# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION
**WASHINGTON, D.C. 20549**

# FORM 10-Q

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

**For the quarterly period ended June 30, 2019**

**or**

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from ______ to _______**

**Commission File Number 001-14585**

# FIRST HAWAIIAN, INC.
(Exact Name of Registrant as Specified in its Charter)

| | |
|---|---|
| **Delaware** | **99-0156159** |
| (State or Other Jurisdiction of Incorporation or Organization) | (I.R.S. Employer Identification No.) |
| **999 Bishop Street, 29th Floor**<br>**Honolulu, HI** | **96813** |
| (Address of Principal Executive Offices) | (Zip Code) |

**(808) 525-7000**
(Registrant’s telephone number, including area code)

**Not Applicable**
(Former name, former address and former fiscal year, if changed since last report)

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, par value $0.01 per share | FHB | NASDAQ Global Select Market |

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 (section 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 the 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 ☒ | Accelerated filer ☐ |
| Non-accelerated filer ☐ | Smaller reporting company ☐ |
| | Emerging growth company ☐ |

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 ☒.

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date: 133,289,212 shares of Common Stock, par value $0.01 per share, were outstanding as of July 18, 2019.

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**PART I. FINANCIAL INFORMATION**
**ITEM 1. FINANCIAL STATEMENTS**

FIRST HAWAIIAN, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

| (dollars in thousands, except per share amounts) | Three Months Ended June 30, 2019 | Three Months Ended June 30, 2018 | Six Months Ended June 30, 2019 | Six Months Ended June 30, 2018 |
|---|---|---|---|---|
| **Interest income** | | | | |
| Loans and lease financing | **$ 146,883** | $ 130,283 | **$ 291,289** | $ 253,834 |
| Available-for-sale securities | **24,784** | 27,397 | **49,270** | 56,390 |
| Other | **2,151** | 1,339 | **5,820** | 3,731 |
| Total interest income | **173,818** | 159,019 | **346,379** | 313,955 |
| **Interest expense** | | | | |
| Deposits | **23,693** | 17,355 | **46,890** | 32,619 |
| Short-term and long-term borrowings | **4,512** | 261 | **8,787** | 261 |
| Total interest expense | **28,205** | 17,616 | **55,677** | 32,880 |
| Net interest income | **145,613** | 141,403 | **290,702** | 281,075 |
| Provision for loan and lease losses | **3,870** | 6,020 | **9,550** | 11,970 |
| Net interest income after provision for loan and lease losses | **141,743** | 135,383 | **281,152** | 269,105 |
| **Noninterest income** | | | | |
| Service charges on deposit accounts | **8,123** | 7,721 | **16,183** | 15,676 |
| Credit and debit card fees | **16,629** | 16,929 | **33,284** | 32,426 |
| Other service charges and fees | **9,403** | 9,633 | **18,532** | 18,975 |
| Trust and investment services income | **8,931** | 7,711 | **17,549** | 15,942 |
| Bank-owned life insurance | **3,390** | 2,395 | **7,203** | 4,439 |
| Investment securities gains (losses), net | **21** | — | **(2,592)** | — |
| Other | **2,276** | 5,408 | **5,686** | 11,039 |
| Total noninterest income | **48,773** | 49,797 | **95,845** | 98,497 |
| **Noninterest expense** | | | | |
| Salaries and employee benefits | **42,185** | 41,636 | **87,045** | 83,796 |
| Contracted services and professional fees | **14,303** | 13,005 | **27,948** | 25,292 |
| Occupancy | **7,286** | 6,908 | **14,272** | 13,392 |
| Equipment | **4,544** | 4,335 | **8,828** | 8,923 |
| Regulatory assessment and fees | **2,149** | 4,225 | **3,596** | 8,198 |
| Advertising and marketing | **1,980** | 1,115 | **3,946** | 2,066 |
| Card rewards program | **7,664** | 6,359 | **14,396** | 12,077 |
| Other | **13,179** | 14,282 | **25,882** | 28,708 |
| Total noninterest expense | **93,290** | 91,865 | **185,913** | 182,452 |
| Income before provision for income taxes | **97,226** | 93,315 | **191,084** | 185,150 |
| Provision for income taxes | **24,793** | 24,262 | **48,727** | 48,139 |
| **Net income** | **$ 72,433** | $ 69,053 | **$ 142,357** | $ 137,011 |
| Basic earnings per share | **$ 0.54** | $ 0.50 | **$ 1.06** | $ 0.99 |
| Diluted earnings per share | **$ 0.54** | $ 0.50 | **$ 1.06** | $ 0.99 |
| Basic weighted-average outstanding shares | **134,420,380** | 137,907,063 | **134,655,217** | 138,749,209 |
| Diluted weighted-average outstanding shares | **134,652,008** | 138,065,879 | **134,924,331** | 138,891,955 |

The accompanying notes are an integral part of these unaudited interim consolidated financial statements.

FIRST HAWAIIAN, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| (dollars in thousands) | **2019** | **2018** | **2019** | **2018** |
| Net income | **$ 72,433** | $ 69,053 | **$ 142,357** | $ 137,011 |
| Other comprehensive income (loss), net of tax: | | | | |
| Net change in pensions and other benefits | **(594)** | — | **(594)** | — |
| Net change in investment securities | **47,364** | (18,039) | **100,805** | (66,816) |
| Net change in cash flow derivative hedges | **—** | 313 | **—** | 857 |
| Other comprehensive income (loss) | **46,770** | (17,726) | **100,211** | (65,959) |
| **Total comprehensive income** | **$ 119,203** | $ 51,327 | **$ 242,568** | $ 71,052 |

The accompanying notes are an integral part of these unaudited interim consolidated financial statements.

FIRST HAWAIIAN, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
(Unaudited)

| (dollars in thousands, except share amount) | June 30, 2019 | December 31, 2018 |
|---|---|---|
| **Assets** | | |
| Cash and due from banks | **$ 423,802** | $ 396,836 |
| Interest-bearing deposits in other banks | **259,713** | 606,801 |
| Investment securities | **4,395,476** | 4,498,342 |
| Loans held for sale | **215** | 432 |
| Loans and leases | **13,264,609** | 13,076,191 |
| Less: allowance for loan and lease losses | **138,535** | 141,718 |
| Net loans and leases | **13,126,074** | 12,934,473 |
| | | |
| Premises and equipment, net | **313,200** | 304,996 |
| Other real estate owned and repossessed personal property | **—** | 751 |
| Accrued interest receivable | **49,205** | 48,920 |
| Bank-owned life insurance | **450,722** | 446,076 |
| Goodwill | **995,492** | 995,492 |
| Mortgage servicing rights | **14,573** | 16,155 |
| Other assets | **497,895** | 446,404 |
| **Total assets** | **$ 20,526,367** | $ 20,695,678 |
| **Liabilities and Stockholders' Equity** | | |
| Deposits: | | |
| Interest-bearing | **$ 11,028,921** | $ 11,142,127 |
| Noninterest-bearing | **5,763,157** | 6,007,941 |
| Total deposits | **16,792,078** | 17,150,068 |
| Short-term borrowings | **200,000** | — |
| Long-term borrowings | **400,028** | 600,026 |
| Retirement benefits payable | **128,610** | 127,909 |
| Other liabilities | **346,210** | 292,836 |
| Total liabilities | **17,866,926** | 18,170,839 |
| | | |
| Commitments and contingent liabilities (Note 13) | | |
| | | |
| Stockholders' equity | | |
| Common stock ($0.01 par value; authorized 300,000,000 shares; issued/outstanding: 139,857,673 / 133,508,212 as of June 30, 2019; issued/outstanding: 139,656,674 / 134,874,302 as of December 31, 2018) | **1,399** | 1,397 |
| Additional paid-in capital | **2,499,946** | 2,495,853 |
| Retained earnings | **363,748** | 291,919 |
| Accumulated other comprehensive loss, net | **(31,984)** | (132,195) |
| Treasury stock (6,349,461 shares as of June 30, 2019 and 4,782,372 shares as of December 31, 2018) | **(173,668)** | (132,135) |
| Total stockholders' equity | **2,659,441** | 2,524,839 |
| **Total liabilities and stockholders' equity** | **$ 20,526,367** | $ 20,695,678 |

The accompanying notes are an integral part of these unaudited interim consolidated financial statements.

FIRST HAWAIIAN, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(Unaudited)

| | Three Months Ended June 30, 2019 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Common Stock | | Additional Paid-In | Retained | Accumulated Other Comprehensive | Treasury | |
| (dollars in thousands, except share amounts) | Shares | Amount | Capital | Earnings | Income (Loss) | Stock | Total |
| Balance as of March 31, 2019 | 135,012,015 | $ 1,399 | $ 2,497,770 | $ 326,451 | $ (78,754) | $ (133,664) | $ 2,613,202 |
| **Net income** | — | — | — | 72,433 | — | — | 72,433 |
| **Cash dividends declared ($0.26 per share)** | — | — | — | (34,916) | — | — | (34,916) |
| **Equity-based awards** | 6,043 | — | 2,176 | (220) | — | (4) | 1,952 |
| **Common stock repurchased** | (1,509,846) | — | — | — | — | (40,000) | (40,000) |
| **Other comprehensive income, net of tax** | — | — | — | — | 46,770 | — | 46,770 |
| **Balance as of June 30, 2019** | 133,508,212 | $ 1,399 | $ 2,499,946 | $ 363,748 | $ (31,984) | $ (173,668) | $ 2,659,441 |

| | Six Months Ended June 30, 2019 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Common Stock | | Additional Paid-In | Retained | Accumulated Other Comprehensive | Treasury | |
| (dollars in thousands, except share amounts) | Shares | Amount | Capital | Earnings | Income (Loss) | Stock | Total |
| Balance as of December 31, 2018 | 134,874,302 | $ 1,397 | $ 2,495,853 | $ 291,919 | $ (132,195) | $ (132,135) | $ 2,524,839 |
| **Net income** | — | — | — | 142,357 | — | — | 142,357 |
| **Cash dividends declared ($0.52 per share)** | — | — | — | (69,984) | — | — | (69,984) |
| **Equity-based awards** | 143,756 | 2 | 4,093 | (544) | — | (1,533) | 2,018 |
| **Common stock repurchased** | (1,509,846) | — | — | — | — | (40,000) | (40,000) |
| **Other comprehensive income, net of tax** | — | — | — | — | 100,211 | — | 100,211 |
| **Balance as of June 30, 2019** | 133,508,212 | $ 1,399 | $ 2,499,946 | $ 363,748 | $ (31,984) | $ (173,668) | $ 2,659,441 |

The accompanying notes are an integral part of these unaudited interim consolidated financial statements.

FIRST HAWAIIAN, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (continued)
(Unaudited)

| | Three Months Ended June 30, 2018 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Common Stock | | Additional Paid-In | Retained | Accumulated Other Comprehensive | Treasury | |
| (dollars in thousands, except share amounts) | Shares | Amount | Capital | Earnings | Loss | Stock | Total |
| Balance as of March 31, 2018 | 139,601,123 | $ 1,396 | $ 2,490,910 | $ 193,522 | $ (164,684) | $ (282) | $ 2,520,862 |
| Net income | — | — | — | 69,053 | — | — | 69,053 |
| Cash dividends declared ($0.24 per share) | — | — | — | (32,792) | — | — | (32,792) |
| Equity-based awards | 9,006 | — | 1,746 | (168) | — | — | 1,578 |
| Common stock repurchased | (2,968,069) | — | — | — | — | (81,800) | (81,800) |
| Other comprehensive loss, net of tax | — | — | — | — | (17,726) | — | (17,726) |
| Balance as of June 30, 2018 | 136,642,060 | $ 1,396 | $ 2,492,656 | $ 229,615 | $ (182,410) | $ (82,082) | $ 2,459,175 |

| | Six Months Ended June 30, 2018 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Common Stock | | Additional Paid-In | Retained | Accumulated Other Comprehensive | Treasury | |
| (dollars in thousands, except share amounts) | Shares | Amount | Capital | Earnings | Loss | Stock | Total |
| Balance as of December 31, 2017 | 139,588,782 | $ 1,396 | $ 2,488,643 | $ 139,177 | $ (96,383) | $ (282) | $ 2,532,551 |
| Net income | — | — | — | 137,011 | — | — | 137,011 |
| Cash dividends declared ($0.48 per share) | — | — | — | (66,296) | — | — | (66,296) |
| Common stock issued under Employee Stock Purchase Plan | 12,341 | — | 342 | — | — | — | 342 |
| Equity-based awards | 9,006 | — | 3,671 | (345) | — | — | 3,326 |
| Common stock repurchased | (2,968,069) | — | — | — | — | (81,800) | (81,800) |
| Adoption of Accounting Standards Update No. 2018-02 | — | — | — | 20,068 | (20,068) | — | — |
| Other comprehensive loss, net of tax | — | — | — | — | (65,959) | — | (65,959) |
| Balance as of June 30, 2018 | 136,642,060 | $ 1,396 | $ 2,492,656 | $ 229,615 | $ (182,410) | $ (82,082) | $ 2,459,175 |

The accompanying notes are an integral part of these unaudited interim consolidated financial statements.

FIRST HAWAIIAN, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

| (dollars in thousands) | Six Months Ended June 30, 2019 | Six Months Ended June 30, 2018 |
|---|---|---|
| **Cash flows from operating activities** | | |
| Net income | **$ 142,357** | $ 137,011 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Provision for loan and lease losses | **9,550** | 11,970 |
| Depreciation, amortization and accretion, net | **32,959** | 27,557 |
| Deferred income taxes | **15,724** | 5,416 |
| Stock-based compensation | **3,551** | 3,326 |
| Other gains | **(8)** | (1,088) |
| Originations of loans held for sale | **(4,091)** | (10,921) |
| Proceeds from sales of loans held for sale | **4,343** | 8,944 |
| Net gains on sales of loans held for sale | **(35)** | (66) |
| Net losses on investment securities | **2,592** | — |
| Change in assets and liabilities: | | |
| Net decrease in other assets | **1,145** | 11,977 |
| Net decrease in other liabilities | **(63,844)** | (14,080) |
| Net cash provided by operating activities | **144,243** | 180,046 |
| **Cash flows from investing activities** | | |
| Available-for-sale securities: | | |
| Proceeds from maturities and principal repayments | **322,954** | 425,182 |
| Proceeds from sales | **905,605** | — |
| Purchases | **(999,491)** | (130,252) |
| Other investments: | | |
| Proceeds from sales | **4,854** | 7,918 |
| Purchases | **(12,693)** | (28,153) |
| Loans: | | |
| Net decrease (increase) in loans and leases resulting from originations and principal repayments | **21,111** | (364,620) |
| Proceeds from sales of loans originated for investment | **—** | 562 |
| Purchases of loans | **(222,816)** | — |
| Proceeds from bank-owned life insurance | **2,557** | — |
| Purchases of premises, equipment and software | **(16,269)** | (9,752) |
| Purchases of mortgage servicing rights | **—** | (6,444) |
| Proceeds from sales of other real estate owned | **759** | 332 |
| Other | **(1,429)** | (1,325) |
| Net cash provided by (used in) investing activities | **5,142** | (106,552) |
| **Cash flows from financing activities** | | |
| Net decrease in deposits | **(357,990)** | (216,584) |
| Proceeds from long-term borrowings | **—** | 200,000 |
| Dividends paid | **(69,984)** | (66,296) |
| Stock tendered for payment of withholding taxes | **(1,533)** | — |
| Proceeds from employee stock purchase plan | **—** | 342 |
| Common stock repurchased | **(40,000)** | (81,800) |
| Net cash used in financing activities | **(469,507)** | (164,338) |
| Net decrease in cash and cash equivalents | **(320,122)** | (90,844) |
| Cash and cash equivalents at beginning of period | **1,003,637** | 1,034,644 |
| **Cash and cash equivalents at end of period** | **$ 683,515** | $ 943,800 |
| | | |
| **Supplemental disclosures** | | |
| Interest paid | **$ 51,421** | $ 32,764 |
| Income taxes paid, net of income tax refunds | **41,593** | 1,548 |
| Noncash investing and financing activities: | | |
| Transfers from loans and leases to other real estate owned | **—** | 64 |
| Operating lease right-of-use assets obtained in exchange for new lease obligations | **680** | — |

The accompanying notes are an integral part of these unaudited interim consolidated financial statements.

FIRST HAWAIIAN, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

**1. Organization and Basis of Presentation**

First Hawaiian, Inc. (“FHI” or the “Parent”), a bank holding company, owns 100% of the outstanding common stock of First Hawaiian Bank (“FHB” or the “Bank”), its only direct, wholly owned subsidiary. FHB offers a comprehensive suite of banking services to consumer and commercial customers including loans, deposit products, wealth management, insurance, trust, retirement planning, credit card and merchant processing services.

The accompanying unaudited interim consolidated financial statements of First Hawaiian, Inc. and Subsidiary (the “Company”) have been prepared in accordance with generally accepted accounting principles in the United States of America (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations.

The accompanying unaudited interim consolidated financial statements and notes thereto should be read in conjunction with the Company’s audited consolidated financial statements and related notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2018.

In the opinion of management, all adjustments, which consist of normal recurring adjustments necessary for a fair presentation of the interim period consolidated financial information, have been made. Results of operations for interim periods are not necessarily indicative of results to be expected for the entire year. Intercompany account balances and transactions have been eliminated in consolidation.

**Transition to an Independent Public Company**

On July 1, 2016, FHI became a direct wholly owned subsidiary of BancWest Corporation (“BWC”), a Delaware corporation and an indirect wholly owned subsidiary of BNP Paribas (“BNPP”). In connection with FHI’s initial public offering (“IPO”) in August 2016, BNPP announced its intent to sell its interest in FHI, including FHI’s wholly owned subsidiary, FHB, over time, subject to market conditions and other considerations.

Following a series of secondary offerings completed in 2017 and 2018, on February 1, 2019, BWC completed the sale of its remaining 24,859,750 shares of FHI common stock in a public offering. FHI did not receive any of the proceeds from the sales of shares of FHI common stock in that offering, in any of the secondary offerings described above or the IPO. As a result of the completion of the February 1, 2019 public offering, BNPP (through BWC, the selling stockholder) fully exited its ownership interest in FHI common stock.

**Use of Estimates in the Preparation of Financial Statements**

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Management bases its estimates on historical experience and various other assumptions believed to be reasonable. Although these estimates are based on management’s best knowledge of current events, actual results may differ from these estimates.

**Accounting Standards Adopted in 2019**

In February 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2016-02, *Leases (Topic 842)*. This guidance provided that lessees would be required to recognize the following for all operating leases (with the exception of short-term leases): 1) a lease liability, which is the present value of a lessee's obligation to make lease payments, and 2) a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Lessor accounting under the new guidance remains largely unchanged as it is substantially equivalent to existing guidance for sales-type leases, direct financing leases and operating leases. The Company adopted the provisions of ASU No. 2016-02 on January 1, 2019 and elected several practical expedients made available by the FASB. Specifically, the Company elected the transition practical expedient to not recast comparative periods upon the adoption of the new guidance. In addition, the Company elected the package of practical expedients which among other things, required no reassessment of whether existing contracts were or contained leases as well as no reassessment of lease classification for existing leases and the practical expedient which permitted the Company to not separate nonlease components from lease components in determining the consideration in the lease agreement when the Company was a lessee or a lessor. The Company identified the primary lease agreements in scope of this new guidance as those relating to branch premises. As a result, the Company recognized a lease liability of $50.3 million and a related right-of-use asset of $50.6 million on its consolidated balance sheet on January 1, 2019. See "Note 16. Leases" for required disclosures related to this new guidance.

