Year ended December 31, 2017</b>				
Net interest income .....	\$ 140,077	\$ 27,626	\$ —	\$ 167,703
Intersegment net interest income (expense) .....	32,977	(25,000)	(7,977)	—
Credit (provision) for loan and lease losses .....	2,674	—	—	2,674
Total other operating income .....	22,511	2,448	11,537	36,496
Total other operating expense .....	(60,939)	(1,433)	(68,701)	(131,073)
Administrative and overhead expense allocation .....	(61,082)	(972)	62,054	—
Income before taxes .....	76,218	2,669	(3,087)	75,800
Income taxes .....	(34,376)	(1,204)	984	(34,596)
Net income (loss) .....	\$ 41,842	\$ 1,465	\$ (2,103)	\$ 41,204

## 27. PARENT COMPANY AND REGULATORY RESTRICTIONS

At December 31, 2019, the accumulated deficit of the parent company, Central Pacific Financial Corp., included \$415.0 million of equity in undistributed losses of Central Pacific Bank.

Central Pacific Bank, as a Hawaii state-chartered 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, 2019, the bank had Statutory Retained Earnings of \$66.6 million. For further information, see Note 13 - Equity.

The Company and the bank are subject to various regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations, involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can initiate regulatory action.

The final rules implementing Basel Committee on Banking Supervision's capital guidelines for U.S. banks ("Basel III rules") became effective for the Company on January 1, 2015, and were fully phased in on January 1, 2019. Under the Basel III rules, the Company must hold a "capital conservation buffer" above the adequately capitalized risk-based capital ratios. The capital conservation buffer was phased in at the rate of 0.625% per year from 0.625% in 2016 to 2.50% on January 1, 2019. The capital conservation buffer for 2019, 2018 and 2017 was 2.50%, 1.875% and 1.25%, respectively. The net unrealized gain or loss on available-for-sale securities is not included in computing regulatory capital. Management believes as of December 31, 2019, the Company and bank meet all capital adequacy requirements to which they are subject.

Prompt corrective action regulations provide five classifications: well-capitalized, adequately capitalized, under-capitalized, significantly under-capitalized, and critically under-capitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If under-capitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required. At year-end 2019 and 2018, the most recent regulatory notifications categorized the bank as "well-capitalized" under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the institution's category.

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

	Actual		Minimum required for capital adequacy purposes		Minimum required to be well-capitalized	
	Amount	Ratio	Amount	Ratio (1)	Amount	Ratio
<b>(Dollars in thousands)</b>						
<b>Company</b>						
As of December 31, 2019						
Tier 1 capital to avg. assets (leverage ratio)...	\$ 568,529	9.5%	\$ 238,630	4.0%		N/A
Tier 1 capital to risk-weighted assets.....	568,529	12.6	271,788	6.0		N/A
Total capital to risk-weighted assets .....	617,772	13.6	362,384	8.0		N/A
Common equity tier 1 ("CET1") capital to risk-weighted assets .....	518,529	11.5	203,841	4.5		N/A
As of December 31, 2018						
Tier 1 capital to avg. assets (leverage ratio)...	570,260	9.9	230,847	4.0		N/A
Tier 1 capital to risk-weighted assets.....	570,260	13.5	252,921	6.0		N/A
Total capital to risk-weighted assets .....	619,419	14.7	337,228	8.0		N/A
CET1 capital to risk-weighted assets.....	500,260	11.9	189,691	4.5		N/A
<b>Central Pacific Bank</b>						
As of December 31, 2019						
Tier 1 capital to avg. assets (leverage ratio)...	\$ 556,077	9.3%	\$ 238,342	4.0%	\$ 297,928	5.0%
Tier 1 capital to risk-weighted assets.....	556,077	12.3	271,350	6.0	361,800	8.0
Total capital to risk-weighted assets .....	605,320	13.4	361,800	8.0	452,250	10.0
CET1 capital to risk-weighted assets.....	556,077	12.3	203,512	4.5	293,962	6.5
As of December 31, 2018						
Tier 1 capital to avg. assets (leverage ratio)...	533,166	9.3	230,638	4.0	288,298	5.0
Tier 1 capital to risk-weighted assets.....	533,166	12.7	252,667	6.0	336,889	8.0
Total capital to risk-weighted assets .....	582,325	13.8	336,889	8.0	421,111	10.0
CET1 capital to risk-weighted assets.....	533,166	12.7	189,500	4.5	273,722	6.5

(1) Under the Basel III Capital Rules, the Company and the bank must also maintain the required Capital Conservation Buffer ("CCB") to avoid becoming subject to restrictions on capital distributions and certain discretionary bonus payments to management. The CCB is calculated as a ratio of CET1 capital to risk-weighted assets, and effectively increases the required minimum risk-based capital ratios. The CCB requirement was phased in over a three-year period that began on January 1, 2016. The phase-in period ended on January 1, 2019, and the CCB is now at its fully phased-in level of 2.5%.



Condensed financial statements of the parent company are as follows:

**CENTRAL PACIFIC FINANCIAL CORP.  
CONDENSED BALANCE SHEETS**

	December 31,	
	2019	2018
	(Dollars in thousands)	
<b>Assets</b>		
Cash and cash equivalents .....	\$ 10,634	\$ 16,743
Equity investment securities, at fair value .....	1,127	826
Investment in subsidiary bank .....	564,460	519,978
Other assets .....	8,354	30,312
Total assets .....	\$ 584,575	\$ 567,859
<b>Liabilities and Equity</b>		
Long-term debt .....	\$ 51,547	\$ 72,166
Other liabilities .....	4,508	3,968
Total liabilities .....	56,055	76,134
Total shareholders' equity .....	528,520	491,725
Total equity .....	528,520	491,725
Total liabilities and equity .....	\$ 584,575	\$ 567,859