In March 2017, the FASB issued ASU No. 2017-08, *Receivables – Nonrefundable Fees and Other Costs (Subtopic 310-20), Premium Amortization on Purchased Callable Debt Securities*. Prior to the adoption of ASU No. 2017-08, entities typically amortized the premium as an adjustment of yield over the contractual life of debt securities. This guidance shortens the amortization period for certain callable debt securities held at a premium to the earliest call date. The Company adopted the provisions of ASU No. 2017-08 on January 1, 2019, and it did not have a material impact on the Company's consolidated financial statements.

In August 2017, the FASB issued ASU No. 2017-12, *Derivatives and Hedging (Topic 815), Targeted Improvements to Accounting for Hedging Activities*. The objectives of the new guidance were to: (1) improve the transparency and understandability of information conveyed to financial statement users about an entity's risk management activities by better aligning the entity's financial reporting for hedging relationships with those risk management activities, and (2) reduce the complexity of and simplify the application of hedge accounting by preparers. Historically, the Company has participated in limited activities in fair value and cash flow hedging relationships. As a result, the adoption of ASU No. 2017-12 on January 1, 2019, did not have a material impact on the Company's consolidated financial statements. See "Note 12. Derivative Financial Instruments" for required disclosures related to this new guidance.

In August 2018, the FASB issued ASU No. 2018-15, *Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That is a Service Contract*. This guidance aligns the accounting for implementation costs related to a hosting arrangement that is a service contract with the guidance on capitalizing costs associated with developing or obtaining internal-use software. Common examples of hosting arrangements include software as a service, platform or infrastructure as a service and other similar types of hosting arrangements. While capitalized costs related to internal-use software is generally considered an intangible asset, costs incurred to implement a cloud computing arrangement that is a service contract would typically be characterized in the company's financial statements in the same manner as other service costs (e.g., other assets). The new guidance provided that an entity would be required to amortize capitalized implementation costs over the term of the hosting arrangement on a straight-line basis unless another systematic and rational basis was more representative of the pattern in which the entity expected to benefit from access to the hosted software. This guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019, with earlier adoption permitted in any annual or interim period for which financial statements have not yet been issued or made available for issuance. The Company early adopted the provisions of ASU No. 2018-15 on January 1, 2019 due to the Company's shift towards utilizing more hosting arrangements that are service contracts. For the six months ended June 30, 2019, the Company capitalized $3.5 million related to hosting arrangements that are service contracts.

In October 2018, the FASB issued ASU No. 2018-16, *Derivatives and Hedging (Topic 815), Inclusion of the Secured Overnight Financing Rate (SOFR) Overnight Index Swap (OIS) Rate as a Benchmark Interest Rate for Hedge Accounting Purposes*. This guidance expands the list of U.S. benchmark interest rates permitted in the application of hedge accounting by adding the OIS rate based on the SOFR. Due to concerns about the sustainability of the London Interbank Offered Rate ("LIBOR"), a committee convened by the Federal Reserve Board and the Federal Reserve Bank of New York initiated an effort to introduce an alternative reference rate in the U.S. The committee identified SOFR as the preferred alternative reference rate to LIBOR. The OIS rate based on SOFR was added as a U.S. benchmark interest rate to facilitate broader use in the marketplace and provide sufficient lead time for entities to prepare for changes to interest rate risk hedging strategies. The Company adopted the provisions of ASU No. 2018-16 on January 1, 2019 and it did not have a material impact on the Company's consolidated financial statements.

**Recent Accounting Pronouncements**

The following ASUs have been issued by the FASB and are applicable to the Company in future reporting periods.

In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments – Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments*. This guidance eliminates the probable recognition threshold for credit losses on financial assets measured at amortized cost. For loans and held-to-maturity debt securities, this guidance requires a current expected credit loss ("CECL") approach to determine the allowance for credit losses. CECL requires loss estimates for the remaining estimated life of the financial asset using historical experience, current conditions, and reasonable and supportable forecasts. In addition, this guidance modifies the other-than-temporary-impairment model for available-for-sale debt securities to require an allowance for credit impairment instead of a direct write-down, which allows for a reversal of credit losses in future periods. 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. This guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019, with earlier adoption permitted. In April 2019, the FASB also issued ASU No. 2019-04, *Codification Improvements to Topic 326, Financial Instruments – Credit Losses, Topic 815, Derivatives and Hedging, and Topic 825, Financial Instruments*. As it relates to CECL, this guidance amends certain provisions contained in ASU No. 2016-13, particularly with regards to the inclusion of accrued interest in the definition of amortized cost, as well as clarifying that extension and renewal options that are not unconditionally cancelable by the entity that are included in the original or modified contract should be considered in the entity's determination of expected credit losses. As permitted by ASU No. 2016-13, the Company expects to elect the practical expedient to use the fair value of the collateral at the reporting date when recording the net carrying amount of the asset and determining the allowance for credit losses for a financial asset for which the repayment is expected to be provided substantially through the operation or sale of the collateral when the borrower is experiencing financial difficulty based on the Company's assessment as of the reporting date.  As permitted by ASU No. 2019-04, the Company expects to make accounting policy elections to not measure an allowance for credit losses on accrued interest receivable, write-off accrued interest receivable by reversing interest income and to present accrued interest receivable separately from the related financial asset on the balance sheet. The Company is also expected to apply a practical expedient to separately disclose the total amount of accrued interest as a single balance in certain disclosure requirements. The new guidance will require significant operational changes, particularly in data collection and analysis. The Company has formed a working group comprised of teams from different disciplines, including credit, finance and information technology, to evaluate the requirements of the new standard and the impact it will have on the Company's current processes. The Company has also engaged a software vendor and is in the final stages of implementing a CECL production platform. Management expects that the preliminary CECL model will be ready for detailed review and testing during the third quarter of 2019. Based on the results of the Company's parallel runs, management expects to have an estimate of the impact that this new guidance will have on the Company's consolidated financial statements in the fourth quarter of 2019. The Company expects that testing, control design and model validation will continue throughout the remainder of 2019.

In January 2017, the FASB issued ASU No. 2017-04, *Intangibles – Goodwill and Other (Topic 350), Simplifying the Test for Goodwill Impairment*. This guidance simplifies the subsequent measurement of goodwill by eliminating Step 2 from the current two-step goodwill impairment test. This guidance provides that a goodwill impairment test be conducted by comparing the fair value of a reporting unit with its carrying amount. Entities are to recognize an impairment charge for goodwill by the amount by which the carrying amount exceeds the reporting unit's fair value. Entities will continue to have the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. This guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. The adoption of ASU No. 2017-04 is not expected to have a material impact on the Company's consolidated financial statements.

In August 2018, the FASB issued ASU No. 2018-13, *Fair Value Measurement (Topic 820), Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement*. This guidance is a part of the FASB's disclosure framework project to improve disclosure effectiveness. This guidance eliminates certain disclosure requirements for fair value measurements: the amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy, an entity's policy for the timing of transfers between levels of the fair value hierarchy and an entity's valuation processes for Level 3 fair value measurements. This guidance also adds new disclosure requirements for public entities: changes in unrealized gains and losses for the period included in other comprehensive income for recurring Level 3 fair value measurements of instruments held at the end of the reporting period, and the range and weighted average of significant unobservable inputs used to develop recurring and nonrecurring Level 3 fair value measurements, including how the weighted average is calculated. Furthermore, this guidance modifies certain requirements which will involve disclosing: transfers into and out of Level 3 of the fair value hierarchy, purchases and issuances of Level 3 assets and liabilities, and information about the measurement uncertainty of Level 3 fair value measurements as of the reporting date. This update is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. The adoption of ASU No. 2018-13 is not expected to have a material impact on the Company's consolidated financial statements.

**2. Investment Securities**

As of June 30, 2019 and December 31, 2018, investment securities consisted predominantly of the following investment categories:

*U.S. Treasury and debt securities* – includes U.S. Treasury notes and debt securities issued by agencies and government-sponsored enterprises.

*Mortgage-backed securities* – includes securities backed by notes or receivables secured by mortgage assets with cash flows based on actual or scheduled payments.

*Collateralized mortgage obligations* – includes securities backed by a pool of mortgages with cash flows distributed based on certain rules rather than pass through payments.

*Debt securities issued by states and political subdivisions* – includes general obligation bonds issued by state and local governments.

As of June 30, 2019 and December 31, 2018, all of the Company's investment securities were classified as available-for-sale. Amortized cost and fair value of securities as of June 30, 2019 and December 31, 2018 were as follows:

| | **June 30, 2019** | | | | **December 31, 2018** | | | |
|---|---|---|---|---|---|---|---|---|
| (dollars in thousands) | **Amortized Cost** | **Unrealized Gains** | **Unrealized Losses** | **Fair Value** | **Amortized Cost** | **Unrealized Gains** | **Unrealized Losses** | **Fair Value** |
| U.S. Treasury securities | **$ 29,477** | **$ 79** | **$ —** | **$ 29,556** | $ 389,470 | $ — | $ — | $ 389,470 |
| Government agency debt securities | **24,583** | **130** | **—** | **24,713** | — | — | — | — |
| Government-sponsored enterprises debt securities | **164,719** | **1** | **(404)** | **164,316** | 248,372 | — | (6,778) | 241,594 |
| Government agency mortgage-backed securities | **363,295** | **2,043** | **(3,117)** | **362,221** | 426,710 | — | (15,174) | 411,536 |
| Government-sponsored enterprises mortgage-backed securities | **152,506** | **852** | **(1,675)** | **151,683** | 156,056 | 85 | (5,294) | 150,847 |
| Collateralized mortgage obligations: | | | | | | | | |
| Government agency | **2,619,502** | **9,107** | **(15,144)** | **2,613,465** | 2,779,620 | — | (97,171) | 2,682,449 |
| Government-sponsored enterprises | **1,045,515** | **8,549** | **(4,542)** | **1,049,522** | 620,337 | — | (17,745) | 602,592 |
| Debt securities issued by states and political subdivisions | **—** | **—** | **—** | **—** | 19,854 | — | — | 19,854 |
| **Total available-for-sale securities** | **$ 4,399,597** | **$ 20,761** | **$ (24,882)** | **$ 4,395,476** | $ 4,640,419 | $ 85 | $ (142,162) | $ 4,498,342 |

Proceeds from calls and sales of investment securities were nil and $42.6 million, respectively, for the three months ended June 30, 2019 and nil and $905.6 million, respectively, for the six months ended June 30, 2019. Proceeds from both calls and sales of investment securities were nil for both the three and six months ended June 30, 2018. The Company recorded gross realized gains of $0.1 million and gross realized losses of $0.1 million for the three months ended June 30, 2019 and gross realized gains of $0.1 million and gross realized losses of $2.7 million for the six months ended June 30, 2019. The Company recorded no gross realized gains and no gross realized losses for the three and six months ended June 30, 2018. The income tax expense related to the Company's net realized gain on the sale of investment securities was nil for the three months ended June 30, 2019. The income tax benefit related to the Company's net realized loss on the sale of investment securities was $0.7 million for the six months ended June 30, 2019. No provision for income taxes related to net realized gains on the sale of investment securities was recorded for the three and six months ended June 30, 2018. Gains and losses realized on sales of securities are determined using the specific identification method.

Interest income from taxable investment securities was $24.8 million and $27.3 million for the three months ended June 30, 2019 and 2018, respectively, and $49.3 million and $56.1 million for the six months ended June 30, 2019 and 2018, respectively. Interest income from non-taxable investment securities was nil and $0.1 million for the three months ended June 30, 2019 and 2018, respectively, and nil and $0.3 million for the six months ended June 30, 2019 and 2018, respectively.

The amortized cost and fair value of debt securities issued by the U.S. Treasury and government-sponsored enterprises as of June 30, 2019, by contractual maturity, are shown below. Debt securities issued by government agencies, mortgage-backed securities and collateralized mortgage obligations are disclosed separately in the table below as remaining expected maturities will differ from contractual maturities as borrowers have the right to prepay obligations.

| (dollars in thousands) | June 30, 2019 Amortized Cost | June 30, 2019 Fair Value |
|---|---|---|
| Due in one year or less | $ 29,477 | $ 29,556 |
| Due after one year through five years | 99,992 | 99,701 |
| Due after five years through ten years | 64,727 | 64,615 |
| Due after ten years | — | — |
| | 194,196 | 193,872 |
| Government agency debt securities | 24,583 | 24,713 |
| Government agency mortgage-backed securities | 363,295 | 362,221 |
| Government-sponsored enterprises mortgage-backed securities | 152,506 | 151,683 |
| Collateralized mortgage obligations: | | |
| Government agency | 2,619,502 | 2,613,465 |
| Government-sponsored enterprises | 1,045,515 | 1,049,522 |
| Total collateralized mortgage obligations | 3,665,017 | 3,662,987 |
| **Total available-for-sale securities** | $ 4,399,597 | $ 4,395,476 |

At June 30, 2019, pledged securities totaled $2.1 billion, of which $1.9 billion was pledged to secure public deposits and $238.0 million was pledged to secure other financial transactions. At December 31, 2018, pledged securities totaled $2.0 billion, of which $1.7 billion was pledged to secure public deposits and $232.7 million was pledged to secure other financial transactions.

The Company held no securities of any single issuer, other than debt securities issued by the U.S. government, government agencies and government-sponsored enterprises, taken in the aggregate, which were in excess of 10% of stockholders' equity as of June 30, 2019 and December 31, 2018.

The following table presents the unrealized gross losses and fair values of securities in the available-for-sale portfolio by length of time that the 108 and 154 individual securities in each category have been in a continuous loss position as of June 30, 2019 and December 31, 2018, respectively. The unrealized losses on investment securities were attributable to changes in interest rates, relative to when the investment securities were purchased, and not due to the credit quality of the investment securities.

| | Time in Continuous Loss as of June 30, 2019 | | | | | |
|---|---|---|---|---|---|---|
| | Less Than 12 Months | | 12 Months or More | | Total | |
| (dollars in thousands) | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value |
| Government-sponsored enterprises debt securities | $ — | $ — | $ (404) | $ 76,290 | $ (404) | $ 76,290 |
| Government agency mortgage-backed securities | — | — | (3,117) | 154,670 | (3,117) | 154,670 |
| Government-sponsored enterprises mortgage-backed securities | — | — | (1,675) | 120,791 | (1,675) | 120,791 |
| Collateralized mortgage obligations: | | | | | | |
| Government agency | (181) | 76,844 | (14,963) | 1,407,580 | (15,144) | 1,484,424 |
| Government-sponsored enterprises | (143) | 138,443 | (4,399) | 271,124 | (4,542) | 409,567 |
| **Total available-for-sale securities with unrealized losses** | $ (324) | $ 215,287 | $ (24,558) | $ 2,030,455 | $ (24,882) | $ 2,245,742 |

| | Time in Continuous Loss as of December 31, 2018 | | | | | |
|---|---|---|---|---|---|---|
| | Less Than 12 Months | | 12 Months or More | | Total | |
| (dollars in thousands) | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value |
| Government-sponsored enterprises debt securities | $ — | $ — | $ (6,778) | $ 157,939 | $ (6,778) | $ 157,939 |
| Government agency mortgage-backed securities | — | — | (15,174) | 373,891 | (15,174) | 373,891 |
| Government-sponsored enterprises mortgage-backed securities | (1) | 172 | (5,293) | 125,869 | (5,294) | 126,041 |
| Collateralized mortgage obligations: | | | | | | |
| Government agency | — | — | (97,171) | 2,475,532 | (97,171) | 2,475,532 |
| Government-sponsored enterprises | — | — | (17,745) | 486,175 | (17,745) | 486,175 |
| **Total available-for-sale securities with unrealized losses** | $ (1) | $ 172 | $ (142,161) | $ 3,619,406 | $ (142,162) | $ 3,619,578 |

**Other-Than-Temporary Impairment ("OTTI")**

Unrealized losses for all investment securities are reviewed to determine whether the losses are other than temporary. Investment securities are evaluated for OTTI on at least a quarterly basis, and more frequently when economic and market conditions warrant such an evaluation, to determine whether the decline in fair 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. The decline in value is not related to any issuer- or industry-specific credit event. At June 30, 2019, the Company did not have the intent to sell and determined it was more likely than not that the Company would not be required to sell the securities prior to recovery of the amortized cost basis. As the Company has the intent and ability to hold securities in an unrealized loss position, each security with an unrealized loss position in the above tables has been further assessed to determine if a credit loss exists. If it is probable that the Company will not collect all amounts due according to the contractual terms of an investment security, an OTTI is considered to have occurred. In determining whether a credit loss exists, the Company estimates the present value of future cash flows expected to be collected from the investment security. If the present value of future cash flows is less than the amortized cost basis of the security, an OTTI exists. As of December 31, 2018, the Company had the intent to sell 48 securities with an aggregated amortized cost basis of $898.2 million. As a result, the Company recorded an OTTI write-down of $24.1 million in December 2018. The OTTI write-down represented the difference between the amortized cost basis and the fair value of the securities as of December 31, 2018. In January 2019, the Company completed its sale of the 48 securities and recorded an additional loss of $2.6 million.

**Visa Class B Restricted Shares**

In 2008, the Company received 394,000 Visa Class B restricted shares as part of Visa's initial public offering. Visa Class B restricted shares are not currently convertible to publicly traded Visa Class A common shares, and only transferable in limited circumstances, until the settlement of certain litigation which are indemnified by Visa members, including the Company. As there are existing transfer restrictions and the outcome of the aforementioned litigation is uncertain, these shares were included in the consolidated balance sheets at their historical cost of $0.

In 2016, the Company recorded a $22.7 million net realized gain related to the sale of 274,000 Visa Class B restricted shares. Concurrent with the sale of the Visa Class B restricted shares, the Company entered into an agreement with the buyer that requires payment to the buyer in the event Visa reduces each member bank's Class B conversion rate to unrestricted Class A common shares. On June 28, 2018, Visa additionally funded its litigation escrow account, thereby reducing each member bank's Class B conversion rate to unrestricted Class A common shares. Accordingly, on July 5, 2018, Visa announced a decrease in conversion rate from 1.6483 to 1.6298 effective June 28, 2018. In July 2018, the Company made a payment of approximately $0.7 million to the buyer as a result of the reduction in the Visa Class B conversion rate. See "Note 12. Derivative Financial Instruments" for more information.

The Company held approximately 120,000 Visa Class B restricted shares as of both June 30, 2019 and December 31, 2018. These shares continued to be carried at $0 cost basis during each of the respective periods.

### 3. Loans and Leases

As of June 30, 2019 and December 31, 2018, loans and leases were comprised of the following:

| (dollars in thousands) | June 30, 2019 | December 31, 2018 |
|---|---|---|
| Commercial and industrial | **$ 3,177,844** | $ 3,208,760 |
| Commercial real estate | **3,194,219** | 2,990,783 |
| Construction | **549,578** | 626,757 |
| Residential: | | |
| Residential mortgage | **3,618,433** | 3,527,101 |
| Home equity line | **908,452** | 912,517 |
| Total residential | **4,526,885** | 4,439,618 |
| Consumer | **1,650,713** | 1,662,504 |
| Lease financing | **165,370** | 147,769 |
| **Total loans and leases** | **$ 13,264,609** | $ 13,076,191 |

Outstanding loan balances are reported net of net deferred loan costs of $38.6 million and $36.3 million at June 30, 2019 and December 31, 2018, respectively.

As of June 30, 2019, residential real estate loans totaling $2.8 billion were pledged to collateralize the Company's borrowing capacity at the Federal Home Loan Bank of Des Moines ("FHLB"), and consumer and commercial and industrial loans totaling $939.0 million were pledged to collateralize the Company's borrowing capacity at the Federal Reserve Bank of San Francisco ("FRB"). As of December 31, 2018, residential real estate loans totaling $2.5 billion were pledged to collateralize the Company's borrowing capacity at the FHLB, and consumer and commercial and industrial loans totaling $957.0 million were pledged to collateralize the Company's borrowing capacity at the FRB. Residential real estate loans collateralized by properties that were in the process of foreclosure totaled $2.8 million and $4.6 million at June 30, 2019 and December 31, 2018, respectively.

In the course of evaluating the credit risk presented by a customer and the pricing that will adequately compensate the Company for assuming that risk, management may require a certain amount of collateral support. The type of collateral held varies, but may include accounts receivable, inventory, land, buildings, equipment, income-producing commercial properties and residential real estate. The Company applies the same collateral policy for loans whether they are funded immediately or on a delayed basis. The Company's loan and lease portfolio is principally located in Hawaii and, to a lesser extent, on the U.S. Mainland, Guam and Saipan. The risk inherent in the portfolio depends upon both the economic stability of the state or territories, which affects property values, and the financial strength and creditworthiness of the borrowers.

At June 30, 2019 and December 31, 2018, remaining loan and lease commitments were comprised of the following:

| (dollars in thousands) | June 30, 2019 | December 31, 2018 |
|---|---|---|
| Commercial and industrial | **$ 2,559,014** | $ 2,484,857 |
| Commercial real estate | **134,523** | 114,186 |
| Construction | **687,925** | 526,938 |
| Residential: | | |
| Residential mortgage | **329** | 121 |
| Home equity line | **863,097** | 913,636 |
| Total residential | **863,426** | 913,757 |
| Consumer | **1,546,200** | 1,509,853 |
| **Total loan and lease commitments** | **$ 5,791,088** | $ 5,549,591 |

### 4. Allowance for Loan and Lease Losses

The Company must maintain an allowance for loan and lease losses (the "Allowance") that is adequate to absorb estimated probable credit losses associated with its loan and lease portfolio. The Allowance consists of an allocated portion, which covers estimated credit losses for specifically identified loans and pools of loans and leases, and an unallocated portion.

**Segmentation**

Management has identified three primary portfolio segments in estimating the Allowance: commercial lending, residential real estate lending and consumer lending. Commercial lending is further segmented into four distinct classes based on characteristics relating to the borrower, transaction, and collateral. These portfolio segments are: commercial and industrial, commercial real estate, construction, and lease financing. Residential real estate is not further segmented, but consists of residential mortgages including real estate secured installment loans and home equity lines of credit. Consumer lending is not further segmented, but consists primarily of automobile loans, credit cards, and other installment loans. Management has developed a methodology for each segment and class taking into consideration portfolio segment-specific and class-specific factors such as product type, loan portfolio characteristics, management information systems, and other risk factors.

**Specific Allocation**

*Commercial*

A specific allocation is determined for individually impaired commercial loans. A loan is considered impaired when it is probable that the Company will be unable to collect the full amount of principal and interest according to the contractual terms of the loan agreement.

Management identifies material impaired loans based on their size in relation to the Company’s total loan and lease portfolio. Each impaired loan equal to or exceeding a specified threshold requires an analysis to determine the appropriate level of reserve for that specific loan. Impaired loans below the specified threshold are treated as a pool, with specific allocations established based on qualitative factors such as asset quality trends, risk identification, lending policies, portfolio growth, and portfolio concentrations.

*Residential*

A specific allocation is determined for residential real estate loans based on delinquency status. In addition, each impaired loan equal to or exceeding a specified threshold requires analysis to determine the appropriate level of reserve for that specific loan, generally based on the value of the underlying collateral less estimated costs to sell. The specific allocation will be zero for impaired loans in which the value of the underlying collateral, less estimated costs to sell, exceeds the unpaid principal balance of the loan.

*Consumer*

A specific allocation is determined for the consumer loan portfolio using delinquency-based formula allocations. The Company uses a formula approach in determining the consumer loan specific allocation and recognizes the statistical validity of measuring losses predicated on past due status.

**Pooled Allocation**

*Commercial*

Pooled allocation for pass, special mention, substandard, and doubtful grade commercial loans and leases that share common risk characteristics and properties is determined using a historical loss rate analysis and qualitative factor considerations. Loan grade categories are discussed under “Credit Quality”.

*Residential and Consumer*

Pooled allocation for non-delinquent consumer and residential real estate loans is determined using a historical loss rate analysis and qualitative factor considerations.

**Qualitative Adjustments**

Qualitative adjustments to historical loss rates or other static sources may be necessary since these rates may not be an accurate indicator of losses inherent in the current portfolio. To estimate the level of adjustments, management considers factors including global, national and local economic conditions; levels and trends in problem loans; the effect of credit concentrations; collateral value trends; changes in risk due to changes in lending policies and practices; management expertise; industry and regulatory trends; and volume of loans.

**Unallocated Allowance**

The Company’s Allowance incorporates an unallocated portion to cover risk factors and events that may have occurred as of the evaluation date that have not been reflected in the risk measures utilized due to inherent limitations in the precision of the estimation process. These risk factors, in addition to past and current events based on facts at the unaudited interim consolidated balance sheet date and realistic courses of action that management expects to take, are assessed in determining the level of unallocated allowance.

The Allowance was comprised of the following for the periods indicated:

| | Three Months Ended June 30, 2019 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Commercial Lending | | | | | | | |
| (dollars in thousands) | Commercial and Industrial | Commercial Real Estate | Construction | Lease Financing | Residential | Consumer | Unallocated | Total |
| **Allowance for loan and lease losses:** | | | | | | | | |
| Balance at beginning of period | **$ 31,793** | **$ 21,197** | **$ 5,381** | **$ 411** | **$ 44,911** | **$ 35,099** | **$ 2,754** | **$ 141,546** |
| Charge-offs | **(2,000)** | **—** | **—** | **—** | **—** | **(7,505)** | **—** | **(9,505)** |
| Recoveries | **25** | **32** | **—** | **—** | **185** | **2,382** | **—** | **2,624** |
| Increase (decrease) in Provision | **1,870** | **975** | **(367)** | **35** | **(1,676)** | **3,662** | **(629)** | **3,870** |
| **Balance at end of period** | **$ 31,688** | **$ 22,204** | **$ 5,014** | **$ 446** | **$ 43,420** | **$ 33,638** | **$ 2,125** | **$ 138,535** |

| | Six Months Ended June 30, 2019 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Commercial Lending | | | | | | | |
| (dollars in thousands) | Commercial and Industrial | Commercial Real Estate | Construction | Lease Financing | Residential | Consumer | Unallocated | Total |
| **Allowance for loan and lease losses:** | | | | | | | | |
| Balance at beginning of period | **$ 34,501** | **$ 19,725** | **$ 5,813** | **$ 432** | **$ 44,906** | **$ 35,813** | **$ 528** | **$ 141,718** |
| Charge-offs | **(2,000)** | **—** | **—** | **(24)** | **—** | **(16,103)** | **—** | **(18,127)** |
| Recoveries | **62** | **63** | **—** | **—** | **435** | **4,834** | **—** | **5,394** |
| Increase (decrease) in Provision | **(875)** | **2,416** | **(799)** | **38** | **(1,921)** | **9,094** | **1,597** | **9,550** |
| **Balance at end of period** | **$ 31,688** | **$ 22,204** | **$ 5,014** | **$ 446** | **$ 43,420** | **$ 33,638** | **$ 2,125** | **$ 138,535** |

| | Three Months Ended June 30, 2018 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Commercial Lending | | | | | | | |
| (dollars in thousands) | Commercial and Industrial | Commercial Real Estate | Construction | Lease Financing | Residential | Consumer | Unallocated | Total |
| **Allowance for loan and lease losses:** | | | | | | | | |
| Balance at beginning of period | $ 34,365 | $ 19,254 | $ 5,976 | $ 585 | $ 43,220 | $ 30,998 | $ 4,176 | $ 138,574 |
| Charge-offs | — | — | — | — | (34) | (6,290) | — | (6,324) |
| Recoveries | 39 | 32 | — | — | 60 | 2,200 | — | 2,331 |
| Increase (decrease) in Provision | 835 | 1,221 | 1,630 | (28) | 679 | 4,601 | (2,918) | 6,020 |
| **Balance at end of period** | $ 35,239 | $ 20,507 | $ 7,606 | $ 557 | $ 43,925 | $ 31,509 | $ 1,258 | $ 140,601 |

| | Six Months Ended June 30, 2018 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Commercial Lending | | | | | | | |
| (dollars in thousands) | Commercial and Industrial | Commercial Real Estate | Construction | Lease Financing | Residential | Consumer | Unallocated | Total |
| **Allowance for loan and lease losses:** | | | | | | | | |
| Balance at beginning of period | $ 34,006 | $ 18,044 | $ 6,817 | $ 611 | $ 42,852 | $ 31,249 | $ 3,674 | $ 137,253 |
| Charge-offs | (475) | — | — | — | (34) | (12,915) | — | (13,424) |
| Recoveries | 103 | 154 | — | — | 242 | 4,303 | — | 4,802 |
| Increase (decrease) in Provision | 1,605 | 2,309 | 789 | (54) | 865 | 8,872 | (2,416) | 11,970 |
| **Balance at end of period** | $ 35,239 | $ 20,507 | $ 7,606 | $ 557 | $ 43,925 | $ 31,509 | $ 1,258 | $ 140,601 |

The disaggregation of the Allowance and recorded investment in loans by impairment methodology as of June 30, 2019 and December 31, 2018 were as follows:

| | June 30, 2019 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Commercial Lending | | | | | | | |
| (dollars in thousands) | Commercial and Industrial | Commercial Real Estate | Construction | Lease Financing | Residential | Consumer | Unallocated | Total |
| **Allowance for loan and lease losses:** | | | | | | | | |
| Individually evaluated for impairment | **$ 108** | **$ 25** | **$ —** | **$ —** | **$ 367** | **$ —** | **$ —** | **$ 500** |
| Collectively evaluated for impairment | **31,580** | **22,179** | **5,014** | **446** | **43,053** | **33,638** | **2,125** | **138,035** |
| **Balance at end of period** | **$ 31,688** | **$ 22,204** | **$ 5,014** | **$ 446** | **$ 43,420** | **$ 33,638** | **$ 2,125** | **$ 138,535** |
| **Loans and leases:** | | | | | | | | |
| Individually evaluated for impairment | **$ 8,882** | **$ 3,726** | **$ —** | **$ —** | **$ 14,805** | **$ —** | **$ —** | **$ 27,413** |
| Collectively evaluated for impairment | **3,168,962** | **3,190,493** | **549,578** | **165,370** | **4,512,080** | **1,650,713** | **—** | **13,237,196** |
| **Balance at end of period** | **$ 3,177,844** | **$ 3,194,219** | **$ 549,578** | **$ 165,370** | **$ 4,526,885** | **$ 1,650,713** | **$ —** | **$ 13,264,609** |

| (dollars in thousands) | December 31, 2018 Commercial Lending Commercial and Industrial | Commercial Real Estate | Construction | Lease Financing | Residential | Consumer | Unallocated | Total |
|---|---|---|---|---|---|---|---|---|
| **Allowance for loan and lease losses:** | | | | | | | | |
| Individually evaluated for impairment | $ 108 | $ 32 | $ — | $ — | $ 396 | $ — | $ — | $ 536 |
| Collectively evaluated for impairment | 34,393 | 19,693 | 5,813 | 432 | 44,510 | 35,813 | 528 | 141,182 |
| **Balance at end of period** | $ 34,501 | $ 19,725 | $ 5,813 | $ 432 | $ 44,906 | $ 35,813 | $ 528 | $ 141,718 |
| **Loans and leases:** | | | | | | | | |
| Individually evaluated for impairment | $ 8,719 | $ 5,743 | $ — | $ — | $ 16,114 | $ — | $ — | $ 30,576 |
| Collectively evaluated for impairment | 3,200,041 | 2,985,040 | 626,757 | 147,769 | 4,423,504 | 1,662,504 | — | 13,045,615 |
| **Balance at end of period** | $ 3,208,760 | $ 2,990,783 | $ 626,757 | $ 147,769 | $ 4,439,618 | $ 1,662,504 | $ — | $ 13,076,191 |

## Credit Quality

The Company performs an internal loan review and grading on an ongoing basis. The review provides management with periodic information as to the quality of the loan portfolio and effectiveness of the Company’s lending policies and procedures. The objective of the loan review and grading procedures is to identify, in a timely manner, existing or emerging credit quality problems so that appropriate steps can be initiated to avoid or minimize future losses.

Loans subject to grading include: commercial and industrial loans, commercial and standby letters of credit, installment loans to businesses or individuals for business and commercial purposes, commercial real estate loans, overdraft lines of credit, commercial credit cards, and other credits as may be determined. Loans which are not subject to grading include loans that are 100% sold with no recourse to the Company, consumer installment loans, indirect automobile loans, credit cards, home equity lines of credit and residential mortgage loans.

Residential real estate and consumer loans are underwritten primarily on the basis of credit bureau scores, debt-service-to-income ratios, and collateral quality and loan to value ratios.

A credit risk rating system is used to determine loan grade and is based on borrower credit risk and transactional risk. The loan grading process is a mechanism used to determine the risk of a particular borrower and is based on the following eight factors of a borrower: character, earnings and operating cash flow, asset and liability structure, debt capacity, financial reporting, management and controls, borrowing entity, and industry and operating environment.

*Pass* – “Pass” (uncriticized) loans and leases, are not considered to carry greater than normal risk. The borrower has the apparent ability to satisfy obligations to the Company, and therefore no loss in ultimate collection is anticipated.

*Special Mention* – Loans and leases that have potential weaknesses deserve management’s close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for assets or in the institution’s credit position at some future date. Special mention assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification.

*Substandard* – Loans and leases that are inadequately protected by the current financial condition and paying capacity of the obligor or by any collateral pledged. Loans and leases so classified must have a well-defined weakness or weaknesses that jeopardize the collection of the debt. They are characterized by the distinct possibility that the bank may sustain some loss if the deficiencies are not corrected.

*Doubtful* – Loans and leases that have weaknesses found in substandard borrowers with the added provision that the weaknesses make collection of debt in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

*Loss* – Loans and leases classified as loss are considered uncollectible and of such little value that their continuance as an asset is not warranted. This classification does not mean that the loan or lease has absolutely no recovery or salvage value, but rather that it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be effected in the future.

The credit risk profiles by internally assigned grade for loans and leases as of June 30, 2019 and December 31, 2018 were as follows:

| | June 30, 2019 | | | | |
|---|---|---|---|---|---|
| (dollars in thousands) | Commercial and Industrial | Commercial Real Estate | Construction | Lease Financing | Total |
| Grade: | | | | | |
| Pass | **$ 3,048,463** | **$ 3,021,877** | **$ 548,480** | **$ 164,245** | **$ 6,783,065** |
| Special mention | **90,410** | **127,097** | **171** | **984** | **218,662** |
| Substandard | **38,971** | **45,245** | **927** | **141** | **85,284** |
| **Total** | **$ 3,177,844** | **$ 3,194,219** | **$ 549,578** | **$ 165,370** | **$ 7,087,011** |

| | December 31, 2018 | | | | |
|---|---|---|---|---|---|
| (dollars in thousands) | Commercial and Industrial | Commercial Real Estate | Construction | Lease Financing | Total |
| Grade: | | | | | |
| Pass | $ 3,069,546 | $ 2,876,907 | $ 625,607 | $ 146,356 | $ 6,718,416 |
| Special mention | 57,012 | 91,298 | 200 | 1,223 | 149,733 |
| Substandard | 82,010 | 22,578 | 950 | 190 | 105,728 |
| Doubtful | 192 | — | — | — | 192 |
| **Total** | $ 3,208,760 | $ 2,990,783 | $ 626,757 | $ 147,769 | $ 6,974,069 |

There were no loans and leases graded as Loss as of June 30, 2019 and December 31, 2018.

The credit risk profiles based on payment activity for loans and leases that were not subject to loan grading as of June 30, 2019 and December 31, 2018 were as follows:

| | June 30, 2019 | | | | | |
|---|---|---|---|---|---|---|
| (dollars in thousands) | Residential Mortgage | Home Equity Line | Consumer | Consumer - Auto | Credit Cards | Total |
| Performing | **$ 3,609,720** | **$ 903,257** | **$ 231,355** | **$ 1,060,248** | **$ 325,746** | **$ 6,130,326** |
| Non-performing and delinquent | **8,713** | **5,195** | **5,909** | **22,695** | **4,760** | **47,272** |
| **Total** | **$ 3,618,433** | **$ 908,452** | **$ 237,264** | **$ 1,082,943** | **$ 330,506** | **$ 6,177,598** |

| | December 31, 2018 | | | | | |
|---|---|---|---|---|---|---|
| (dollars in thousands) | Residential Mortgage | Home Equity Line | Consumer | Consumer - Auto | Credit Cards | Total |
| Performing | $ 3,519,172 | $ 903,284 | $ 234,458 | $ 1,044,393 | $ 339,162 | $ 6,040,469 |
| Non-performing and delinquent | 7,929 | 9,233 | 5,448 | 33,739 | 5,304 | 61,653 |
| **Total** | $ 3,527,101 | $ 912,517 | $ 239,906 | $ 1,078,132 | $ 344,466 | $ 6,102,122 |

**Impaired and Nonaccrual Loans and Leases**

The Company evaluates certain loans and leases individually for impairment. A loan or lease is considered to be impaired when it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan or lease. An allowance for impaired commercial loans, including commercial real estate and construction loans, is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's observable market price or the estimated fair value of the collateral, less any selling costs, if the loan is collateral dependent. An allowance for impaired residential loans is measured based on the estimated fair value of the collateral, less any selling costs. Management exercises significant judgment in developing these estimates.

The Company generally places a loan on nonaccrual status when management believes that collection of principal or interest has become doubtful or when a loan or lease becomes 90 days past due as to principal or interest, unless it is well secured and in the process of collection.

It is the Company's policy to charge off a loan when the facts indicate that the loan is considered uncollectible.