**CENTRAL PACIFIC FINANCIAL CORP.  
CONDENSED STATEMENTS OF INCOME**

	Year Ended December 31,		
	2019	2018	2017
	(Dollars in thousands)		
Income:			
Dividends from subsidiary bank .....	\$ 42,008	\$ 103,001	\$ 43,000
Interest income from subsidiary bank .....	5	5	6
Other income .....	92	160	150
Total income .....	42,105	103,166	43,156
Expense:			
Interest expense on long-term debt .....	2,453	4,338	3,479
Other expenses .....	2,599	1,617	2,002
Total expenses .....	5,052	5,955	5,481
Income before income taxes and equity in undistributed income of subsidiaries .....	37,053	97,211	37,675
Income tax expense (benefit) .....	(1,289)	(1,261)	(1,781)
Income before equity in undistributed income of subsidiaries .....	38,342	98,472	39,456
Equity in undistributed income (loss) of subsidiary bank .....	19,980	(38,986)	1,748
Net income .....	\$ 58,322	\$ 59,486	\$ 41,204

**CENTRAL PACIFIC FINANCIAL CORP.  
CONDENSED STATEMENTS OF CASH FLOWS**

	Year Ended December 31,		
	2019	2018	2017
	(Dollars in thousands)		
Cash flows from operating activities:			
Net income .....	\$ 58,322	\$ 59,486	\$ 41,204
Adjustments to reconcile net income to net cash provided by operating activities:			
Deferred income tax expense (benefit) .....	3,055	450	(442)
Net change in dividends receivable from subsidiary bank .....	21,004	(21,004)	—
Equity in undistributed loss (income) of subsidiary bank .....	(19,980)	38,986	(1,748)
Share-based compensation expense .....	2,735	2,778	1,918
Net change in other assets and liabilities .....	(2,900)	(920)	1,357
Net cash provided by operating activities .....	62,236	79,776	42,289
Cash flows from investing activities:			
Distributions from unconsolidated subsidiaries .....	622	622	—
Net cash provided by investing activities .....	622	622	—
Cash flows from financing activities:			
Net proceeds from issuance of common stock and stock option exercises .....	151	—	—
Repayments of long-term debt .....	(20,619)	(20,619)	—
Repurchases of common stock .....	(22,793)	(32,824)	(26,559)
Cash dividends paid on common stock .....	(25,706)	(24,143)	(21,299)
Net cash used in financing activities .....	(68,967)	(77,586)	(47,858)
Net increase (decrease) in cash and cash equivalents .....	(6,109)	2,812	(5,569)
Cash and cash equivalents at beginning of year .....	16,743	13,931	19,500
Cash and cash equivalents at end of year .....	\$ 10,634	\$ 16,743	\$ 13,931

## 28. UNAUDITED QUARTERLY FINANCIAL INFORMATION

As discussed in Note 1 - Summary of Significant Accounting Policies and Note 7 - Investments in Unconsolidated Subsidiaries, during the fourth quarter of 2018, the Company voluntarily changed its accounting policy for its investments in LIHTC partnerships. As a result, financial information for the periods prior to the fourth quarter of 2018 was revised to reflect the reclassification of amortization of investments in LIHTC partnerships from total other operating expense to income tax expense, which provides users a better understanding of the nature of the returns of such investments, in connection with the change in accounting policy:

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Full Year
	(Dollars in thousands, except per share data)				
<b>2019</b>					
Total interest income.....	\$ 53,141	\$ 54,105	\$ 53,980	\$ 55,157	\$ 216,383
Total interest expense.....	8,028	8,727	8,331	7,223	32,309
Net interest income .....	45,113	45,378	45,649	47,934	184,074
Provision (credit) for loan and lease losses .....	1,283	1,404	1,532	2,098	6,317
Net interest income after provision (credit) for loan and lease losses .....	43,830	43,974	44,117	45,836	177,757
Investment securities gains (losses).....	—	—	36	—	36
Income before income taxes .....	21,155	17,961	19,449	19,362	77,927
Net income.....	16,037	13,534	14,554	14,197	58,322
Basic earnings per share .....	\$ 0.56	\$ 0.47	\$ 0.51	\$ 0.50	\$ 2.05
Diluted earnings per share .....	0.55	0.47	0.51	0.50	2.03

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Full Year
	(Dollars in thousands, except per share data)				
<b>2018</b>					
Total interest income.....	\$ 47,310	\$ 48,509	\$ 50,136	\$ 52,339	\$ 198,294
Total interest expense.....	4,988	5,837	6,811	7,660	25,296
Net interest income.....	42,322	42,672	43,325	44,679	172,998
Provision (credit) for loan and lease losses.....	(211)	532	(59)	(1,386)	(1,124)
Net interest income after provision (credit) for loan and lease losses .....	42,533	42,140	43,384	46,065	174,122
Investment securities gains (losses).....	—	—	—	(279)	(279)
Income before income taxes.....	18,083	18,159	20,179	21,823	78,244
Net income .....	14,277	14,224	15,193	15,792	59,486
Basic earnings per share.....	\$ 0.48	\$ 0.48	\$ 0.52	\$ 0.54	\$ 2.02
Diluted earnings per share.....	0.48	0.48	0.52	0.54	2.01

## **29. SUBSEQUENT EVENTS**

In January 2020, the Board of Directors authorized the repurchase of up to \$30.0 million of its common stock from time to time of the open market or in privately negotiated transactions, pursuant to a newly authorized share repurchase program. The share repurchase program replaced and superseded in its entirety the 2019 Repurchase Plan. The 2019 Repurchase Plan had 21.1 million in remaining repurchase authority as of December 31, 2019.

## **ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

On May 16, 2018, the Audit Committee of the Company's Board of Directors (the "Audit Committee") concluded a competitive review process of independent registered public accounting firms. As a result of this process and following careful deliberation, the Audit Committee approved the dismissal of KPMG LLP ("KPMG") as the Company's independent registered public accounting firm, effective May 16, 2018. The Company provided KPMG with formal notice of such dismissal on May 16, 2018.

For further information regarding our change in accounting firm, please see Item 4.01 of our Report on Form 8-K filed on May 17, 2018, which information is incorporated herein by reference.