The aging analyses of past due loans and leases as of June 30, 2019 and December 31, 2018 were as follows:

| | June 30, 2019 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Accruing Loans and Leases | | | | | | | |
| (dollars in thousands) | 30-59 Days Past Due | 60-89 Days Past Due | Greater Than or Equal to 90 Days Past Due | Total Past Due | Current | Total Accruing Loans and Leases | Total Non Accruing Loans and Leases | Total Outstanding |
| Commercial and industrial | $ 1,213 | $ 2,247 | $ 807 | $ 4,267 | $ 3,173,458 | $ 3,177,725 | $ 119 | $ 3,177,844 |
| Commercial real estate | 124 | 195 | — | 319 | 3,193,900 | 3,194,219 | — | 3,194,219 |
| Construction | — | — | — | — | 549,578 | 549,578 | — | 549,578 |
| Lease financing | — | — | — | — | 165,370 | 165,370 | — | 165,370 |
| Residential mortgage | 3,223 | 1,719 | — | 4,942 | 3,609,720 | 3,614,662 | 3,771 | 3,618,433 |
| Home equity line | 3,116 | 444 | 1,635 | 5,195 | 903,257 | 908,452 | — | 908,452 |
| Consumer | 24,596 | 5,473 | 3,295 | 33,364 | 1,617,349 | 1,650,713 | — | 1,650,713 |
| **Total** | $ 32,272 | $ 10,078 | $ 5,737 | $ 48,087 | $ 13,212,632 | $ 13,260,719 | $ 3,890 | $ 13,264,609 |

| | December 31, 2018 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Accruing Loans and Leases | | | | | | | |
| (dollars in thousands) | 30-59 Days Past Due | 60-89 Days Past Due | Greater Than or Equal to 90 Days Past Due | Total Past Due | Current | Total Accruing Loans and Leases | Total Non Accruing Loans and Leases | Total Outstanding |
| Commercial and industrial | $ 1,293 | $ — | $ 141 | $ 1,434 | $ 3,207,052 | $ 3,208,486 | $ 274 | $ 3,208,760 |
| Commercial real estate | — | — | — | — | 2,989,125 | 2,989,125 | 1,658 | 2,990,783 |
| Construction | 91 | — | — | 91 | 626,666 | 626,757 | — | 626,757 |
| Lease financing | 47 | — | — | 47 | 147,722 | 147,769 | — | 147,769 |
| Residential mortgage | 2,274 | 1,012 | 32 | 3,318 | 3,519,172 | 3,522,490 | 4,611 | 3,527,101 |
| Home equity line | 5,616 | 775 | 2,842 | 9,233 | 903,284 | 912,517 | — | 912,517 |
| Consumer | 32,406 | 8,712 | 3,373 | 44,491 | 1,618,013 | 1,662,504 | — | 1,662,504 |
| **Total** | $ 41,727 | $ 10,499 | $ 6,388 | $ 58,614 | $ 13,011,034 | $ 13,069,648 | $ 6,543 | $ 13,076,191 |

The total carrying amounts and the total unpaid principal balances of impaired loans and leases as of June 30, 2019 and December 31, 2018 were as follows:

| | June 30, 2019 | | |
|---|---|---|---|
| (dollars in thousands) | Recorded Investment | Unpaid Principal Balance | Related Allowance |
| Impaired loans with no related allowance recorded: | | | |
| Commercial and industrial | $ 5,278 | $ 5,311 | $ — |
| Commercial real estate | 3,016 | 3,016 | — |
| Residential mortgage | 7,675 | 7,834 | — |
| **Total** | $ 15,969 | $ 16,161 | $ — |
| Impaired loans with a related allowance recorded: | | | |
| Commercial and industrial | $ 3,604 | $ 3,604 | $ 108 |
| Commercial real estate | 710 | 710 | 25 |
| Residential mortgage | 7,130 | 7,516 | 367 |
| **Total** | $ 11,444 | $ 11,830 | $ 500 |
| Total impaired loans: | | | |
| Commercial and industrial | $ 8,882 | $ 8,915 | $ 108 |
| Commercial real estate | 3,726 | 3,726 | 25 |
| Residential mortgage | 14,805 | 15,350 | 367 |
| **Total** | $ 27,413 | $ 27,991 | $ 500 |

| (dollars in thousands) | December 31, 2018 Recorded Investment | Unpaid Principal Balance | Related Allowance |
|---|---|---|---|
| Impaired loans with no related allowance recorded: | | | |
| Commercial and industrial | $ 4,449 | $ 4,498 | $ — |
| Commercial real estate | 5,016 | 5,016 | — |
| Residential mortgage | 9,112 | 9,426 | — |
| **Total** | $ 18,577 | $ 18,940 | $ — |
| Impaired loans with a related allowance recorded: | | | |
| Commercial and industrial | $ 4,270 | $ 4,270 | $ 108 |
| Commercial real estate | 727 | 727 | 32 |
| Residential mortgage | 7,002 | 7,387 | 396 |
| **Total** | $ 11,999 | $ 12,384 | $ 536 |
| Total impaired loans: | | | |
| Commercial and industrial | $ 8,719 | $ 8,768 | $ 108 |
| Commercial real estate | 5,743 | 5,743 | 32 |
| Residential mortgage | 16,114 | 16,813 | 396 |
| **Total** | $ 30,576 | $ 31,324 | $ 536 |

The following tables provide information with respect to the Company's average balances, and of interest income recognized from, impaired loans for the three and six months ended June 30, 2019 and 2018:

| | Three Months Ended June 30, 2019 | | Six Months Ended June 30, 2019 | |
|---|---|---|---|---|
| (dollars in thousands) | Average Recorded Investment | Interest Income Recognized | Average Recorded Investment | Interest Income Recognized |
| Impaired loans with no related allowance recorded: | | | | |
| Commercial and industrial | **$ 3,833** | **$ 94** | **$ 4,038** | **$ 175** |
| Commercial real estate | **3,102** | **40** | **3,740** | **212** |
| Residential mortgage | **7,948** | **92** | **8,336** | **191** |
| **Total** | **$ 14,883** | **$ 226** | **$ 16,114** | **$ 578** |
| Impaired loans with a related allowance recorded: | | | | |
| Commercial and industrial | **$ 5,645** | **$ 61** | **$ 5,187** | **$ 117** |
| Commercial real estate | **715** | **10** | **719** | **20** |
| Residential mortgage | **7,220** | **103** | **7,147** | **199** |
| **Total** | **$ 13,580** | **$ 174** | **$ 13,053** | **$ 336** |
| Total impaired loans: | | | | |
| Commercial and industrial | **$ 9,478** | **$ 155** | **$ 9,225** | **$ 292** |
| Commercial real estate | **3,817** | **50** | **4,459** | **232** |
| Residential mortgage | **15,168** | **195** | **15,483** | **390** |
| **Total** | **$ 28,463** | **$ 400** | **$ 29,167** | **$ 914** |

| (dollars in thousands) | Three Months Ended June 30, 2018 Average Recorded Investment | Three Months Ended June 30, 2018 Interest Income Recognized | Six Months Ended June 30, 2018 Average Recorded Investment | Six Months Ended June 30, 2018 Interest Income Recognized |
|---|---|---|---|---|
| Impaired loans with no related allowance recorded: | | | | |
| Commercial and industrial | $ 15,815 | $ 171 | $ 16,556 | $ 337 |
| Commercial real estate | 9,144 | 72 | 9,345 | 127 |
| Construction | 2,120 | — | 1,413 | — |
| Residential mortgage | 9,475 | 110 | 9,199 | 240 |
| **Total** | $ 36,554 | $ 353 | $ 36,513 | $ 704 |
| Impaired loans with a related allowance recorded: | | | | |
| Commercial and industrial | $ 749 | $ 18 | $ 548 | $ 35 |
| Commercial real estate | 878 | 10 | 882 | 20 |
| Residential mortgage | 7,456 | 113 | 7,598 | 197 |
| **Total** | $ 9,083 | $ 141 | $ 9,028 | $ 252 |
| Total impaired loans: | | | | |
| Commercial and industrial | $ 16,564 | $ 189 | $ 17,104 | $ 372 |
| Commercial real estate | 10,022 | 82 | 10,227 | 147 |
| Construction | 2,120 | — | 1,413 | — |
| Residential mortgage | 16,931 | 223 | 16,797 | 437 |
| **Total** | $ 45,637 | $ 494 | $ 45,541 | $ 956 |

**Modifications**

Commercial and industrial loans modified in a troubled debt restructuring ("TDR") may involve temporary interest-only payments, term extensions, and converting revolving credit lines to term loans. Modifications of commercial real estate and construction loans in a TDR may involve reducing the interest rate for the remaining term of the loan, extending the maturity date at an interest rate lower than the current market rate for new debt with similar risk, or substituting or adding a new borrower or guarantor. Modifications of construction loans in a TDR may also involve extending the interest-only payment period. Interest continues to accrue on the missed payments and as a result, the effective yield on the loan remains unchanged. As the forbearance period usually involves an insignificant payment delay, lease financing modifications typically do not meet the reporting criteria for a TDR. Residential real estate loans modified in a TDR may be comprised of loans where monthly payments are lowered to accommodate the borrowers' financial needs for a period of time, normally two years. Generally, consumer loans are not classified as a TDR as they are normally charged off upon reaching a predetermined delinquency status that ranges from 120 to 180 days and varies by product type.

Loans modified in a TDR may already be on nonaccrual status and in some cases partial charge-offs may have already been taken against the outstanding loan balance. Loans modified in a TDR are evaluated for impairment. As a result, this may have a financial effect of increasing the specific Allowance associated with the loan. An Allowance for impaired commercial loans, including commercial real estate and construction loans, that have been modified in a TDR is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's observable market price, or the estimated fair value of the collateral, less any selling costs, if the loan is collateral dependent. An Allowance for impaired residential loans that have been modified in a TDR is measured based on the estimated fair value of the collateral, less any selling costs. Management exercises significant judgment in developing these estimates.

The following presents, by class, information related to loans modified in a TDR during the three and six months ended June 30, 2019 and 2018:

| (dollars in thousands) | Three Months Ended June 30, 2019 Number of Contracts | Three Months Ended June 30, 2019 Recorded Investment(1) | Three Months Ended June 30, 2019 Related Allowance | Six Months Ended June 30, 2019 Number of Contracts | Six Months Ended June 30, 2019 Recorded Investment(1) | Six Months Ended June 30, 2019 Related Allowance |
|---|---|---|---|---|---|---|
| Commercial and industrial | — | $ — | $ — | 4 | $ 906 | $ 41 |
| Residential mortgage | — | — | — | 1 | 351 | 14 |
| **Total** | — | $ — | $ — | 5 | $ 1,257 | $ 55 |

(1) The recorded investment balances reflect all partial paydowns and charge-offs since the modification date and do not include TDRs that have been fully paid off, charged off, or foreclosed upon by the end of the period.

| Three Months Ended June 30, 2018 | Six Months Ended June 30, 2018 |
|---|---|

| (dollars in thousands) | Number of Contracts | Recorded Investment(1) | Related Allowance | Number of Contracts | Recorded Investment(1) | Related Allowance |
|---|---|---|---|---|---|---|
| Commercial and industrial | 1 | $ 450 | $ 13 | 1 | $ 450 | $ 13 |
| **Total** | 1 | $ 450 | $ 13 | 1 | $ 450 | $ 13 |

(1) The recorded investment balances reflect all partial paydowns and charge-offs since the modification date and do not include TDRs that have been fully paid off, charged off, or foreclosed upon by the end of the period.

The above loans were modified in a TDR through an extension of maturity dates, temporary interest-only payments, reduced payments, or below-market interest rates.

The Company had commitments to extend credit, standby letters of credit, and commercial letters of credit totaling $6.0 billion and $5.8 billion as of June 30, 2019 and December 31, 2018, respectively. Of the $6.0 billion at June 30, 2019, there were commitments of $1.4 million related to borrowers who had loan terms modified in a TDR. Of the $5.8 billion at December 31, 2018, there were commitments of $1.8 million related to borrowers who had loan terms modified in a TDR.

The following table presents, by class, loans modified in TDRs that have defaulted in the current period within 12 months of their permanent modification date for the periods indicated. The Company is reporting these defaulted TDRs based on a payment default definition of 30 days past due:

| | Three Months Ended June 30, 2019 | | Six Months Ended June 30, 2019 | | Three Months Ended June 30, 2018 | | Six Months Ended June 30, 2018 | |
|---|---|---|---|---|---|---|---|---|
| (dollars in thousands) | Number of Contracts | Recorded Investment(1) | Number of Contracts | Recorded Investment(1) | Number of Contracts | Recorded Investment(1) | Number of Contracts | Recorded Investment(1) |
| Commercial and industrial(2) | **4** | **$ 906** | **4** | **$ 906** | — | $ — | 2 | $ 409 |
| Residential mortgage(3) | **1** | **351** | **1** | **351** | — | — | — | — |
| **Total** | **5** | **$ 1,257** | **5** | **$ 1,257** | — | $ — | 2 | $ 409 |

(1) The recorded investment balances reflect all partial paydowns and charge-offs since the modification date and do not include TDRs that have been fully paid off, charged off, or foreclosed upon by the end of the period.

(2) For the three and six months ended June 30, 2019, the commercial and industrial loans that subsequently defaulted were temporarily modified to interest-only payments. For the six months ended June 30, 2018, the maturity dates for the commercial and industrial loans that subsequently defaulted were extended.

(3) For the three and six months ended June 30, 2019, the maturity date for the residential mortgage loan that subsequently defaulted was extended.

**Foreclosure Proceedings**

There was one residential mortgage loan collateralized by real estate property of $0.3 million that was modified in a TDR that was in process of foreclosure as of both June 30, 2019 and December 31, 2018.

**Foreclosed Property**

As of June 30, 2019, there were no residential real estate properties held from foreclosed residential mortgages. Residential real estate properties held from one foreclosed residential mortgage loan and one foreclosed home equity line included in other real estate owned and repossessed personal property shown in the unaudited interim consolidated balance sheets were $0.8 million as of December 31, 2018.

## 5. Mortgage Servicing Rights

Mortgage servicing activities include collecting principal, interest, tax, and insurance payments from borrowers while accounting for and remitting payments to investors, taxing authorities, and insurance companies. The Company also monitors delinquencies and administers foreclosure proceedings.

Mortgage loan servicing income is recorded in noninterest income as a part of other service charges and fees and amortization of the servicing assets is recorded in noninterest income as part of other income. The unpaid principal amount of residential real estate loans serviced for others was $2.5 billion and $2.7 billion as of June 30, 2019 and December 31, 2018, respectively. Servicing fees include contractually specified fees, late charges, and ancillary fees, and were $1.6 million and $1.9 million for the three months ended June 30, 2019 and 2018, respectively, and $3.2 million and $3.6 million for the six months ended June 30, 2019 and 2018, respectively.

Amortization of mortgage servicing rights ("MSRs") was $0.8 million and $1.0 million for the three months ended June 30, 2019 and 2018, respectively, and $1.6 million and $2.0 million for the six months ended June 30, 2019 and 2018, respectively. The estimated future amortization expenses for MSRs over the next five years are as follows:

| (dollars in thousands) | Estimated Amortization |
|---|---|
| Under one year | $ 2,254 |
| One to two years | 1,950 |
| Two to three years | 1,687 |
| Three to four years | 1,463 |
| Four to five years | 1,269 |

The details of the Company's MSRs are presented below:

| (dollars in thousands) | June 30, 2019 | December 31, 2018 |
|---|---|---|
| Gross carrying amount | $ 63,366 | $ 63,342 |
| Less: accumulated amortization | 48,793 | 47,187 |
| Net carrying value | $ 14,573 | $ 16,155 |

The following table presents changes in amortized MSRs for the three and six months ended June 30, 2019 and 2018:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| (dollars in thousands) | 2019 | 2018 | 2019 | 2018 |
| Balance at beginning of period | $ 15,399 | $ 18,659 | $ 16,155 | $ 13,196 |
| Originations | 16 | 21 | 24 | 28 |
| Purchases | — | — | — | 6,444 |
| Amortization | (842) | (1,020) | (1,606) | (2,008) |
| **Balance at end of period** | $ 14,573 | $ 17,660 | $ 14,573 | $ 17,660 |
| Fair value of amortized MSRs at beginning of period | $ 26,383 | $ 29,048 | $ 27,662 | $ 21,697 |
| Fair value of amortized MSRs at end of period | $ 23,398 | $ 28,344 | $ 23,398 | $ 28,344 |

MSRs are evaluated for impairment if events and circumstances indicate a possible impairment. No impairment of MSRs was recorded for the six months ended June 30, 2019 and 2018.

The quantitative assumptions used in determining the lower of cost or fair value of the Company's MSRs as of June 30, 2019 and December 31, 2018 were as follows:

| | June 30, 2019 | | December 31, 2018 | |
|---|---|---|---|---|
| | Range | Weighted Average | Range | Weighted Average |
| Conditional prepayment rate | 9.57 % - 22.35 % | 10.01 % | 7.86 % - 19.26 % | 8.31 % |
| Life in years (of the MSR) | 2.16 - 6.85 | 6.44 | 3.43 - 7.68 | 7.19 |
| Weighted-average coupon rate | 3.96 % - 7.38 % | 4.02 % | 3.97 % - 6.70 % | 4.02 % |
| Discount rate | 10.00 % - 10.01 % | 10.00 % | 10.00 % - 10.02 % | 10.00 % |

The sensitivities surrounding MSRs are expected to have an immaterial impact on fair value.

**6. Transfers of Financial Assets**

The Company's transfers of financial assets with continuing interest may include pledges of collateral to secure public deposits and repurchase agreements, FHLB and FRB borrowing capacity, automated clearing house ("ACH") transactions and interest rate swaps.

For public deposits and repurchase agreements, the Company enters into bilateral agreements with the entity to pledge investment securities as collateral in the event of default. The right of setoff for a repurchase agreement resembles a secured borrowing, whereby the collateral pledged by the Company would be used to settle the fair value of the repurchase agreement should the Company be in default. The counterparty has the right to sell or repledge the investment securities.

The Company is required by the counterparty to maintain adequate collateral levels. In the event the collateral fair value falls below stipulated levels, the Company will pledge additional investment securities. For transfers of assets with the FHLB and the FRB, the Company enters into bilateral agreements to pledge loans as collateral to secure borrowing capacity. For ACH transactions, the Company enters into bilateral agreements to collateralize possible daylight overdrafts. For interest rate swaps, the Company enters into bilateral agreements to pledge collateral when either party is in a negative fair value position to mitigate counterparty credit risk. Counterparties to ACH transactions, certain interest rate swaps, the FHLB and the FRB do not have the right to sell or repledge the collateral.

The carrying amounts of the assets pledged as collateral to secure public deposits, borrowing arrangements and other transactions as of June 30, 2019 and December 31, 2018 were as follows:

| (dollars in thousands) | June 30, 2019 | December 31, 2018 |
|---|---|---|
| Public deposits | **$ 1,884,572** | $ 1,749,726 |
| Federal Home Loan Bank | **2,790,454** | 2,497,030 |
| Federal Reserve Bank | **939,046** | 957,017 |
| ACH transactions | **150,292** | 150,903 |
| Interest rate swaps | **36,311** | 28,843 |
| **Total** | **$ 5,800,675** | $ 5,383,519 |

As the Company did not enter into reverse repurchase agreements or repurchase agreements, no collateral was accepted or pledged as of June 30, 2019 and December 31, 2018. In addition, no debt was extinguished by in-substance defeasance.