### **ITEM 9A. CONTROLS AND PROCEDURES**

#### **(a) Evaluation of Disclosure Controls and Procedures**

Under the supervision and with the participation of the Company's management, including our principal executive officer and principal financial officer, the Company conducted an evaluation of the effectiveness of its disclosure controls and procedures (as defined in Rule 13a-15(e) promulgated under the Exchange Act) as of December 31, 2019. Based on that evaluation, the principal executive officer and principal financial officer concluded that, as of December 31, 2019, the Company's disclosure controls and procedures are effective.

#### **(b) Management's Report on Internal Control Over Financial Reporting**

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting (as such term is defined in Rule 13a-15(f) under the Exchange Act). The Company's internal control over financial reporting is a process designed under the supervision of the Company's principal executive and principal financial officer to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company's financial statements for external reporting purposes in accordance with U.S. generally accepted accounting principles.

The Company's internal control over financial reporting includes policies and procedures that pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect transactions and dispositions of assets; provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles, and that receipts and expenditures are being made only in accordance with authorizations of management and the directors of the Company; and 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 its 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.

As of December 31, 2019, management conducted an assessment of the effectiveness of the Company's internal control over financial reporting based on the framework established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013). Based on this assessment, management has determined that the Company's internal control over financial reporting as of December 31, 2019 is effective.

The Company's internal control over financial reporting as of December 31, 2019 has been audited by Crowe LLP, an independent registered public accounting firm, as stated in their report appearing herein under the heading "Report of Independent Registered Public Accounting Firm."

#### **(c) Changes in Internal Control Over Financial Reporting**

There have not been any changes in the Company's internal control over financial reporting, as such term is defined in Rule 13a-15(f) under the Exchange Act during the Company's fiscal quarter ended December 31, 2019 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**ITEM 9B. OTHER INFORMATION**

None.

### PART III

#### ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

Except as hereinafter noted, the information concerning directors and executive officers of the Company is incorporated by reference from the section entitled "Directors' and Executive Officers' Information" of the Company's definitive Proxy Statement for the 2020 Annual Meeting of Shareholders (the "2020 Proxy Statement") to be filed with the SEC within 120 days of the fiscal year ended December 31, 2019. Information concerning the Company's Code of Conduct & Ethics is set forth above under "Available Information" and incorporated by reference from the section entitled "Corporate Governance and Board Matters—Code of Conduct & Ethics" of the Company's 2020 Proxy Statement.

#### ITEM 11. EXECUTIVE COMPENSATION

Information concerning executive compensation is incorporated by reference from the section entitled "Compensation of Directors and Executive Officers" of the Company's 2020 Proxy Statement.

Information concerning the members of the Compensation Committee of the Company is incorporated by reference from the section entitled "Compensation Committee Interlocks and Insider Participation" of the Company's 2020 Proxy Statement.

Information concerning the report of the Compensation Committee of the Company is incorporated by reference from the section entitled "Compensation Committee Report" of the Company's 2020 Proxy Statement.

#### ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

Information concerning security ownership of certain beneficial owners and management is incorporated by reference from the sections entitled "Introduction—Principal Shareholders," and "Introduction—Security Ownership of Directors, Nominees and Executive Officers" of the Company's 2020 Proxy Statement.

The following table provides information as of December 31, 2019 regarding securities issued under our equity compensation plans that were in effect during fiscal 2019.

<b>Plan Category</b>	<b>(a) Number of securities to be issued upon exercise of outstanding options, warrants and rights</b>	<b>(b) Weighted- average exercise price of outstanding options, warrants and rights</b>	<b>(c) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))</b>
Equity compensation plans approved by security holders .....	133,813	\$ 14.31	1,304,773
Equity compensation plans not approved by security holders .....	—	—	—
Total.....	<u>133,813</u>	14.31	<u>1,304,773</u>

#### ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

Information concerning certain relationships and related transactions is incorporated by reference from the section entitled "Election of Directors" and "Corporate Governance and Board Matters—Director Independence and Relationships," and "Corporate Governance and Board Matters—Loans to Related Persons" of the Company's 2020 Proxy Statement.

Information concerning director independence is incorporated by reference from the section entitled "Corporate Governance and Board Matters—Director Independence and Relationships" of the Company's 2020 Proxy Statement.



**ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

Information concerning principal accountant fees and services is incorporated by reference from the section entitled "Discussion of Proposals Recommended by the Board of Directors—Proposal 3—Ratification of the Appointment of Independent Registered Public Accounting Firm—Services Rendered By and Fees Paid to Independent Registered Public Accounting Firm" of the Company's 2020 Proxy Statement.

## PART IV

### ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

#### (a) 1. Financial Statements

The following consolidated financial statements are included in Item 8 of this report:

Central Pacific Financial Corp. and Subsidiaries:

Report of Independent Registered Public Accounting Firm

Consolidated Balance Sheets at December 31, 2019 and 2018

Consolidated Statements of Income for the Years ended December 31, 2019, 2018 and 2017

Consolidated Statements of Comprehensive Income for the Years ended December 31, 2019, 2018 and 2017

Consolidated Statements of Changes in Equity for the Years ended December 31, 2019, 2018 and 2017

Consolidated Statements of Cash Flows for the Years ended December 31, 2019, 2018 and 2017

Notes to Consolidated Financial Statements

**(a) 2. All schedules required by this Item 15(a) 2 are omitted because they are not applicable, not material or because the information is included in the consolidated financial statements or the notes thereto.**