**7. Deposits**

As of June 30, 2019 and December 31, 2018, deposits were categorized as interest-bearing or noninterest-bearing as follows:

| (dollars in thousands) | June 30, 2019 | December 31, 2018 |
|---|---|---|
| U.S.: | | |
| Interest-bearing | **$ 10,244,217** | $ 10,393,449 |
| Noninterest-bearing | **5,116,416** | 5,368,729 |
| Foreign: | | |
| Interest-bearing | **784,704** | 748,678 |
| Noninterest-bearing | **646,741** | 639,212 |
| **Total deposits** | **$ 16,792,078** | $ 17,150,068 |

The following table presents the maturity distribution of time certificates of deposit as of June 30, 2019:

| (dollars in thousands) | Under $250,000 | $250,000 or More | Total |
|---|---|---|---|
| Three months or less | **$ 213,616** | **$ 1,057,207** | **$ 1,270,823** |
| Over three through six months | **187,476** | **245,745** | **433,221** |
| Over six through twelve months | **420,212** | **426,115** | **846,327** |
| One to two years | **121,211** | **79,494** | **200,705** |
| Two to three years | **113,193** | **49,338** | **162,531** |
| Three to four years | **51,273** | **22,497** | **73,770** |
| Four to five years | **71,970** | **10,677** | **82,647** |
| Thereafter | **54** | **—** | **54** |
| **Total** | **$ 1,179,005** | **$ 1,891,073** | **$ 3,070,078** |

Time certificates of deposit in denominations of $250,000 or more, in the aggregate, were $1.9 billion as of both June 30, 2019 and December 31, 2018. Overdrawn deposit accounts are classified as loans and totaled $2.9 million and $2.4 million as of June 30, 2019 and December 31, 2018, respectively.

### 8. Short-Term Borrowings

At June 30, 2019 and December 31, 2018, short-term borrowings were comprised of the following:

| (dollars in thousands) | June 30, 2019 | December 31, 2018 |
|---|---|---|
| Short-term FHLB fixed-rate advance[1] | **$ 200,000** | $ — |
| **Total short-term borrowings** | **$ 200,000** | $ — |

(1) Interest is payable monthly.

As of June 30, 2019, the Company's short-term borrowings consisted of a $200.0 million short-term FHLB fixed-rate advance with a 2.79% annual interest rate that matures in June 2020. The short-term FHLB fixed-rate advance requires monthly interest-only payments with the principal amount due on the maturity date. See "Note 6. Transfers of Financial Assets" for more information.

### 9. Long-Term Borrowings

Long-term borrowings consisted of the following as of June 30, 2019 and December 31, 2018:

| (dollars in thousands) | June 30, 2019 | December 31, 2018 |
|---|---|---|
| Finance lease[1] | **$ 28** | $ 26 |
| FHLB fixed-rate advances[1] | **400,000** | 600,000 |
| **Total long-term borrowings** | **$ 400,028** | $ 600,026 |

(1) Interest is payable monthly.

As of June 30, 2019 and December 31, 2018, the Company's long-term borrowings included $400.0 million and $600.0 million, respectively, in FHLB fixed-rate advances with a weighted average interest rate of 2.80% and maturity dates ranging from 2020 to 2024. The FHLB fixed-rate advances require monthly interest-only payments with the principal amount due on the maturity date. As of June 30, 2019 and December 31, 2018, the available remaining borrowing capacity with the FHLB was $1.6 billion and $1.3 billion, respectively. The FHLB fixed-rate advances and remaining borrowing capacity were secured by residential real estate loan collateral as of June 30, 2019 and December 31, 2018. See "Note 6. Transfers of Financial Assets" for more information.

As of June 30, 2019 and December 31, 2018, the Company's long-term borrowings included a finance lease obligation with a 6.78% annual interest rate that matures in 2022.

As of June 30, 2019, future contractual principal payments and maturities on long-term borrowings were as follows:

| (dollars in thousands) | Principal Payments |
|---|---|
| 2019 | **$ 9** |
| 2020 | **200,009** |
| 2021 | **10** |
| 2022 | **—** |
| 2023[1] | **100,000** |
| Thereafter[2] | **100,000** |
| Total | **$ 400,028** |

(1) FHLB fixed-rate advance callable on December 4, 2020 with an interest rate of 2.80%.
(2) FHLB fixed-rate advance callable on January 15, 2021 with an interest rate of 2.65%.

## 10. Accumulated Other Comprehensive Loss

Accumulated other comprehensive loss is defined as the revenues, expenses, gains and losses that are included in comprehensive income but excluded from net income. The Company's significant items of accumulated other comprehensive loss are pension and other benefits, net unrealized gains or losses on investment securities and net unrealized gains or losses on cash flow derivative hedges.

Changes in accumulated other comprehensive loss for the three and six months ended June 30, 2019 and 2018 are presented below:

| (dollars in thousands) | Pre-tax Amount | Income Tax Benefit (Expense) | Net of Tax |
|---|---|---|---|
| Accumulated other comprehensive loss at March 31, 2019 | $ (107,779) | $ 29,025 | $ (78,754) |
| **Three months ended June 30, 2019** | | | |
| Pension and other benefits: | | | |
| Net actuarial losses arising during the period | **(813)** | **219** | **(594)** |
| Net change in pension and other benefits | **(813)** | **219** | **(594)** |
| Investment securities: | | | |
| Unrealized net gains arising during the period | **64,841** | **(17,462)** | **47,379** |
| Reclassification of net gains to net income: | | | |
| Investment securities gains, net | **(21)** | **6** | **(15)** |
| Net change in unrealized gains on investment securities | **64,820** | **(17,456)** | **47,364** |
| Other comprehensive income | **64,007** | **(17,237)** | **46,770** |
| **Accumulated other comprehensive loss at June 30, 2019** | **$ (43,772)** | **$ 11,788** | **$ (31,984)** |

| (dollars in thousands) | Pre-tax Amount | Income Tax Benefit (Expense) | Net of Tax |
|---|---|---|---|
| Accumulated other comprehensive loss at December 31, 2018 | $ (180,915) | $ 48,720 | $ (132,195) |
| **Six months ended June 30, 2019** | | | |
| Pension and other benefits: | | | |
| Net actuarial losses arising during the period | **(813)** | **219** | **(594)** |
| Net change in pension and other benefits | **(813)** | **219** | **(594)** |
| Investment securities: | | | |
| Unrealized net gains arising during the period | **135,364** | **(36,453)** | **98,911** |
| Reclassification of net losses to net income: | | | |
| Investment securities losses, net | **2,592** | **(698)** | **1,894** |
| Net change in unrealized gains on investment securities | **137,956** | **(37,151)** | **100,805** |
| Other comprehensive income | **137,143** | **(36,932)** | **100,211** |
| **Accumulated other comprehensive loss at June 30, 2019** | **$ (43,772)** | **$ 11,788** | **$ (31,984)** |

| (dollars in thousands) | Pre-tax Amount | Income Tax Benefit (Expense) | Net of Tax |
|---|---|---|---|
| Accumulated other comprehensive loss at March 31, 2018 | $ (225,385) | $ 60,701 | $ (164,684) |
| **Three months ended June 30, 2018** | | | |
| Investment securities: | | | |
| Unrealized net losses arising during the period | (24,688) | 6,649 | (18,039) |
| Net change in unrealized losses on investment securities | (24,688) | 6,649 | (18,039) |
| Cash flow derivative hedges: | | | |
| Unrealized net gains on cash flow derivative hedges arising during the period | 425 | (112) | 313 |
| Net change in unrealized gains on cash flow derivative hedges | 425 | (112) | 313 |
| Other comprehensive loss | (24,263) | 6,537 | (17,726) |
| Accumulated other comprehensive loss at June 30, 2018 | $ (249,648) | $ 67,238 | $ (182,410) |

| (dollars in thousands) | Pre-tax Amount | Income Tax Benefit (Expense) | Net of Tax |
|---|---|---|---|
| Accumulated other comprehensive loss at December 31, 2017 | $ (159,423) | $ 63,040 | $ (96,383) |
| **Six months ended June 30, 2018** | | | |
| Early adoption of ASU No. 2018-02 | — | (20,068) | (20,068) |
| Investment securities: | | | |
| Unrealized net losses arising during the period | (91,388) | 24,572 | (66,816) |
| Net change in unrealized losses on investment securities | (91,388) | 24,572 | (66,816) |
| Cash flow derivative hedges: | | | |
| Unrealized net gains on cash flow derivative hedges arising during the period | 1,163 | (306) | 857 |
| Net change in unrealized gains on cash flow derivative hedges | 1,163 | (306) | 857 |
| Other comprehensive loss | (90,225) | 24,266 | (65,959) |
| Accumulated other comprehensive loss at June 30, 2018 | $ (249,648) | $ 67,238 | $ (182,410) |

The following table summarizes changes in accumulated other comprehensive loss, net of tax, for the periods indicated:

| (dollars in thousands) | Pensions and Other Benefits | Investment Securities | Cash Flow Derivative Hedges | Total Accumulated Other Comprehensive Loss |
|---|---|---|---|---|
| **Three Months Ended June 30, 2019** | | | | |
| Balance at beginning of period | $ (28,379) | $ (50,375) | $ — | $ (78,754) |
| Other comprehensive income | **(594)** | **47,364** | **—** | **46,770** |
| Balance at end of period | **$ (28,973)** | **$ (3,011)** | **$ —** | **$ (31,984)** |
| | | | | |
| **Six Months Ended June 30, 2019** | | | | |
| Balance at beginning of period | **$ (28,379)** | **$ (103,816)** | **$ —** | **$ (132,195)** |
| Other comprehensive income | **(594)** | **100,805** | **—** | **100,211** |
| Balance at end of period | **$ (28,973)** | **$ (3,011)** | **$ —** | **$ (31,984)** |
| | | | | |
| **Three Months Ended June 30, 2018** | | | | |
| Balance at beginning of period | $ (31,339) | $ (138,334) | $ 4,989 | $ (164,684) |
| Other comprehensive loss | — | (18,039) | 313 | (17,726) |
| Balance at end of period | $ (31,339) | $ (156,373) | $ 5,302 | $ (182,410) |
| | | | | |
| **Six Months Ended June 30, 2018** | | | | |
| Balance at beginning of period | $ (25,946) | $ (74,117) | $ 3,680 | $ (96,383) |
| Early adoption of ASU No. 2018-02 | (5,393) | (15,440) | 765 | (20,068) |
| Other comprehensive loss | — | (66,816) | 857 | (65,959) |
| Balance at end of period | $ (31,339) | $ (156,373) | $ 5,302 | $ (182,410) |

## 11. Regulatory Capital Requirements

Federal and state laws and regulations limit the amount of dividends the Company may declare or pay. The Company depends primarily on dividends from FHB as the source of funds for the Company's payment of dividends.

The Company and the Bank are subject to various regulatory capital requirements imposed by federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Company's and the Bank's operating activities and financial condition. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and Bank must meet specific capital guidelines that involve quantitative measures of its assets and certain off-balance-sheet items. The capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and Bank to maintain minimum amounts and ratios of Common Equity Tier 1 ("CET1") capital, Tier 1 capital and total capital to risk-weighted assets, as well as a minimum leverage ratio.

The table below sets forth those ratios at June 30, 2019 and December 31, 2018:

| (dollars in thousands) | First Hawaiian, Inc. Amount | First Hawaiian, Inc. Ratio | First Hawaiian Bank Amount | First Hawaiian Bank Ratio | Minimum Capital Ratio(1) | Well-Capitalized Ratio(1) |
|---|---|---|---|---|---|---|
| **June 30, 2019:** | | | | | | |
| Common equity tier 1 capital to risk-weighted assets | **$ 1,695,933** | **11.84 %** | **$ 1,685,158** | **11.76 %** | **4.50 %** | **6.50 %** |
| Tier 1 capital to risk-weighted assets | **1,695,933** | **11.84 %** | **1,685,158** | **11.76 %** | **6.00 %** | **8.00 %** |
| Total capital to risk-weighted assets | **1,835,068** | **12.81 %** | **1,824,293** | **12.73 %** | **8.00 %** | **10.00 %** |
| Tier 1 capital to average assets (leverage ratio) | **1,695,933** | **8.75 %** | **1,685,158** | **8.70 %** | **4.00 %** | **5.00 %** |
| | | | | | | |
| December 31, 2018: | | | | | | |
| Common equity tier 1 capital to risk-weighted assets | $ 1,661,542 | 11.97 % | $ 1,658,172 | 11.94 % | 4.50 % | 6.50 % |
| Tier 1 capital to risk-weighted assets | 1,661,542 | 11.97 % | 1,658,172 | 11.94 % | 6.00 % | 8.00 % |
| Total capital to risk-weighted assets | 1,803,860 | 12.99 % | 1,800,490 | 12.97 % | 8.00 % | 10.00 % |
| Tier 1 capital to average assets (leverage ratio) | 1,661,542 | 8.72 % | 1,658,172 | 8.70 % | 4.00 % | 5.00 % |

(1) As defined by the regulations issued by the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, and Federal Deposit Insurance Corporation ("FDIC").

A new capital conservation buffer, comprised of CET1 capital, was established above the regulatory minimum capital requirements. This capital conservation buffer was phased in beginning January 1, 2016 at 0.625% of risk-weighted assets and increased each subsequent year by an additional 0.625% until reaching 2.5% on January 1, 2019. As of June 30, 2019, under the bank regulatory capital guidelines, the Company and Bank were both classified as well-capitalized. Management is not aware of any conditions or events that have occurred since June 30, 2019, to change the capital adequacy category of the Company or the Bank.

### 12. Derivative Financial Instruments

The Company enters into derivative contracts primarily to manage its interest rate risk, as well as for customer accommodation purposes. Derivatives used for risk management purposes consist of interest rate swaps that are designated as either a fair value hedge or a cash flow hedge. The derivatives are recognized on the unaudited interim consolidated balance sheets as either assets or liabilities at fair value. Derivatives entered into for customer accommodation purposes consist of various free-standing interest rate derivative products and foreign exchange contracts. The Company is party to master netting arrangements with its financial institution counterparties; however, the Company does not offset assets and liabilities under these arrangements for financial statement presentation purposes.

The following table summarizes notional amounts and fair values of derivatives held by the Company as of June 30, 2019 and December 31, 2018:

| | June 30, 2019 | | | December 31, 2018 | | |
|---|---|---|---|---|---|---|
| | | Fair Value | | | Fair Value | |
| (dollars in thousands) | Notional Amount | Asset Derivatives(1) | Liability Derivatives(2) | Notional Amount | Asset Derivatives(1) | Liability Derivatives(2) |
| Derivatives designated as hedging instruments: | | | | | | |
| Interest rate swaps | **$ 23,545** | **$ —** | **$ (776)** | $ 41,317 | $ 31 | $ (44) |
| Derivatives not designated as hedging instruments: | | | | | | |
| Interest rate swaps | **2,592,239** | **60,281** | **—** | 2,269,247 | 12,305 | (12,007) |
| Funding swap | **66,840** | **—** | **(1,179)** | 62,039 | — | (2,607) |
| Foreign exchange contracts | **1,629** | **1** | **(2)** | 1,191 | — | (34) |

(1) The positive fair values of derivative assets are included in other assets.
(2) The negative fair values of derivative liabilities are included in other liabilities.

Certain interest rate swaps noted above, are cleared through clearinghouses, rather than directly with counterparties. Those transactions cleared through a clearinghouse require initial margin collateral and variation margin payments depending on the contracts being in a net asset or liability position. The amount of initial margin cash collateral posted by the Company was $3.1 million and $2.1 million as of June 30, 2019 and December 31, 2018, respectively.

Effective January 3, 2017, the Chicago Mercantile Exchange ("CME") amended its rulebook to legally characterize variation margin payments, for derivative contracts that are referred to as settled-to-market ("STM"), as settlements of the derivative's mark-to-market exposure and not collateral. Based on these changes, the Company has treated the CME variation margin as a settlement, which has resulted in a decrease in our cash collateral, and a corresponding decrease in our derivative asset and liability. The change was applied prospectively effective January 3, 2017. As of June 30, 2019 and December 31, 2018, the CME variation margin was $1.2 million and $0.5 million, respectively.

Effective January 16, 2018, the London Clearing House ("LCH") also amended its rulebook to legally characterize variation margin payments, for derivative contracts that are referred to as STM, as settlements of the derivative's mark-to-market exposure and not collateral. Consistent with the CME's amended requirements discussed above, the Company has treated the LCH variation margin as a settlement, which has resulted in a decrease in our cash collateral, and a corresponding decrease in our derivative asset and liability. The change was applied prospectively effective January 16, 2018. As of June 30, 2019 and December 31, 2018, the LCH variation margin was $59.1 million and $0.6 million, respectively.

As of June 30, 2019, the Company pledged $29.6 million in financial instruments and $6.8 million in cash as collateral for interest rate swaps. As of December 31, 2018, the Company pledged $26.2 million in financial instruments and $2.6 million in cash as collateral for interest rate swaps. As of June 30, 2019 and December 31, 2018, the cash collateral includes the excess initial margin for interest rate swaps cleared through clearinghouses and cash collateral for interest rate swaps with financial institution counterparties.

**Fair Value Hedges**

To manage the risk related to the Company's net interest margin, interest rate swaps are utilized to hedge certain fixed-rate loans. These swaps have maturity, amortization and prepayment features that correspond to the loans hedged, and are designated and qualify as fair value hedges. Any gain or loss on the swaps, as well as the offsetting loss or gain on the hedged item attributable to the hedged risk, is recognized in current period earnings.

At June 30, 2019, the Company carried one interest rate swap with a notional amount of $23.5 million with a negative fair value of $0.8 million that was categorized as a fair value hedge for a commercial and industrial loan. The Company received a USD Prime floating rate and paid a fixed rate of 2.90%. The swap matures in 2023. At December 31, 2018, the Company carried interest rate swaps with notional amounts totaling $41.3 million with a positive fair value of nil and a negative fair value of nil that were categorized as fair value hedges for commercial and industrial loans and commercial real estate loans.

The following table shows the gains and losses recognized in income related to derivatives in fair value hedging relationships for the three and six months ended June 30, 2019 and 2018:

| (dollars in thousands) | Gains (losses) recognized in the consolidated statements of income line item | Three Months Ended June 30, 2019 | Three Months Ended June 30, 2018 | Six Months Ended June 30, 2019 | Six Months Ended June 30, 2018 |
|---|---|---|---|---|---|
| **Gains (losses) on fair value hedging relationships recognized in Interest Income(1):** | | | | | |
| Recognized on interest rate swap | Loans and lease financing | **$ (424)** | $ — | **$ (766)** | $ — |
| Recognized on hedged item | Loans and lease financing | **427** | — | **689** | — |
| **Gains (losses) on fair value hedging relationships recognized in Noninterest Income(2):** | | | | | |
| Recognized on interest rate swap | Other | **$ —** | $ 408 | **$ —** | $ 958 |
| Recognized on hedged item | Other | **—** | (325) | **—** | (1,088) |

(1) In connection with the adoption of ASU 2017-12, beginning January 1, 2019, gain (loss) amounts for the interest rate swap qualifying as fair value hedging and the hedged item are included in Loans and Lease Financing Interest Income.

(2) Prior to January 1, 2019, gain (loss) amounts for the interest rate swaps qualifying as fair value hedging and the hedged items were included in Other Noninterest Income.