**(b) Exhibits**

<b>Exhibit Number</b>	<b>Description</b>
3.1	Restated Articles of Incorporation of the Registrant (1)
3.2	Bylaws of the Registrant, as amended through January 25, 2012 (2)
4.1	Description of Securities of the Registrant Registered Pursuant to Section 12 of the Exchange Act (*)
4.2	Form of Registrant's Common Stock Certificate (*)
10.1	Central Pacific Bank Supplemental Executive Retirement Plan (3) (4)
10.2	The Registrant's Directors' Deferred Compensation Plan (3) (5)
10.3	The Registrant's 2004 Stock Compensation Plan (3) (6)
10.4	Form of Restricted Share Grant Agreement to Non-Employee Director under 2004 Stock Compensation Plan (3) (6)
10.5	Supplemental Executive Retirement Agreement for Blenn A. Fujimoto, effective July 1, 2005 (3) (9)
10.6	Amendment No. 1 to the Supplemental Executive Retirement Plan between the Registrant and Blenn A. Fujimoto, effective December 31, 2008 (3) (8)
10.7	The Registrant's Long-Term Executive Incentive Plan, effective January 1, 2005 (3) (10)
10.8	Amendment No. 2008-1 to the Registrant's Long-Term Executive Incentive Plan (3) (8)
10.9	The Registrant's 2004 Annual Executive Incentive Plan (3) (6)
10.10	Amendment No. 2008-1 to the Registrant's 2004 Annual Executive Incentive Plan dated December 31, 2008 (3) (8)
10.11	Amendment No. 2011-1 to the Registrant's 2004 Stock Compensation Plan (3) (11)
10.12	Amendment No. 2012-1 to the Registrant's 2004 Stock Compensation Plan (12)
10.13	Form of Stock Option Grant Agreement for the Registrant's 2004 Stock Compensation Plan (12)
10.14	Form of Restricted Stock Unit Grant Agreement for the Registrant's 2004 Stock Compensation Plan (12)
10.15	The Registrant's 2013 Stock Compensation Plan (13)
10.16	Form of Stock Option Grant Agreement for the Registrant's 2013 Stock Compensation Plan (14)
10.17	Form of Restricted Stock Grant Agreement for the Registrant's 2013 Stock Compensation Plan (14)
10.18	Form of Restricted Stock Unit Agreement for the Registrant's 2013 Stock Compensation Plan (14)
10.19	Form of Stock Appreciation Rights Grant Agreement for the Registrant's 2013 Stock Compensation Plan (14)
10.20	Form of Key Employee Restricted Stock Unit Grant Agreement for the Registrant's 2013 Stock Compensation Plan (14)
10.21	Employment Agreement with Paul Yonamine, dated September 25, 2018 (3) (7)
14.1	The Registrant's Code of Conduct & Ethics (10)
14.2	The Registrant's Code of Conduct & Ethics for Senior Financial Officers (10)
21	Subsidiaries of the Registrant *
23.1	Consent of Independent Registered Public Accounting Firm (KPMG) *
23.2	Consent of Independent Registered Public Accounting Firm (Crowe) *
31.1	Rule 13a-14(a) Certification of Chief Executive Officer in accordance with Section 302 of the Sarbanes-Oxley Act of 2002 *

Exhibit Number	Description
31.2	Rule 13a-14(a) Certification of Chief Financial Officer in accordance with Section 302 of the Sarbanes-Oxley Act of 2002 *
32.1	Section 1350 Certification of Chief Executive Officer in accordance with Section 906 of the Sarbanes-Oxley Act of 2002 **
32.2	Section 1350 Certification of Chief Financial Officer in accordance with Section 906 of the Sarbanes-Oxley Act of 2002 **
101.INS	XBRL Instance Document *
101.SCH	XBRL Taxonomy Extension Schema Document *
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document *
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document *
101.LAB	XBRL Taxonomy Extension Label Linkbase Document *
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document *
104	Cover Page Interactive Data File (formatted as Inline XBRL and included within the Exhibit 101 attachments)

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\* Filed herewith.

\*\* Furnished herewith.

All of the references to Form 8-K, Form 10-K, Form 10-Q, Form DEF 14A and Form S-1/A identified in the exhibit index have SEC file number **001-31567**.

Upon request of the Securities and Exchange Commission, we will furnish any agreements relating to our long-term debt not otherwise contained herein.

- (1) Incorporated herein by reference to Exhibit 3.1 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2014, filed with the Securities and Exchange Commission on February 27, 2015.
- (2) Incorporated herein by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K, filed with the Securities and Exchange Commission on January 27, 2012.
- (3) Denotes management contract or compensation plan or arrangement.
- (4) Incorporated herein by reference to Exhibit 10.8 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 1996, filed with the Securities and Exchange Commission on March 28, 1997.
- (5) Incorporated herein by reference to Exhibit 10.12 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2000, filed with the Securities and Exchange Commission on March 30, 2001.
- (6) Incorporated herein by reference to Exhibits 10.8, 10.9 and 10.20, respectively, to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2004, filed with the Securities and Exchange Commission on March 16, 2005.
- (7) Incorporated herein by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K, filed with the Securities and Exchange Commission on September 26, 2018.
- (8) Incorporated herein by reference to Exhibits 10.15, 10.19 and 10.21, respectively, to the Registrant's Annual Report on Form 10-K/A for the year ended December 31, 2008, filed with the Securities and Exchange Commission on March 2, 2009.
- (9) Incorporated herein by reference to Exhibit 99.1 to the Registrant's Current Report on Form 8-K, filed with the Securities and Exchange Commission on January 31, 2006.
- (10) Incorporated herein by reference to Exhibits 10.19, 14.1 and 14.2, respectively, to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2005, filed with the Securities and Exchange Commission on March 15, 2006.
- (11) Incorporated herein by reference to Appendix B to the Registrant's Definitive Proxy Statement on Form DEF 14A filed with the Securities and Exchange Commission on March 4, 2011.
- (12) Incorporated herein by reference to Exhibits 10.1, 10.2 and 10.3, respectively, to the Registrant's Current Report on Form 8-K, filed with the Securities and Exchange Commission on April 30, 2012.
- (13) Incorporated herein by reference to Exhibit 10.15 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2018, filed with the Securities and Exchange Commission on February 27, 2019.
- (14) Incorporated herein by reference to Exhibits 10.2, 10.3, 10.4, 10.5 and 10.6, respectively, to the Registrant's Current Report on Form 8-K, filed with the Securities and Exchange Commission on May 1, 2013.