As of June 30, 2019 and December 31, 2018, the following amounts were recorded in the unaudited interim consolidated balance sheets related to the cumulative basis adjustments for fair value hedges:

| (dollars in thousands) | Carrying Amount of the Hedged Asset | | Cumulative Amount of Fair Value Hedging Adjustment Included in the Carrying Amount of the Hedged Asset | |
|---|---|---|---|---|
| | June 30, 2019 | December 31, 2018 | June 30, 2019 | December 31, 2018 |
| **Line Item in the Consolidated Balance Sheets in Which the Hedged Item is Included** | | | | |
| Loans and leases | **$ 24,710** | $ 42,496 | **$ 971** | $ 293 |

**Cash Flow Hedges**

During 2018, the Company carried two interest rate swaps with notional amounts totaling $150.0 million, in order to reduce exposure to interest rate increases associated with short-term fixed-rate liabilities. The Company received 6-month LIBOR and paid fixed rates ranging from 2.98% to 3.03%. The swaps matured in December 2018. As of June 30, 2019 and December 31, 2018, the Company held no cash flow hedges. The interest rate swaps designated as cash flow hedges resulted in net interest expense of $0.4 million and $0.9 million during the three and six months ended June 30, 2018, respectively.

The Company utilized interest rate swaps to reduce exposure to interest rates associated with short-term fixed-rate liabilities. The Company entered into interest rate swaps paying fixed rates and receiving LIBOR. The LIBOR index corresponded to the short-term fixed-rate nature of the liabilities being hedged. If interest rates rose, the increase in interest received on the swaps offset increases in interest costs associated with these liabilities. By hedging with interest rate swaps, the Company minimized the adverse impact on interest expense associated with increasing rates on short-term liabilities.

The interest rate swaps were designated and qualified as cash flow hedges. The effective portion of the gain or loss on the interest rate swaps was reported as a component of other comprehensive income and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. There were no recognized expenses related to the ineffective portion of the change in fair value of derivatives designated as a cash flow hedge during the three and six months ended June 30, 2018.

The following table summarizes the effect of cash flow hedging relationships for the three and six months ended June 30, 2018:

| (dollars in thousands) | Three Months Ended June 30, 2018 | Six Months Ended June 30, 2018 |
|---|---|---|
| Pretax gains recognized in other comprehensive income on derivatives (effective portion) | $ 425 | $ 1,163 |

There were no gains or losses reclassified from accumulated other comprehensive loss to earnings during the three and six months ended June 30, 2018.

**Free-Standing Derivative Instruments**

For the derivatives that are not designated as hedges, changes in fair value are reported in current period earnings. The following table summarizes the impact on pretax earnings of derivatives not designated as hedges, as reported on the unaudited interim consolidated statements of income for the three and six months ended June 30, 2019 and 2018:

| (dollars in thousands) | Net gains (losses) recognized in the consolidated statements of income line item | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|---|
| | | 2019 | 2018 | 2019 | 2018 |
| **Derivatives Not Designated As Hedging Instruments:** | | | | | |
| Interest rate swaps | Other noninterest income | **$ —** | $ 227 | **$ 16** | $ 631 |
| Funding swap | Other noninterest income | **(247)** | 4 | **(242)** | (80) |
| Foreign exchange contracts | Other noninterest income | **(1)** | (30) | **(1)** | (92) |

As of June 30, 2019, the Company carried multiple interest rate swaps with notional amounts totaling $2.6 billion, all of which were related to the Company's customer swap program, with a positive fair value of $60.3 million and a negative fair value of nil. The Company received 1-month LIBOR and paid fixed rates ranging from 2.02% to 8.73%. The swaps mature between November 2019 and January 2039. As of December 31, 2018, the Company carried multiple interest rate swaps with notional amounts totaling $2.3 billion, including $2.2 billion related to the Company's customer swap program, with a positive fair value of $12.3 million and a negative fair value of $12.0 million. The Company received 1-month LIBOR and paid fixed rates ranging from 2.02% to 5.78%. These swaps resulted in net interest expense of nil and $0.1 million for the three months ended June 30, 2019 and 2018, respectively, and nil and $0.3 million for the six months ended June 30, 2019 and 2018, respectively.

The Company's customer swap program is designed by offering customers a variable-rate loan that is swapped to fixed-rate through an interest rate swap. The Company simultaneously executes an offsetting interest rate swap with a swap dealer. Upfront fees on the dealer swap are recorded in other noninterest income and totaled $1.1 million and $1.8 million for the three months ended June 30, 2019 and 2018, respectively, and $2.0 million and $5.0 million for the six months ended June 30, 2019 and 2018, respectively. Interest rate swaps related to the program had asset fair values of $60.3 million and $12.3 million as of June 30, 2019 and December 31, 2018, respectively, and liability fair values of nil and $11.2 million as of June 30, 2019 and December 31, 2018, respectively.

In conjunction with the 2016 sale of Class B restricted shares of common stock issued by Visa, the Company entered into a funding swap agreement with the buyer that requires payment to the buyer in the event Visa reduces each member bank's Class B conversion rate to unrestricted Class A common shares. On June 28, 2018, Visa additionally funded its litigation escrow account, thereby reducing each member bank's Class B conversion rate to unrestricted Class A common shares. Accordingly, on July 5, 2018, Visa announced a decrease in conversion rate from 1.6483 to 1.6298 effective June 28, 2018. In July 2018, the Company made a payment of approximately $0.7 million to the buyer as a result of the reduction in the Visa Class B conversion rate. Under the terms of the funding swap agreement, the Company will make monthly payments to the buyer based on Visa's Class A stock price and the number of Visa Class B restricted shares that were sold until the date on which the covered litigation is settled. A derivative liability ("Visa derivative") of $1.2 million and $2.6 million was included in the unaudited interim consolidated balance sheets at June 30, 2019 and December 31, 2018, respectively, to provide for the fair value of this liability. There were no sales of these shares prior to 2016. See "Note 18. Fair Value" for more information.

**Counterparty Credit Risk**

By using derivatives, the Company is exposed to counterparty credit risk if counterparties to the derivative contracts do not perform as expected. If a counterparty fails to perform, the Company's counterparty credit risk is equal to the amount reported as a derivative asset, net of cash or other collateral received, and net of derivatives in a loss position with the same counterparty to the extent master netting arrangements exist. The Company minimizes counterparty credit risk through credit approvals, limits, monitoring procedures, executing master netting arrangements and obtaining collateral, where appropriate. Counterparty credit risk related to derivatives is considered in determining fair value.

The Company's interest rate swap agreements include bilateral collateral agreements with collateral requirements, which begin with exposures in excess of $0.5 million. For each counterparty, the Company reviews the interest rate swap collateral daily. Collateral for customer interest rate swap agreements, calculated as the pledged asset less loan balance, requires valuation of the pledged asset. Counterparty credit risk adjustments of $0.1 million were recognized during both the six months ended June 30, 2019 and 2018.

**Credit-Risk Related Contingent Features**

Certain of our derivative contracts contain provisions whereby if the Company's credit rating were to be downgraded by certain major credit rating agencies as a result of a merger or material adverse change in the Company's financial condition, the counterparty could require an early termination of derivative instruments in a net liability position. The aggregate fair value of all derivative instruments with such credit-risk related contingent features that are in a net liability position was $3.8 million and $0.8 million at June 30, 2019 and December 31, 2018, respectively, for which we posted $3.6 million and $0.5 million, respectively, in collateral in the normal course of business. If the Company's credit rating had been downgraded as of June 30, 2019 and December 31, 2018, we may have been required to settle the contracts in an amount equal to their fair value.

## 13. Commitments and Contingent Liabilities

### Contingencies

On January 27, 2017, a putative class action lawsuit was filed by a Bank customer alleging that FHB improperly charged an overdraft fee in circumstances where an account had sufficient funds to cover the transaction at the time the transaction was authorized but not at the time the transaction was presented for payment, and that this practice constituted an unjust and deceptive trade practice and a breach of contract. The lawsuit further alleged that FHB's practice of assessing a one-time continuous negative balance overdraft fee on accounts remaining in a negative balance for a seven-day period constituted a usurious interest charge and an unfair and deceptive trade practice. On October 2, 2018, the parties reached an agreement in principle to resolve this class action lawsuit. In connection with the anticipated settlement agreement, the Company recorded an expense of approximately $4.1 million during the three months ended September 30, 2018. During the six months ended June 30, 2019, the Court entered an order preliminarily approving the settlement agreement, pursuant to which the Company funded a $4.1 million settlement account. The final approval hearing has been set for August 6, 2019.

In addition to the litigation noted above, various other legal proceedings are pending or threatened against the Company. After consultation with legal counsel, management does not expect that the aggregate liability, if any, resulting from these proceedings would have a material effect on the Company's unaudited interim consolidated financial position, results of operations or cash flows.

### Financial Instruments with Off-Balance Sheet Risk

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby and commercial letters of credit which are not reflected in the unaudited interim consolidated financial statements.

### Unfunded Commitments to Extend Credit

A commitment to extend credit is a legally binding agreement to lend funds to a customer, usually at a stated interest rate and for a specified purpose. Commitments are reported net of participations sold to other institutions. Such commitments have fixed expiration dates and generally require a fee. The extension of a commitment gives rise to credit risk. The actual liquidity requirements or credit risk that the Company will experience is expected to be lower than the contractual amount of commitments to extend credit because a significant portion of those commitments are expected to expire without being drawn upon. Certain commitments are subject to loan agreements containing covenants regarding the financial performance of the customer that must be met before the Company is required to fund the commitment. The Company uses the same credit policies in making commitments to extend credit as it does in making loans. In addition, the Company manages the potential credit risk in commitments to extend credit by limiting the total amount of arrangements, both by individual customer and in the aggregate, by monitoring the size and expiration structure of these portfolios and by applying the same credit standards maintained for all of its related credit activities. Commitments to extend credit are reported net of participations sold to other institutions of $92.0 million and $92.3 million at June 30, 2019 and December 31, 2018, respectively.

### Standby and Commercial Letters of Credit

Standby letters of credit are issued on behalf of customers in connection with contracts between the customers and third parties. Under standby letters of credit, the Company assures that the third parties will receive specified funds if customers fail to meet their contractual obligations. The credit risk to the Company arises from its obligation to make payment in the event of a customer's contractual default. Standby letters of credit are reported net of participations sold to other institutions of $17.3 million as of both June 30, 2019 and December 31, 2018. The Company also had commitments for commercial and similar letters of credit. Commercial letters of credit are issued specifically to facilitate commerce whereby the commitment is typically drawn upon when the underlying transaction between the customer and a third-party is consummated. The maximum amount of potential future payments guaranteed by the Company is limited to the contractual amount of these letters. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Collateral held supports those commitments for which collateral is deemed necessary. The commitments outstanding as of June 30, 2019 have maturities ranging from July 2019 to July 2021. Substantially all fees received from the issuance of such commitments are deferred and amortized on a straight-line basis over the term of the commitment.

Financial instruments with off-balance sheet risk at June 30, 2019 and December 31, 2018 were as follows:

| (dollars in thousands) | June 30, 2019 | December 31, 2018 |
|---|---|---|
| Financial instruments whose contract amounts represent credit risk: | | |
| Commitments to extend credit | **$ 5,791,088** | $ 5,549,591 |
| Standby letters of credit | **185,872** | 204,324 |
| Commercial letters of credit | **6,994** | 7,535 |

**Guarantees**

The Company sells residential mortgage loans in the secondary market primarily to The Federal National Mortgage Association ("Fannie Mae") and The Federal Home Loan Mortgage Corporation ("Freddie Mac") that may potentially require repurchase under certain conditions. This risk is managed through the Company's underwriting practices. The Company services loans sold to investors and loans originated by other originators under agreements that may include repurchase remedies if certain servicing requirements are not met. This risk is managed through the Company's quality assurance and monitoring procedures. Management does not anticipate any material losses as a result of these transactions.

**Foreign Exchange Contracts**

The Company has forward foreign exchange contracts that represent commitments to purchase or sell foreign currencies at a future date at a specified price. The Company's utilization of forward foreign exchange contracts is subject to the primary underlying risk of movements in foreign currency exchange rates and to additional counterparty risk should its counterparties fail to meet the terms of their contracts. Forward foreign exchange contracts are utilized to mitigate the Company's risk to satisfy customer demand for foreign currencies and are not used for trading purposes. See "Note 12. Derivative Financial Instruments" for more information.

**Reorganization Transactions**

On April 1, 2016, a series of reorganization transactions (the "Reorganization Transactions") were undertaken to facilitate FHI's IPO. In connection with the Reorganization Transactions, FHI distributed its interest in BancWest Holding Inc. ("BWHI"), including Bank of the West ("BOW") to BNPP so that BWHI was held directly by BNPP. As a result of the Reorganization Transactions that occurred on April 1, 2016, various tax or other contingent liabilities could arise related to the business of BOW, or related to the Company's operations prior to the restructuring when it was known as BWC, including its then wholly owned subsidiary, BOW. The Company is not able to determine the ultimate outcome or estimate the amounts of these contingent liabilities, if any, at this time.

## 14. Revenue from Contracts with Customers

**Revenue Recognition**

In accordance with Topic 606, revenues are recognized when control of promised goods or services is transferred to customers in an amount that reflects the consideration the Company expects to be entitled to in exchange for those goods or services. To determine revenue recognition for arrangements that an entity determines are within the scope of Topic 606, the Company performs the following five steps: (i) identify the contract(s) with a customer; (ii) identify the performance obligations in the contract; (iii) determine the transaction price; (iv) allocate the transaction price to the performance obligations in the contract; and (v) recognize revenue when (or as) the Company satisfies a performance obligation. The Company only applies the five-step model to contracts when it is probable that the entity will collect the consideration it is entitled to in exchange for the goods or services it transfers to the customer. At contract inception, once the contract is determined to be within the scope of Topic 606, the Company assesses the goods or services that are promised within each contract and identifies those that contain performance obligations, and assesses whether each promised good or service is distinct. The Company then recognizes as revenue the amount of the transaction price that is allocated to the respective performance obligation when (or as) the performance obligation is satisfied.

**Disaggregation of Revenue**

The following table summarizes the Company's revenues, which includes net interest income on financial instruments and noninterest income, disaggregated by type of service and business segments for the periods indicated:

| | Three Months Ended June 30, 2019 | | | |
|---|---|---|---|---|
| (dollars in thousands) | Retail Banking | Commercial Banking | Treasury and Other | Total |
| **Net interest income[(1)]** | **$ 114,127** | **$ 28,581** | **$ 2,905** | **$ 145,613** |
| | | | | |
| Service charges on deposit accounts | **7,437** | **3** | **683** | **8,123** |
| Credit and debit card fees | **—** | **14,481** | **1,687** | **16,168** |
| Other service charges and fees | **4,944** | **868** | **578** | **6,390** |
| Trust and investment services income | **8,931** | **—** | **—** | **8,931** |
| Other | **142** | **761** | **327** | **1,230** |
| Not in scope of Topic 606[(1)] | **2,228** | **2,305** | **3,398** | **7,931** |
| Total noninterest income | **23,682** | **18,418** | **6,673** | **48,773** |
| **Total revenue** | **$ 137,809** | **$ 46,999** | **$ 9,578** | **$ 194,386** |

| | Six Months Ended June 30, 2019 | | | |
|---|---|---|---|---|
| (dollars in thousands) | Retail Banking | Commercial Banking | Treasury and Other | Total |
| **Net interest income[(1)]** | **$ 228,030** | **$ 56,561** | **$ 6,111** | **$ 290,702** |
| | | | | |
| Service charges on deposit accounts | **14,979** | **6** | **1,198** | **16,183** |
| Credit and debit card fees | **—** | **28,941** | **3,417** | **32,358** |
| Other service charges and fees | **10,277** | **1,237** | **1,120** | **12,634** |
| Trust and investment services income | **17,549** | **—** | **—** | **17,549** |
| Other | **357** | **2,270** | **535** | **3,162** |
| Not in scope of Topic 606[(1)] | **4,696** | **4,045** | **5,218** | **13,959** |
| Total noninterest income | **47,858** | **36,499** | **11,488** | **95,845** |
| **Total revenue** | **$ 275,888** | **$ 93,060** | **$ 17,599** | **$ 386,547** |

(1) Most of the Company's revenue is not within the scope of ASU No. 2014-09, *Revenue from Contracts with Customers.* The guidance explicitly excludes net interest income from financial assets and liabilities as well as other noninterest income from loans, leases, investment securities and derivative financial instruments.

| | Three Months Ended June 30, 2018 | | | |
|---|---|---|---|---|
| (dollars in thousands) | Retail Banking | Commercial Banking | Treasury and Other | Total |
| **Net interest income[(1)]** | $ 111,273 | $ 28,802 | $ 1,328 | $ 141,403 |
| | | | | |
| Service charges on deposit accounts | 7,135 | 3 | 583 | 7,721 |
| Credit and debit card fees | — | 20,186 | 1,810 | 21,996 |
| Other service charges and fees | 5,098 | 1,036 | 520 | 6,654 |
| Trust and investment services income | 7,711 | — | — | 7,711 |
| Other | 148 | 1,990 | 218 | 2,356 |
| Not in scope of Topic 606[(1)] | 2,066 | (1,752) | 3,045 | 3,359 |
| Total noninterest income | 22,158 | 21,463 | 6,176 | 49,797 |
| **Total revenue** | $ 133,431 | $ 50,265 | $ 7,504 | $ 191,200 |

| (dollars in thousands) | Six Months Ended June 30, 2018 Retail Banking | Commercial Banking | Treasury and Other | Total |
|---|---|---|---|---|
| **Net interest income**[1] | $ 220,927 | $ 56,681 | $ 3,467 | $ 281,075 |
| | | | | |
| Service charges on deposit accounts | 14,583 | 7 | 1,086 | 15,676 |
| Credit and debit card fees | — | 38,807 | 3,597 | 42,404 |
| Other service charges and fees | 9,843 | 1,934 | 1,153 | 12,930 |
| Trust and investment services income | 15,942 | — | — | 15,942 |
| Other | 296 | 3,797 | 669 | 4,762 |
| Not in scope of Topic 606[1] | 4,226 | (3,082) | 5,639 | 6,783 |
| Total noninterest income | 44,890 | 41,463 | 12,144 | 98,497 |
| **Total revenue** | $ 265,817 | $ 98,144 | $ 15,611 | $ 379,572 |

(1) Most of the Company's revenue is not within the scope of ASU No. 2014-09, *Revenue from Contracts with Customers.* The guidance explicitly excludes net interest income from financial assets and liabilities as well as other noninterest income from loans, leases, investment securities and derivative financial instruments.

For the three and six months ended June 30, 2019 and 2018, substantially all of the Company's revenues under the scope of Topic 606 were related to performance obligations satisfied at a point in time.

The following is a discussion of revenues within the scope of Topic 606.

*Service Charges on Deposit Accounts*

Service charges on deposit accounts relate to fees generated from a variety of deposit products and services rendered to customers. Charges include, but are not limited to, overdraft fees, non-sufficient fund fees, dormant fees and monthly service charges. Such fees are recognized concurrent with the event on a daily basis or on a monthly basis depending upon the customer's cycle date.

*Credit and Debit Card Fees*

Credit and debit card fees primarily represent revenues earned from interchange fees, ATM fees and merchant processing fees. Interchange and network revenues are earned on credit and debit card transactions conducted with payment networks. ATM fees are primarily earned as a result of surcharges assessed to non-FHB customers who use a FHB ATM. Merchant processing fees are primarily earned on transactions in which FHB is the acquiring bank. Such fees are generally recognized concurrently with the delivery of services on a daily basis.

*Trust and Investment Services Fees*

Trust and investment services fees represent revenue earned by directing, holding and managing customers' assets. Fees are generally computed based on a percentage of the previous period's value of assets under management. The transaction price (i.e., percentage of assets under management) is established at the inception of each contract. Trust and investment services fees also include fees collected when the Company acts as agent or personal representative and executes security transactions, performs collection and disbursement of income, and completes investment management and other administrative tasks.

*Other Fees*

Other fees primarily include revenues generated from wire transfers, lockboxes, bank issuance of checks and insurance commissions. Such fees are recognized concurrent with the event or on a monthly basis.

**Contract Balances**

A contract liability is an entity's obligation to transfer goods or services to a customer for which the entity has received consideration (or the amount is due) from the customer. In prior years, the Company received signing bonuses from two vendors which are being amortized over the term of the respective contracts. As of June 30, 2019 and December 31, 2018, the Company had contract liabilities of $2.2 million and $2.6 million, respectively, which will be recognized over the remaining term of the respective contracts with the vendors. For the three and six months ended June 30, 2019, the Company's recognized revenues and contract liabilities decreased by approximately $0.2 million and $0.4 million, respectively, due to the passage of time. For the three and six months ended June 30, 2018, the Company's recognized revenues and contract liabilities decreased by approximately $0.2 million and $0.4 million, respectively, due to the passage of time. There were no changes in contract liabilities due to changes in transaction price estimates.

A contract asset is the right to consideration for transferred goods or services when the amount is conditioned on something other than the passage of time. As of June 30, 2019 and December 31, 2018, there were no receivables from contracts with customers or contract assets recorded on the Company's consolidated balance sheets.

**Other**

Except for the contract liabilities noted above, the Company did not have any significant performance obligations as of June 30, 2019 and December 31, 2018. The Company also did not have any material contract acquisition costs or use any significant judgments or estimates in recognizing revenue for financial reporting purposes.

### 15. Earnings per Share

For the three and six months ended June 30, 2019 and 2018, the Company made no adjustments to net income for the purpose of computing earnings per share and there were no antidilutive securities. For the three and six months ended June 30, 2019 and 2018, the computations of basic and diluted earnings per share were as follows:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| (dollars in thousands, except shares and per share amounts) | **2019** | **2018** | **2019** | **2018** |
| **Numerator:** | | | | |
| Net income | **$ 72,433** | $ 69,053 | **$ 142,357** | $ 137,011 |
| | | | | |
| **Denominator:** | | | | |
| Basic: weighted-average shares outstanding | **134,420,380** | 137,907,063 | **134,655,217** | 138,749,209 |
| Add: weighted-average equity-based awards | **231,628** | 158,816 | **269,114** | 142,746 |
| Diluted: weighted-average shares outstanding | **134,652,008** | 138,065,879 | **134,924,331** | 138,891,955 |
| | | | | |
| Basic earnings per share | **$ 0.54** | $ 0.50 | **$ 1.06** | $ 0.99 |
| Diluted earnings per share | **$ 0.54** | $ 0.50 | **$ 1.06** | $ 0.99 |

### 16. Leases

The Company, as lessee, is obligated under a number of noncancelable operating leases primarily for branch premises and related real estate. Terms of such leases extend for periods up to 45 years, many of which provide for periodic adjustment of rent payments based on changes in various economic indicators. Renewal options are included in the Company's lease liabilities and related right-of-use assets to the extent that the Company is reasonably certain to exercise such options. For all of the Company's short-term leases (i.e., leases with an initial term of 12 months or less), the Company recognizes lease expense on a straight-line basis over the lease term and variable lease payments in the period in which the obligation for those payments is incurred.

The Company's branch premises leases typically require that the Company is responsible to pay for non-lease variable components, primarily maintenance expense, as well as costs that are not a component of a lease agreement such as real property taxes, property insurance and sales taxes. Maintenance expense is paid to maintain common areas and covers costs including landscaping, cleaning and general maintenance. Such variable costs are typically re-evaluated by the landlord on an annual basis and are charged to the Company based on the portion of the total building premises that is occupied by the Company.

The Company subleases certain premises and real estate to third parties. The sublease portfolio consists of operating leases for space connected with three of the Company's branch properties.

The components of the Company's net lease expense for the three and six months ended June 30, 2019 were as follows:

| (dollars in thousands) | Three Months Ended June 30, 2019 | Six Months Ended June 30, 2019 |
|---|---|---|
| Operating lease expense | $ 2,340 | $ 4,655 |
| Short-term lease expense | 77 | 275 |
| Variable lease expense | 329 | 1,046 |
| Finance lease expense: | | |
| Amortization of right-of-use assets | 1 | 1 |
| Interest on lease liabilities | — | 1 |
| Total finance lease expense | 1 | 2 |
| Less: Sublease income | (249) | (498) |
| **Net lease expense** | $ 2,498 | $ 5,480 |

Other information related to the Company's lease liabilities as of and for the six months ended June 30, 2019 was as follows:

| (dollars in thousands) | Six Months Ended June 30, 2019 |
|---|---|
| **Supplemental Cash Flows Information** | |
| Cash paid for amounts included in the measurement of lease liabilities: | |
| Operating cash flows paid for operating leases | $ 3,426 |
| Operating cash flows paid for finance leases | 61 |
| Financing cash flows paid for finance leases | — |
| Right-of-use assets obtained in exchange for new lease obligations: | |
| Operating leases | $ 680 |
| **Weighted Average Remaining Lease Term** | |
| Operating leases | 15.2 years |
| Finance leases | 3.0 years |
| **Weighted Average Discount Rate** | |
| Operating leases | 3.42 % |
| Finance leases | 6.78 % |

Operating lease right-of-use assets were $47.4 million and finance lease right-of-use assets were not material as of June 30, 2019. Operating lease right-of-use assets and finance lease right-of use assets were recorded as a component of other assets and premises and equipment, respectively, as of June 30, 2019. Operating lease liabilities were $48.3 million and finance lease liabilities were not material as of June 30, 2019. Operating lease liabilities and finance lease liabilities were recorded as a component of other liabilities and long-term borrowings, respectively, as of June 30, 2019.

The most significant assumption related to the Company's application of ASC Topic 842 was the discount rate assumption. As most of the Company's lease agreements do not provide for an implicit interest rate, the Company used the collateralized interest rate that the Company would have to pay to borrow over a similar term to estimate the Company's lease liability as of January 1, 2019.

The following table sets forth future minimum rental payments under noncancelable leases with terms in excess of one year as of June 30, 2019:

| (dollars in thousands) | Net Operating Lease Payments |
|---|---|
| Year ending December 31: | |
| 2019 (excluding the six months ended June 30, 2019) | $ 5,360 |
| 2020 | 8,667 |
| 2021 | 7,977 |
| 2022 | 5,346 |
| 2023 | 2,854 |
| Thereafter | 34,853 |
| Total future minimum lease payments | 65,057 |
| Less: Imputed interest | (16,737) |
| Total | $ 48,320 |

The following table presents future minimum rental payments under leases with terms in excess of one year as of December 31, 2018 presented in accordance with ASC Topic 840, *"Leases"*:

| (dollars in thousands) | Operating Lease Payments | Less Sublease Income | Net Operating Lease Payments |
|---|---|---|---|
| Year ending December 31: | | | |
| 2019 | $ 8,780 | $ 903 | $ 7,877 |
| 2020 | 8,668 | 903 | 7,765 |
| 2021 | 7,961 | 892 | 7,069 |
| 2022 | 5,101 | — | 5,101 |
| 2023 | 2,632 | — | 2,632 |
| Thereafter | 34,638 | — | 34,638 |
| Total future minimum lease payments | $ 67,780 | $ 2,698 | $ 65,082 |

The Company has several operating leases with related parties associated with its branch premises. The lease payments to related parties were $0.1 million and $0.2 million for the three and six months ended June 30, 2019, respectively. The future minimum rental payments due to related parties are $0.2 million (remainder of 2019), $0.3 million (2020), $0.3 million (2021), $0.2 million (2022), $0.2 million (2023), and $7.5 million thereafter.

The Company, as lessor, rents office space in its headquarters office building as well as office space located primarily in Hawaii to third party lessees. The cost and accumulated depreciation related to leased properties were $288.7 million and $137.4 million, respectively, as of June 30, 2019, and $289.2 million and $133.7 million, respectively, as of December 31, 2018. Terms of such leases, including renewal options, may be extended for up to nine years, many of which provide for periodic adjustment of rent payments based on changes in consumer or other price indices. The Company recognizes lease income on a straight-line basis over the lease term. Non-lease components, primarily consisting of costs incurred by the Company for maintenance and utilities, are recognized as income in the period in which the payments are due.

The Company recognized operating lease income related to lease payments of $1.5 million and $3.0 million for the three and six months ended June 30, 2019, respectively. In addition, the Company recognized $1.3 million and $2.6 million of lease income related to variable lease payments for the three and six months ended June 30, 2019, respectively.

Certain of the Company's leases are with related parties for the use of space at the Company's headquarters office building. The rental income paid by the related parties for the three and six months ended June 30, 2019 and the future minimum rental income from related parties as of June 30, 2019 was $0.1 million and $0.2 million, respectively.

The following table sets forth future minimum rental income under noncancelable operating leases with terms in excess of one year as of June 30, 2019:

| (dollars in thousands) | Minimum Rental Income |
|---|---|
| Year ending December 31: | |
| 2019 (excluding the six months ended June 30, 2019) | **$ 2,926** |
| 2020 | **5,747** |
| 2021 | **5,438** |
| 2022 | **3,719** |
| 2023 | **2,795** |
| Thereafter | **5,049** |
| Total | **$ 25,674** |

## 17. Benefit Plans

The Company sponsors an unfunded supplemental executive retirement plan ("SERP") for certain key executives. On March 11, 2019, the Company's board of directors approved an amendment to the SERP to freeze the SERP. As a result of such amendment, effective July 1, 2019, there will be no new accruals of benefits, including service accruals. Existing benefits under the SERP, as of the effective date of the amendment described above, will otherwise continue in accordance with the terms of the SERP.

The following table sets forth the components of net periodic benefit cost for the Company's pension and postretirement benefit plans for the three and six months ended June 30, 2019 and 2018:

| (dollars in thousands) | Income line item where recognized in the consolidated statements of income | Pension Benefits 2019 | Pension Benefits 2018 | Other Benefits 2019 | Other Benefits 2018 |
|---|---|---|---|---|---|
| **Three Months Ended June 30,** | | | | | |
| Service cost | Salaries and employee benefits | **$ 17** | $ 174 | **$ 159** | $ 213 |
| Interest cost | Other noninterest expense | **2,044** | 1,795 | **206** | 184 |
| Expected return on plan assets | Other noninterest expense | **(1,195)** | (1,239) | **—** | — |
| Prior service credit | Other noninterest expense | **—** | — | **(107)** | (107) |
| Recognized net actuarial loss | Other noninterest expense | **1,564** | 1,609 | **(76)** | — |
| **Total net periodic benefit cost** | | **$ 2,430** | $ 2,339 | **$ 182** | $ 290 |
| **Six Months Ended June 30,** | | | | | |
| Service cost | Salaries and employee benefits | **$ 34** | $ 348 | **$ 318** | $ 425 |
| Interest cost | Other noninterest expense | **4,088** | 3,589 | **412** | 369 |
| Expected return on plan assets | Other noninterest expense | **(2,390)** | (2,479) | **—** | — |
| Prior service credit | Other noninterest expense | **—** | — | **(214)** | (214) |
| Recognized net actuarial loss | Other noninterest expense | **3,128** | 3,220 | **(152)** | — |
| **Total net periodic benefit cost** | | **$ 4,860** | $ 4,678 | **$ 364** | $ 580 |

## 18. Fair Value

The Company determines the fair values of its financial instruments based on the requirements established in Accounting Standards Codification ("ASC") 820, *Fair Value Measurements*, which provides a framework for measuring fair value under GAAP and requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. ASC 820 defines fair value as the exit price, the price that would be received for an asset or paid to transfer a liability, in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date under current market conditions.

### Fair Value Hierarchy

ASC 820 establishes three levels of fair values based on the markets in which the assets or liabilities are traded and the reliability of the assumptions used to determine fair value. The levels are:

- Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access.

- Level 2: Observable inputs other than Level 1 prices, such as quoted prices for similar assets and liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3: Valuation is generated from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect the Company's own estimates of assumptions that market participants would use in pricing the asset or liability ("Company-level data"). Level 3 assets and liabilities include financial instruments whose value is determined using unobservable inputs to pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

ASC 820 requires that the Company disclose estimated fair values for certain financial instruments. Financial instruments include such items as investment securities, loans, deposits, interest rate and foreign exchange contracts, swaps and other instruments as defined by the standard. The Company has an organized and established process for determining and reviewing the fair value of financial instruments reported in the Company's financial statements. The fair value measurements are reviewed to ensure they are reasonable and in line with market experience in similar asset and liability classes.

Additionally, the Company may be required to record at fair value other assets on a nonrecurring basis, such as other real estate owned, other customer relationships, and other intangible assets. These nonrecurring fair value adjustments typically involve the application of lower-of-cost-or-fair-value accounting or write-downs of individual assets.

Disclosure of fair values is not required for certain items such as lease financing, obligations for pension and other postretirement benefits, premises and equipment, prepaid expenses, deposit liabilities with no defined or contractual maturity, and income tax assets and liabilities.

Reasonable comparisons of fair value information with that of other financial institutions cannot necessarily be made because the standard permits many alternative calculation techniques, and numerous assumptions have been used to estimate the Company's fair values.

**Valuation Techniques Used in the Fair Value Measurement of Assets and Liabilities Carried at Fair Value**

For the assets and liabilities measured at fair value on a recurring basis (categorized in the valuation hierarchy table below), the Company applies the following valuation techniques:

*Available-for-sale securities*

Available-for-sale debt securities are recorded at fair value on a recurring basis. Fair value measurement is based on quoted prices, including estimates by third-party pricing services, if available. If quoted prices are not available, fair values are measured using proprietary valuation models that utilize market observable parameters from active market makers and inter-dealer brokers whereby securities are valued based upon available market data for securities with similar characteristics. Management reviews the pricing information received from the Company's third-party pricing service to evaluate the inputs and valuation methodologies used to place securities into the appropriate level of the fair value hierarchy and transfers of securities within the fair value hierarchy are made if necessary. On a monthly basis, management reviews the pricing information received from the third-party pricing service which includes a comparison to non-binding third-party broker quotes, as well as a review of market-related conditions impacting the information provided by the third-party pricing service. Management also identifies investment securities which may have traded in illiquid or inactive markets by identifying instances of a significant decrease in the volume or frequency of trades, relative to historical levels, as well as instances of a significant widening of the bid-ask spread in the brokered markets. As of June 30, 2019 and December 31, 2018, management did not make adjustments to prices provided by the third-party pricing services as a result of illiquid or inactive markets. The Company's third-party pricing service has also established processes for the Company to submit inquiries regarding quoted prices. Periodically, the Company will challenge the quoted prices provided by the third-party pricing service. The Company's third-party pricing service will review the inputs to the evaluation in light of the new market data presented by the Company. The Company's third-party pricing service may then affirm the original quoted price or may update the evaluation on a going forward basis. The Company classifies all available-for-sale securities as Level 2.

*Derivatives*

Most of the Company's derivatives are traded in over-the-counter markets where quoted market prices are not readily available. For those derivatives, the Company measures fair value on a recurring basis using proprietary valuation models that primarily use market observable inputs, such as yield curves, and option volatilities. The fair value of derivatives includes values associated with counterparty credit risk and the Company's own credit standing. The Company classifies these derivatives, included in other assets and other liabilities, as Level 2.

Concurrent with the sale of the Visa Class B restricted shares, the Company entered into an agreement with the buyer that requires payment to the buyer in the event Visa reduces each member bank's Class B conversion rate to unrestricted Class A common shares. On July 5, 2018, Visa announced a decrease in conversion rate from 1.6483 to 1.6298 effective June 28, 2018. The Visa derivative of $1.2 million and $2.6 million was included in the unaudited interim consolidated balance sheets at June 30, 2019 and December 31, 2018, respectively, to provide for the fair value of this liability. The potential liability related to this funding swap agreement was determined based on management's estimate of the timing and the amount of Visa's litigation settlement and the resulting payments due to the counterparty under the terms of the contract. As such, the funding swap agreement is classified as Level 3 in the fair value hierarchy. The significant unobservable inputs used in the fair value measurement of the Company's funding swap agreement are the potential future changes in the conversion rate, expected term and growth rate of the market price of Visa Class A common shares. Material increases or (decreases) in any of those inputs may result in a significantly higher or (lower) fair value measurement.

**Assets and Liabilities Recorded at Fair Value on a Recurring Basis**

Assets and liabilities measured at fair value on a recurring basis as of June 30, 2019 and December 31, 2018 are summarized below:

| | Fair Value Measurements as of June 30, 2019 | | | |
|---|---|---|---|---|
| (dollars in thousands) | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total |
| **Assets** | | | | |
| U.S. Treasury securities | $ — | $ 29,556 | $ — | $ 29,556 |
| Government agency debt securities | — | 24,713 | — | 24,713 |
| Government-sponsored enterprises debt securities | — | 164,316 | — | 164,316 |
| Government agency mortgage-backed securities[1] | — | 362,221 | — | 362,221 |
| Government-sponsored enterprises mortgage-backed securities[1] | — | 151,683 | — | 151,683 |
| Collateralized mortgage obligations: | | | | |
| Government agency | — | 2,613,465 | — | 2,613,465 |
| Government-sponsored enterprises | — | 1,049,522 | — | 1,049,522 |
| **Total available-for-sale securities** | — | 4,395,476 | — | 4,395,476 |
| Other assets[2] | — | 60,282 | — | 60,282 |
| **Liabilities** | | | | |
| Other liabilities[3] | — | (778) | (1,179) | (1,957) |
| **Total** | $ — | $ 4,454,980 | $ (1,179) | $ 4,453,801 |

(1) Backed by residential real estate.
(2) Other assets include derivative assets.
(3) Other liabilities include derivative liabilities.

| (dollars in thousands) | Fair Value Measurements as of December 31, 2018<br>Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total |
|---|---|---|---|---|
| **Assets** | | | | |
| U.S. Treasury securities | $ — | $ 389,470 | $ — | $ 389,470 |
| Government-sponsored enterprises debt securities | — | 241,594 | — | 241,594 |
| Government agency mortgage-backed securities(1) | — | 411,536 | — | 411,536 |
| Government-sponsored enterprises mortgage-backed securities(1) | — | 150,847 | — | 150,847 |
| Collateralized mortgage obligations: | | | | |
| Government agency | — | 2,682,449 | — | 2,682,449 |
| Government-sponsored enterprises | — | 602,592 | — | 602,592 |
| Debt securities issued by states and political subdivisions | — | 19,854 | — | 19,854 |
| **Total available-for-sale securities** | — | 4,498,342 | — | 4,498,342 |
| Other assets(2) | — | 12,336 | — | 12,336 |
| **Liabilities** | | | | |
| Other liabilities(3) | — | (12,085) | (2,607) | (14,692) |
| **Total** | $ — | $ 4,498,593 | $ (2,607) | $ 4,495,986 |

(1) Backed by residential real estate.
(2) Other assets include derivative assets.
(3) Other liabilities include derivative liabilities.