**(c) Financial Statement Schedules**

All financial statement schedules have been omitted as the information is not required under the related instructions or is inapplicable.

**ITEM 16. FORM 10-K SUMMARY**

**Not applicable.**

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Exchange Act, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: February 25, 2020

CENTRAL PACIFIC FINANCIAL CORP.

(Registrant)

/s/ Paul K. Yonamine

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Paul K. Yonamine

*Chairman and Chief Executive Officer*

Pursuant to the requirements of the Exchange Act, this report has been signed below by the following persons on behalf of the registrant in the capacities and on the dates indicated.

<b>Signature</b>	<b>Title</b>	<b>Date</b>
<u>/s/ Paul K. Yonamine</u> Paul K. Yonamine	Chairman and Chief Executive Officer (Principal Executive Officer)	February 25, 2020
<u>/s/ David S. Morimoto</u> David S. Morimoto	Executive Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)	February 25, 2020
<u>/s/ A. Catherine Ngo</u> A. Catherine Ngo	President, Director	February 25, 2020
<u>/s/ John C. Dean</u> John C. Dean	Director	February 25, 2020
<u>/s/ Christine H. H. Camp</u> Christine H. H. Camp	Director	February 25, 2020
<u>/s/ Earl E. Fry</u> Earl E. Fry	Director	February 25, 2020
<u>/s/ Wayne K. Kamitaki</u> Wayne K. Kamitaki	Director	February 25, 2020
<u>/s/ Paul J. Kosasa</u> Paul J. Kosasa	Director	February 25, 2020
<u>/s/ Duane K. Kurisu</u> Duane K. Kurisu	Director	February 25, 2020
<u>/s/ Colbert M. Matsumoto</u> Colbert M. Matsumoto	Director	February 25, 2020
<u>/s/ Saedene K. Ota</u> Saedene K. Ota	Director	February 25, 2020
<u>/s/ Crystal K. Rose</u> Crystal K. Rose	Director	February 25, 2020
<u>/s/ Christopher T. Lutes</u> Christopher T. Lutes	Director	February 25, 2020

## **Description of Central Pacific Financial Corp.'s Securities Registered Pursuant to Section 12 of the Securities Exchange Act of 1934**

The following is a summary description of Central Pacific Financial Corp's Common Stock. This description is not complete and is qualified in its entirety by reference to the provisions of our Restated Articles of Incorporation and Amended Bylaws, each of which is incorporated herein by reference as an exhibit to the Annual Report on Form 10-K of which this Exhibit 4.1 is a part, and the applicable provisions of the Hawaii Business Corporation Act (the "HBCA").

### Common Stock

Our authorized Common Stock consists of 185,000,000 shares of Common Stock, no par value per share, of which 28,289,257 shares are outstanding as of December 31, 2019. The issued Common Stock represent non-withdrawable capital and are not federally insured.

### **Dividend Rights**

Holders of our Common Stock are entitled to receive dividends if, as and when declared by the Board of Directors out of any funds legally available for dividends. The ability to pay dividends depends on the amount of dividends paid to the Company by Central Pacific Bank (the "Bank"), a wholly-owned subsidiary of the Company. As further described in Part I, Item 1 of the Form 10-K of which this Exhibit 4.1 is a part, the Company's payment of dividends, and the Bank's payment of dividends to the Company, are subject to extensive government regulation, in that regulatory authorities may invoke their authority to prohibit banks and their holding companies from paying dividends for a number of reasons, including, for example, a determination that such payments would constitute an unsafe or unsound banking practice or a determination that such payments would reduce the amount of either entity's capital below that necessary to meet minimum applicable regulatory capital requirements. Our ability to pay dividends is also subject to restrictions set forth under Hawaii law and restrictions and covenants set forth in various agreements we are a party to, including covenants set forth in our subordinated debentures. The Bank, in addition to obtaining approval from the Federal Deposit Insurance Corporation and Hawaii Division of Financial Institutions, if required, is not permitted under Hawaii law to pay dividends except out of retained earnings as defined under Hawaii banking law.

### **Liquidation and Dissolution**

In the event of our liquidation or dissolution, the holders of Common Stock are entitled to receive proportionately all assets available for distribution to shareholders after the payment of all debts and other liabilities and subject to the prior rights of any outstanding preferred stock. Holders of Common Stock are not entitled to a liquidation preference in respect of those shares.

### **No Preemptive or Conversion Rights**

Holders of Common Stock generally do not have preemptive rights to purchase additional Common Stock or conversion or redemption rights under our Restated Articles of Incorporation or the HBCA.

### **Voting Rights**

Holders of our Common Stock are entitled to one vote for each share held on all matters submitted to a vote of shareholders and do not have cumulative voting rights. An election of directors by our shareholders shall be determined by a plurality of the votes cast by the shareholders entitled to vote on the election.

### **Restrictions on Ownership-Bank Regulatory Restrictions**

Federal law prohibits a person or group of persons "acting in concert" from acquiring "control" of a bank holding company unless the Federal Reserve Board has been given prior written notice of such proposed acquisition and within that time period the Federal Reserve has not issued a notice disapproving the proposed acquisition or extending for up to another statutory period during which such a disapproval may be issued. An acquisition may be made prior to the expiration of the disapproval period if the Federal Reserve issues written notice of its intent not to disapprove the action. Whether or not a party is presumed to have acquired control or have a controlling influence over a bank holding company depends on, among other things, its percentage of voting ownership, the number of director representatives such party has and overall business relationships with



the bank holding company. Similarly, the Hawaii Commissioner of Financial Institutions is required to approve any acquisition of control of the Bank or Central Pacific Financial Corp.

### **Anti-Takeover Effects of Hawaii Law**

The Hawaii Control Share Acquisitions Act (the "CSA Act") is applicable to the Company and is designed to inhibit hostile acquisitions by restricting Control Share Acquisitions. A Control Share Acquisition is the acquisition of shares of an issuer resulting in beneficial ownership of a new range of voting power (with thresholds for the ranges starting at 10% and set at 10% intervals up to a majority) for the election of directors. Certain acquisitions are exempt from the CSA Act, including acquisitions from the issuer or where the issuer's prior approval has been obtained. The CSA Act prohibits the consummation of a Control Share Acquisition unless each such acquisition is separately approved by a majority of the corporation's outstanding shares (excluding shares beneficially owned by the acquiring person) and imposes certain state law disclosure and timing requirements. If a Control Share Acquisition is made without the requisite shareholder approval, then, for a period of one year after the acquisition, the shares acquired by the acquiring person will (i) be denied voting rights, (ii) be non-transferable, and (iii) be subject to redemption at the option of the corporation either at the price at which the shares were acquired or at book value per share as of the last day of the fiscal quarter ended prior to the date of the call for redemption.

Thus, under certain circumstances, the CSA Act may make it more difficult for an acquiring person to exercise control over the Company due to the limitations placed on that person's ability to vote the shares so acquired and the right of the Company to acquire the subject shares.

In addition, the HBCA requires mergers and share exchanges to be approved by the affirmative vote of the holders of  $\frac{3}{4}$  of all the issued and outstanding shares having voting power.

### **Anti-Takeover Provisions in our Restated Articles and Amended Bylaws**

The following discussion is a general summary of certain provisions of the Restated Articles of Incorporation, and Amended Bylaws of the Company which may be deemed to have an "anti-takeover" effect.

*Advance Notice Requirement for Director Nominations.* Our Amended Bylaws provide that shareholder nominations for the election of directors may not be brought before a meeting of shareholders unless the shareholder has given timely written notice in proper form of such nomination to the Secretary of the Company at the principal executive office. Such proposals or nominations may be made only by persons who are shareholders of record on the date on which such notice is given and on the record date for determination of shareholders entitled to vote at that meeting. To be timely, a shareholder's notice shall be delivered to or mailed and received at the executive office of the corporation not less than 90 calendar days nor more than 120 calendar days prior to the first anniversary date of the annual meeting for the preceding year; provided, however, if and only if the annual meeting is not scheduled to be held within a period that commences 30 days before such anniversary date and ends 30 days after such anniversary date, the shareholder's notice shall be given in the manner provided herein by the later of (i) the close of business on the date 90 days prior to the meeting date or (ii) the tenth day following the date the meeting is first publicly announced or disclosed, and (iii) in the case of a special meeting of shareholders called for the purpose of electing directors, not later than the close of business on the tenth day following the day on which the date of the special meeting and of the nominees proposed by the Board of Directors to be elected at such meeting is publicly announced or disclosed.

No person nominated by a shareholder is eligible for election to the Board of Directors unless nominated in accordance with the foregoing procedures, and thus such procedures could make it more difficult for dissident shareholders to nominate and elect their candidates.

*Supermajority Shareholder Vote to Call a Special Shareholders Meeting to Amend Bylaws.* Subject to repeal or change at any regular meeting of the shareholders, or at any special meeting called for that purpose by the vote of the holders of eighty percent (80%) of the outstanding shares entitled to vote at such meeting, the power to alter, amend or repeal our Amended Bylaws or adopt new bylaws is vested in the Board of Directors. The supermajority vote required to call a special meeting of shareholders to amend the bylaws could have the effect of discouraging a tender offer or other takeover attempt where the ability to make fundamental changes through bylaw amendments adopted by the shareholders at a special meeting is an important element of the takeover strategy.

*Fair Price Provisions Involving Business Combinations.* Our Restated Articles of Incorporation contain a "fair price" provision that applies to certain business combination transactions involving any interested shareholder, which is (i) any person that beneficially owns more than 10% of our voting stock or (ii) any affiliate of the Company that within the past five years beneficially owned more than 10% of our voting stock. This provision requires the affirmative vote of the holders of at least

75% of our voting stock to approve specified transactions between an interested shareholder or its affiliate and us or our subsidiaries, including:

- any merger or consolidation;
- any sale, lease, license, exchange, pledge, transfer or other disposition of assets (in one transaction or a series of transactions) having a fair market value of \$2 million or more;
- the issuance or transfer of any of our securities or any of our subsidiaries' securities by us or any of our subsidiaries to an interested shareholder or its affiliates having a fair market value of \$2 million or more;
- the adoption of a plan or proposal for our liquidation or dissolution proposed by or on behalf of an interested shareholder or its affiliate; and
- any reclassification of securities (including any reverse stock split), recapitalization, merger or consolidation of our company with any of our subsidiaries or other transaction (whether or not involving an interested shareholder) that has the effect of increasing the proportionate share of the outstanding shares of any class of our equity or convertible securities or those of our subsidiaries owned by an interested shareholder or its affiliate.

This voting requirement will not apply to any particular transaction approved by a majority vote of the directors who are unaffiliated with the interested shareholder and who were members of the Board of Directors before the latter of the first public announcement of the terms of the proposed business combination and the day the interested shareholder became a shareholder and any successor to such directors who were unaffiliated with the interested shareholder and recommended to the Board of Directors by a majority of such directors. This voting requirement will also not apply to any transaction involving the payment of consideration to holders of our outstanding Common Stock in which certain minimum "fair price" and procedural requirements are met.

This "fair price" provision could have the effect of delaying or preventing a change in control of our company in a transaction of series of transactions that does not satisfy the stated criteria.

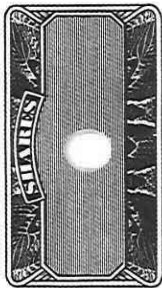
*Preferred Stock.* Our Restated Articles of Incorporation allow the Board of Directors to issue up to 1,000,000 shares of preferred stock, no par value per share. The Board of Directors also has the authority to designate the rights, preferences, privileges and restrictions of such preferred stock, including dividend rights, dividend rates, conversion rights, voting rights, terms of redemption, redemption prices, liquidation preferences and the number of shares constituting any series. The issuance of preferred stock may have the effect of delaying, deterring or preventing a change of control of our company without further action by the shareholders. The issuance of preferred stock with voting and conversion rights may also adversely affect the voting power of the holders of Common Stock. In certain circumstances, an issuance of preferred stock could have the effect of decreasing the market price of our Common Stock.

COMMON STOCK



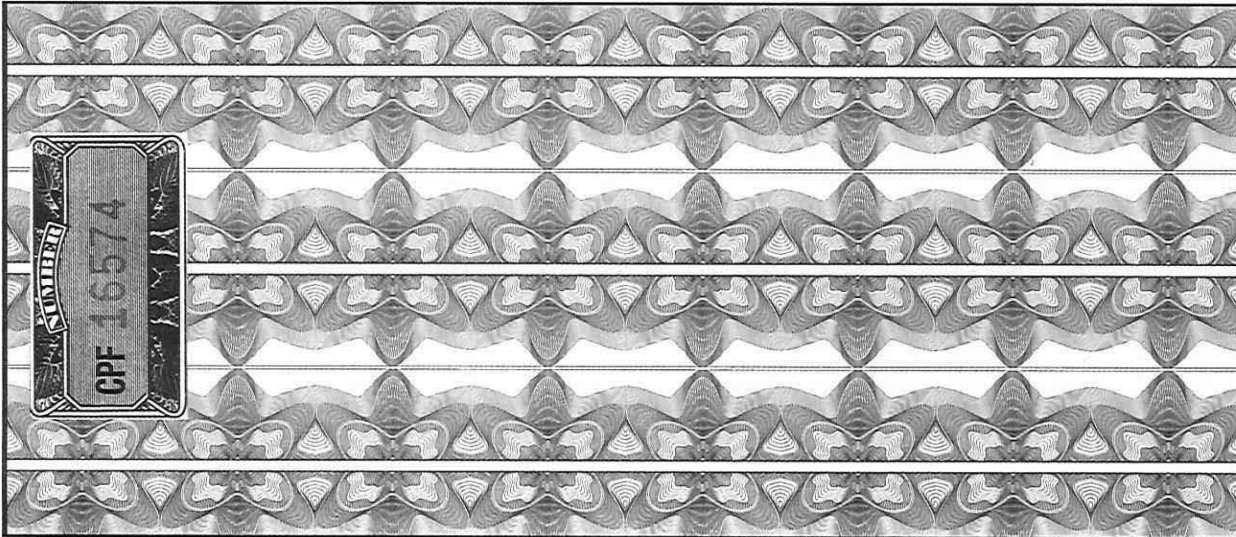
# CENTRAL PACIFIC FINANCIAL CORP

INCORPORATED UNDER THE LAWS OF THE STATE OF HAWAII



SEE REVERSE SIDE FOR CERTAIN DEFINITIONS

CUSIP 154760 40 9



THIS CERTIFIES THAT

# SPECIMEN

is the owner of

FULLY PAID AND NON-ASSESSABLE COMMON STOCK, WITHOUT PAR VALUE, OF

**CENTRAL PACIFIC FINANCIAL CORP.**

transferable on the books of the Corporation by the holder hereof in person or by Attorney upon surrender of this certificate properly endorsed. This certificate is not valid until countersigned and registered by the Transfer Agent and Registrar.

IN WITNESS WHEREOF, the said Corporation has caused this certificate to be signed by facsimile signatures of its duly authorized officers.

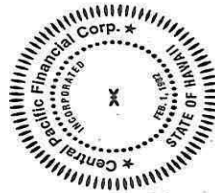
Dated:

COUNTERSIGNED AND REGISTERED:  
EQUINITI TRU COMPANY

BY *[Signature]*

TRANSFER AGENT AND REGISTRAR

AUTHORIZED SIGNATURE



*[Signature]*

EXECUTIVE VICE PRESIDENT,  
CHIEF LEGAL OFFICER &  
CORPORATE SECRETARY

*[Signature]*

CHAIRMAN &  
CHIEF EXECUTIVE OFFICER

**DESIGNATIONS, PREFERENCES, LIMITATIONS AND RELATIVE RIGHTS**

A full statement of the designations, preferences, limitations and relative rights of the shares of each class of stock authorized to be issued, including the variations in the relative rights and preferences between the shares of preferred stock, may be obtained by any shareholder, upon request and without charge, from the Secretary of the Company at Central Pacific Financial Corp., 220 South King Street, Honolulu, Hawaii 96813.

KEEP THIS CERTIFICATE IN A SAFE PLACE. IF IT IS LOST, STOLEN, OR DESTROYED THE CORPORATION WILL REQUIRE A BOND OF INDEMNITY AS A CONDITION TO THE ISSUANCE OF A REPLACEMENT CERTIFICATE.

The following abbreviations, when used in the inscription on the face of this certificate, shall be construed as though they were written out in full according to applicable laws or regulations:

- TEN COM - as tenants in common
  - TEN ENT - as tenants by entireties
  - JT TEN - as joint tenants with right of survivorship and not as tenants in common
  - UTMA - \_\_\_\_\_ Custodian \_\_\_\_\_ (Cust) \_\_\_\_\_ (Minor) under Uniform Transfers to Minors Act \_\_\_\_\_ (State)
- Additional abbreviations may also be used though not in above list.

*For value received \_\_\_\_\_ hereby sell, assign, and transfer unto*

PLEASE INSERT SOCIAL SECURITY OR OTHER IDENTIFYING NUMBER OF ASSIGNEE

[Empty box for Social Security or other identifying number]

(PLEASE PRINT OR TYPEWRITE NAME AND ADDRESS INCLUDING ZIP CODE OF ASSIGNEE)

*\_\_\_\_\_ Shares of the capital stock represented by the within Certificate, and do hereby irrevocably constitute and appoint \_\_\_\_\_ Attorney to transfer the said stock on the books of the within-named Corporation with full power of substitution in the premises.*

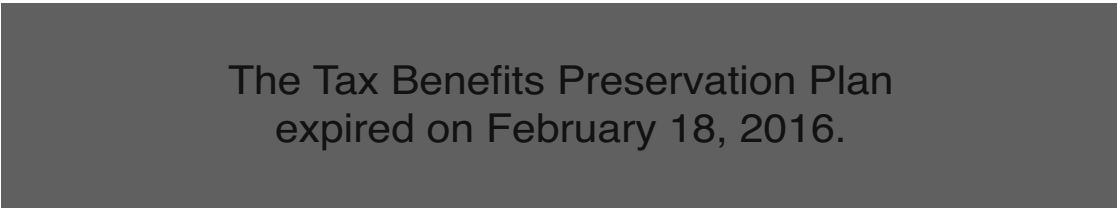
*Dated \_\_\_\_\_* **X** \_\_\_\_\_

**X** \_\_\_\_\_

NOTICE: THE SIGNATURE TO THIS ASSIGNMENT MUST CORRESPOND WITH THE NAME AS WRITTEN UPON THE FACE OF THE CERTIFICATE IN EVERY PARTICULAR WITHOUT ALTERATION OR ENLARGEMENT OR ANY CHANGE WHATSOEVER.

**SIGNATURE GUARANTEED**

ALL GUARANTEES MUST BE MADE BY A FINANCIAL INSTITUTION (SUCH AS A BANK OR BROKER) WHICH IS A PARTICIPANT IN THE SECURITIES TRANSFER AGENTS MEDALLION PROGRAM ("STAMP"), THE NEW YORK STOCK EXCHANGE, INC. MEDALLION SIGNATURE PROGRAM ("MSIP"), OR THE STOCK EXCHANGES MEDALLION PROGRAM ("SEMP") AND MUST NOT BE DATED. GUARANTEES BY A NOTARY PUBLIC ARE NOT ACCEPTABLE.



### Subsidiaries of the Registrant

The Company or one of its wholly-owned subsidiaries owned the following percent of the outstanding common stock, voting securities and interests of each of the corporations listed below as of December 31, 2019:

Name	State or Other Jurisdiction of Incorporation	Percent Owned
Central Pacific Bank	Hawaii	100%
CPB Capital Trust II	Delaware	100% <sup>(1)</sup>
CPB Statutory Trust III	Connecticut	100% <sup>(1)</sup>
CPB Capital Trust IV	Delaware	100%
CPB Statutory Trust V	Delaware	100%
Gentry HomeLoans, LLC	Hawaii	50%
Haseko HomeLoans, LLC	Hawaii	50%
Island Pacific HomeLoans, LLC	Hawaii	50%

<sup>(1)</sup> Terminated in January 2019.

**Consent of Independent Registered Public Accounting Firm**

The Board of Directors  
Central Pacific Financial Corp.:

We consent to the incorporation by reference in the registration statements (Nos. 333-141232, 333-188445, 333-119538, 333-196873, and 333-211155) on Form S-8 of Central Pacific Financial Corp. of our report dated February 28, 2018, with respect to the Central Pacific Financial Corp. and subsidiaries consolidated statements of income, comprehensive income, changes in equity, and cash flows for the year ended December 31, 2017, and the related notes, before the effects of the adjustments to retroactively apply the change in accounting related to investments in low income housing tax credit partnerships described in Note 1, which report appears in the December 31, 2019 annual report on Form 10-K of Central Pacific Financial Corp.

/s/ KPMG LLP

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Honolulu, Hawaii

February 25, 2020

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We consent to the incorporation by reference in Registration Statement No. 333-141232, No. 333-188445, No. 333-119538, No. 333-196873, and No. 333-211155 on Form S-8 of Central Pacific Financial Corp. of our report dated February 25, 2020 relating to the financial statements and effectiveness of internal control over financial reporting, appearing in this Annual Report on Form 10-K.

/s/ Crowe LLP

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Sacramento, California

February 25, 2020

**CERTIFICATION PURSUANT TO EXCHANGE ACT RULE 13a-14(a)**

I, Paul K. Yonamine, Chairman and Chief Executive Officer of Central Pacific Financial Corp. (the “Company”), certify that:

1. I have reviewed this Annual Report on Form 10-K of the Company;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report.
4. The registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
  - c. Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and
5. The registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent functions):
  - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and
  - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: February 25, 2020

By: /s/ Paul K. Yonamine

Paul K. Yonamine

*Chairman and Chief Executive Officer*

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**CERTIFICATION PURSUANT TO EXCHANGE ACT RULE 13a-14(a)**

I, David S. Morimoto, Executive Vice President and Chief Financial Officer of Central Pacific Financial Corp. (the “Company”), certify that:

1. I have reviewed this Annual Report on Form 10-K of the Company;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report.
4. The registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
  - c. Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and
5. The registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent functions):
  - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and
  - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: February 25, 2020

By: /s/ David S. Morimoto

David S. Morimoto

*Executive Vice President and Chief Financial Officer*

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**Certification Pursuant to 18 U.S.C. Section 1350,  
as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**

I, Paul K. Yonamine, Chairman and Chief Executive Officer of Central Pacific Financial Corp. (the "Company"), do hereby certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

1. The Annual Report on Form 10-K of the Company for the fiscal year ended December 31, 2019, as filed with the Securities and Exchange Commission (the "Report"), fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: February 25, 2020

By: /s/ Paul K. Yonamine

\_\_\_\_\_  
Paul K. Yonamine

*Chairman and Chief Executive Officer*

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

This certification accompanies the Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not be deemed filed by the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.

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**Certification Pursuant to 18 U.S.C. Section 1350,  
as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**

I, David S. Morimoto, Executive Vice President and Chief Financial Officer of Central Pacific Financial Corp. (the “Company”), do hereby certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

1. The Annual Report on Form 10-K of the Company for the fiscal year ended December 31, 2019, as filed with the Securities and Exchange Commission (the “Report”), fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: February 25, 2020

By: /s/ David S. Morimoto

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David S. Morimoto

*Executive Vice President and Chief Financial Officer*

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

This certification accompanies the Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not be deemed filed by the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.

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