**Changes in Fair Value Levels**

For the three and six months ended June 30, 2019, there were no transfers between fair value hierarchy levels.

The changes in Level 3 liabilities measured at fair value on a recurring basis for the three and six months ended June 30, 2019 and 2018 are summarized below.

| (dollars in thousands) | Visa Derivative<br>2019 | 2018 |
|---|---|---|
| **Three Months Ended June 30,** | | |
| Balance as of April 1, | **$ (1,839)** | $ (4,845) |
| Total net (losses) gains included in other noninterest income | **(247)** | 4 |
| Settlements | **907** | 727 |
| Balance as of June 30, | **$ (1,179)** | $ (4,114) |
| Total net (losses) gains included in net income attributable to the change in unrealized gains or losses related to liabilities still held as of June 30, | **$ (247)** | $ 4 |
| | | |
| **Six Months Ended June 30,** | | |
| Balance as of January 1, | **$ (2,607)** | $ (5,439) |
| Total net losses included in other noninterest income | **(242)** | (80) |
| Settlements | **1,670** | 1,405 |
| Balance as of June 30, | **$ (1,179)** | $ (4,114) |
| Total net losses included in net income attributable to the change in unrealized gains or losses related to liabilities still held as of June 30, | **$ (242)** | $ (80) |

**Assets and Liabilities Carried at Other Than Fair Value**

The following tables summarize for the periods indicated the estimated fair value of the Company’s financial instruments that are not required to be carried at fair value on a recurring basis, excluding leases and deposit liabilities with no defined or contractual maturity.

| (dollars in thousands) | June 30, 2019 Book Value | Fair Value Measurements: Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total |
|---|---|---|---|---|---|
| **Financial assets:** | | | | | |
| Cash and cash equivalents | **$ 683,515** | **$ 423,802** | **$ 259,713** | **$ —** | **$ 683,515** |
| Loans held for sale | **215** | **—** | **215** | **—** | **215** |
| Loans[1] | **13,099,239** | **—** | **—** | **13,197,876** | **13,197,876** |
| **Financial liabilities:** | | | | | |
| Time deposits[2] | **$ 3,070,078** | **$ —** | **$ 3,056,128** | **$ —** | **$ 3,056,128** |
| Short-term borrowings | **200,000** | **—** | **201,035** | **—** | **201,035** |
| Long-term borrowings[3] | **400,000** | **—** | **408,898** | **—** | **408,898** |

| (dollars in thousands) | December 31, 2018 Book Value | Fair Value Measurements: Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total |
|---|---|---|---|---|---|
| **Financial assets:** | | | | | |
| Cash and cash equivalents | $ 1,003,637 | $ 396,836 | $ 606,801 | $ — | $ 1,003,637 |
| Loans held for sale | 432 | — | 432 | — | 432 |
| Loans[1] | 12,928,422 | — | — | 12,664,170 | 12,664,170 |
| **Financial liabilities:** | | | | | |
| Time deposits[2] | $ 3,092,164 | $ — | $ 3,058,792 | $ — | $ 3,058,792 |
| Long-term borrowings[3] | 600,000 | — | 602,088 | — | 602,088 |

(1) Excludes financing leases of $165.4 million at June 30, 2019 and $147.8 million at December 31, 2018.
(2) Excludes deposit liabilities with no defined or contractual maturity of $13.7 billion and $14.1 billion as of June 30, 2019 and December 31, 2018, respectively.
(3) Excludes capital lease obligations of $28 thousand and $26 thousand at June 30, 2019 and December 31, 2018, respectively.

Unfunded loan and lease commitments and letters of credit are not included in the tables above. As of June 30, 2019 and December 31, 2018, the Company had $6.0 billion and $5.8 billion, respectively, of unfunded loan and lease commitments and letters of credit. A reasonable estimate of the fair value of these instruments is the carrying value of deferred fees plus the related reserve for unfunded commitments, which totaled $14.3 million and $14.2 million at June 30, 2019 and December 31, 2018, respectively. No active trading market exists for these instruments, and the estimated fair value does not include value associated with the borrower relationship. The Company does not estimate the fair values of certain unfunded loan and lease commitments that can be canceled by providing notice to the borrower. As Company-level data is incorporated into the fair value measurement, unfunded loan and lease commitments and letters of credit are classified as Level 3.

**Valuation Techniques Used in the Fair Value Measurement of Assets and Liabilities Carried at the Lower of Cost or Fair Value**

The Company applies the following valuation techniques to assets measured at the lower of cost or fair value:

*Mortgage servicing rights*

MSRs are carried at the lower of cost or fair value and are therefore subject to fair value measurements on a nonrecurring basis. The fair value of MSRs is determined using models which use significant unobservable inputs, such as estimates of prepayment rates, the resultant weighted average lives of the MSRs and the option-adjusted spread levels. Accordingly, the Company classifies MSRs as Level 3.

*Impaired loans*

A large portion of the Company's impaired loans are collateral dependent and are measured at fair value on a nonrecurring basis using collateral values as a practical expedient. The fair values of collateral for impaired loans are primarily based on real estate appraisal reports prepared by third-party appraisers less disposition costs, present value of the expected future cash flows or the loan's observable market price. Certain loans are measured based on the present value of expected future cash flows, discounted at the loan's effective rate, which is not a fair value measurement. The Company measures the impairment on certain loans and leases by performing a lower-of-cost-or-fair-value analysis. If impairment is determined by the value of the collateral or an observable market price, it is written down to fair value on a nonrecurring basis as Level 3.

*Other real estate owned*

The Company values these properties at fair value at the time the Company acquires them, which establishes their new cost basis. After acquisition, the Company carries such properties at the lower of cost or fair value less estimated selling costs on a nonrecurring basis. Fair value is measured on a nonrecurring basis using collateral values as a practical expedient. The fair values of collateral for other real estate owned are primarily based on real estate appraisal reports prepared by third-party appraisers less disposition costs, and are classified as Level 3.

**Assets and Liabilities Recorded at Fair Value on a Nonrecurring Basis**

The Company may be required to record certain assets at fair value on a nonrecurring basis in accordance with GAAP. These assets are subject to fair value adjustments that result from the application of lower of cost or fair value accounting or write-downs of individual assets to fair value.

The following table provides the level of valuation inputs used to determine each fair value adjustment and the fair value of the related individual assets or portfolio of assets with fair value adjustments on a nonrecurring basis as of June 30, 2019 and December 31, 2018:

| (dollars in thousands) | Level 1 | Level 2 | Level 3 |
|---|---|---|---|
| **June 30, 2019** | | | |
| Impaired loans | **$ —** | **$ —** | **$ 357** |
| **December 31, 2018** | | | |
| Impaired loans | $ — | $ — | $ 402 |

Total losses on impaired loans were $0.5 million for the six months ended June 30, 2018. No losses were recognized on impaired loans for the three and six months ended June 30, 2019 and for the three months ended June 30, 2018.

For Level 3 assets and liabilities measured at fair value on a recurring or nonrecurring basis as of June 30, 2019 and December 31, 2018, the significant unobservable inputs used in the fair value measurements were as follows:

| | Quantitative Information about Level 3 Fair Value Measurements at June 30, 2019 | | | |
|---|---|---|---|---|
| **(dollars in thousands)** | **Fair value** | **Valuation Technique** | **Significant Unobservable Input** | **Range (Weighted Average)** |
| **Impaired loans** | **$ 357** | **Appraisal Value** | **Appraisal Value** | **n/m(1)** |
| **Visa derivative** | **$ (1,179)** | **Discounted Cash Flow** | **Expected Conversion Rate** | **1.6298** |
| | | | **Expected Term** | **4 years** |
| | | | **Growth Rate** | **15%** |

| | Quantitative Information about Level 3 Fair Value Measurements at December 31, 2018 | | | |
|---|---|---|---|---|
| **(dollars in thousands)** | **Fair value** | **Valuation Technique** | **Unobservable Input** | **Range (Weighted Average)** |
| Impaired loans | $ 402 | Appraisal Value | Appraisal Value | n/m(1) |
| Visa derivative | $ (2,607) | Discounted Cash Flow | Expected Conversion Rate | 1.6298 |
| | | | Expected Term | 4 years |
| | | | Growth Rate | 15% |

(1) The fair value of these assets is determined based on appraised values of collateral or broker price opinions, the range of which is not meaningful to disclose.

## 19. Reportable Operating Segments

The Company's operations are organized into three business segments – Retail Banking, Commercial Banking, and Treasury and Other. These segments reflect how discrete financial information is currently evaluated by the chief operating decision maker and how performance is assessed and resources allocated. The Company's internal management process measures the performance of these business segments. This process, which is not necessarily comparable with similar information for any other financial institution, uses various techniques to assign balance sheet and income statement amounts to the business segments, including allocations of income, expense, the provision for loan and lease losses, and capital. This process is dynamic and requires certain allocations based on judgment and other subjective factors. Unlike financial accounting, there is no comprehensive authoritative guidance for management accounting that is equivalent to GAAP.

The net interest income of the business segments reflects the results of a funds transfer pricing process that matches assets and liabilities with similar interest rate sensitivity and maturity characteristics and reflects the allocation of net interest income related to the Company's overall asset and liability management activities on a proportionate basis. The basis for the allocation of net interest income is a function of the Company's assumptions that are subject to change based on changes in current interest rates and market conditions. Funds transfer pricing also serves to transfer interest rate risk to Treasury.

The Company allocates the provision for loan and lease losses to each segment based on management's estimate of the inherent loss content in each of the specific loan and lease portfolios.

Noninterest income and expense includes allocations from support units to the business segments. These allocations are based on actual usage where practicably calculated or by management's estimate of such usage. Income tax expense is allocated to each business segment based on the consolidated effective income tax rate for the period shown.

**Business Segments**

*Retail Banking*

Retail Banking offers a broad range of financial products and services to consumers and small businesses. Loan and lease products offered include residential and commercial mortgage loans, home equity lines of credit, automobile loans and leases, personal lines of credit, installment loans and small business loans and leases. Deposit products offered include checking, savings, and time deposit accounts. Retail Banking also offers wealth management services. Products and services from Retail Banking are delivered to customers through 59 banking locations throughout the State of Hawaii, Guam, and Saipan.

*Commercial Banking*

Commercial Banking offers products that include corporate banking, residential and commercial real estate loans, commercial lease financing, automobile loans and auto dealer financing, business deposit products and credit cards. Commercial lending and deposit products are offered primarily to middle-market and large companies locally, nationally, and internationally.

*Treasury and Other*

Treasury consists of corporate asset and liability management activities including interest rate risk management. The segment's assets and liabilities (and related interest income and expense) consist of interest-bearing deposits, investment securities, federal funds sold and purchased, government deposits, short- and long-term borrowings and bank-owned properties. The primary sources of noninterest income are from bank-owned life insurance, net gains from the sale of investment securities, foreign exchange income related to customer-driven currency requests from merchants and island visitors and management of bank-owned properties. The net residual effect of the transfer pricing of assets and liabilities is included in Treasury, along with the elimination of intercompany transactions.

Other organizational units (Technology, Operations, Credit and Risk Management, Human Resources, Finance, Administration, Marketing, and Corporate and Regulatory Administration) provide a wide-range of support to the Company's other income earning segments. Expenses incurred by these support units are charged to the business segments through an internal cost allocation process.

The following tables present selected business segment financial information for the periods indicated.

| (dollars in thousands) | Retail Banking | Commercial Banking | Treasury and Other | Total |
|---|---|---|---|---|
| **Three Months Ended June 30, 2019** | | | | |
| Net interest income | **$ 114,127** | **$ 28,581** | **$ 2,905** | **$ 145,613** |
| Provision for loan and lease losses | **(1,752)** | **(2,118)** | **—** | **(3,870)** |
| Net interest income after provision for loan and lease losses | **112,375** | **26,463** | **2,905** | **141,743** |
| | | | | |
| Noninterest income | **23,682** | **18,418** | **6,673** | **48,773** |
| Noninterest expense | **(59,492)** | **(19,741)** | **(14,057)** | **(93,290)** |
| Income (loss) before (provision) benefit for income taxes | **76,565** | **25,140** | **(4,479)** | **97,226** |
| | | | | |
| (Provision) benefit for income taxes | **(19,470)** | **(6,456)** | **1,133** | **(24,793)** |
| **Net income (loss)** | **$ 57,095** | **$ 18,684** | **$ (3,346)** | **$ 72,433** |

| (dollars in thousands) | Retail Banking | Commercial Banking | Treasury and Other | Total |
|---|---|---|---|---|
| **Six Months Ended June 30, 2019** | | | | |
| Net interest income | **$ 228,030** | **$ 56,561** | **$ 6,111** | **$ 290,702** |
| Provision for loan and lease losses | **(4,324)** | **(5,226)** | **—** | **(9,550)** |
| Net interest income after provision for loan and lease losses | **223,706** | **51,335** | **6,111** | **281,152** |
| | | | | |
| Noninterest income | **47,858** | **36,499** | **11,488** | **95,845** |
| Noninterest expense | **(116,658)** | **(39,226)** | **(30,029)** | **(185,913)** |
| Income (loss) before (provision) benefit for income taxes | **154,906** | **48,608** | **(12,430)** | **191,084** |
| | | | | |
| (Provision) benefit for income taxes | **(39,397)** | **(12,497)** | **3,167** | **(48,727)** |
| **Net income (loss)** | **$ 115,509** | **$ 36,111** | **$ (9,263)** | **$ 142,357** |

| (dollars in thousands) | Retail Banking | Commercial Banking | Treasury and Other | Total |
|---|---|---|---|---|
| **Three Months Ended June 30, 2018** | | | | |
| Net interest income | $ 111,273 | $ 28,802 | $ 1,328 | $ 141,403 |
| Provision for loan and lease losses | (2,376) | (3,644) | — | (6,020) |
| Net interest income after provision for loan and lease losses | 108,897 | 25,158 | 1,328 | 135,383 |
| | | | | |
| Noninterest income | 22,158 | 21,463 | 6,176 | 49,797 |
| Noninterest expense | (55,584) | (21,196) | (15,085) | (91,865) |
| Income (loss) before (provision) benefit for income taxes | 75,471 | 25,425 | (7,581) | 93,315 |
| | | | | |
| (Provision) benefit for income taxes | (19,634) | (6,566) | 1,938 | (24,262) |
| **Net income (loss)** | $ 55,837 | $ 18,859 | $ (5,643) | $ 69,053 |

| (dollars in thousands) | Retail Banking | Commercial Banking | Treasury and Other | Total |
|---|---|---|---|---|
| **Six Months Ended June 30, 2018** | | | | |
| Net interest income | $ 220,927 | $ 56,681 | $ 3,467 | $ 281,075 |
| Provision for loan and lease losses | (4,724) | (7,246) | — | (11,970) |
| Net interest income after provision for loan and lease losses | 216,203 | 49,435 | 3,467 | 269,105 |
| | | | | |
| Noninterest income | 44,890 | 41,463 | 12,144 | 98,497 |
| Noninterest expense | (112,045) | (40,844) | (29,563) | (182,452) |
| Income (loss) before (provision) benefit for income taxes | 149,048 | 50,054 | (13,952) | 185,150 |
| | | | | |
| (Provision) benefit for income taxes | (38,841) | (12,894) | 3,596 | (48,139) |
| **Net income (loss)** | $ 110,207 | $ 37,160 | $ (10,356) | $ 137,011 |

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

**Cautionary Note Regarding Forward-Looking Statements**

This Quarterly Report on Form 10-Q, including the documents incorporated by reference herein, contains, and from time to time our management may make, forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements reflect our current views with respect to, among other things, future events and our financial performance. These statements are often, but not always, made through the use of words or phrases such as "may," "might," "should," "could," "predict," "potential," "believe," "expect," "continue," "will," "anticipate," "seek," "estimate," "intend," "plan," "projection," "would," "annualized" and "outlook," or the negative version of those words or other comparable words or phrases of a future or forward-looking nature. These forward-looking statements are not historical facts, and are based on current expectations, estimates and projections about our industry, management's beliefs and certain assumptions made by management, many of which, by their nature, are inherently uncertain and beyond our control. Accordingly, we caution you that any such forward-looking statements are not guarantees of future performance and are subject to risks, assumptions, estimates and uncertainties that are difficult to predict. Although we believe that the expectations reflected in these forward-looking statements are reasonable as of the date made, actual results may prove to be materially different from the results expressed or implied by the forward-looking statements.

A number of important factors could cause our actual results to differ materially from those indicated in these forward-looking statements, including the following: the geographic concentration of our business; current and future economic and market conditions in the United States generally or in Hawaii, Guam and Saipan in particular; concentrated exposures to certain asset classes and individual obligors; the effect of the current low interest rate environment or changes in interest rates on our business including our net interest income, net interest margin, the fair value of our investment securities, and our mortgage loan originations, mortgage servicing rights and mortgage loans held for sale; changes in the method pursuant to which LIBOR and other benchmark rates are determined or relating to the discontinuance of such rates; the possibility we might underestimate the credit losses inherent in our loan and lease portfolio; our inability to receive dividends from the Bank, pay dividends to our common stockholders and satisfy obligations as they become due; the effects of geopolitical instability, including war, terrorist attacks, pandemics and man-made and natural disasters; our ability to maintain the Bank's reputation; our ability to attract and retain skilled employees or changes in our management personnel; our ability to effectively compete with other financial services companies and the effects of competition in the financial services industry on our business; our ability to successfully develop and commercialize new or enhanced products and services; changes in the demand for our products and services; the effectiveness of our risk management and internal disclosure controls and procedures; any failure or interruption of our information and communications systems; our ability to identify and address cybersecurity risks; the effect of a material breach of, or disruption to, the security of any of our or our vendors' systems; the failure to properly use and protect our customer and employee information and data; our ability to keep pace with technological changes; our ability to attract and retain customer deposits; the effects of problems encountered by other financial institutions; our access to sources of liquidity and capital to address our liquidity needs; our use of the secondary mortgage market as a source of liquidity; risks associated with the sale of loans and with our use of appraisals in valuing and monitoring loans; the possibility that actual results may differ from estimates and forecasts; the potential for environmental liability; fluctuations in the fair value of our assets and liabilities and off-balance sheet exposures; the effects of the failure of any component of our business infrastructure provided by a third-party; the impact of, and changes in, applicable laws, regulations and accounting standards and policies; possible changes in trade, monetary and fiscal policies of, and other activities undertaken by, governments, agencies, central banks and similar organizations; our likelihood of success in, and the impact of, litigation or regulatory actions; our ability to continue to pay dividends on our common stock; contingent liabilities and unexpected tax liabilities that may be applicable to us as a result of the reorganization transactions effected by BNPP; the incremental costs of operating as a stand-alone public company; our ability to meet our obligations as a public company, including our obligations under Section 404 of the Sarbanes-Oxley Act of 2002; and damage to our reputation from any of the factors described above.

The foregoing factors should not be considered an exhaustive list and should be read together with the other cautionary statements included in our Annual Report on Form 10-K for the year ended December 31, 2018. If one or more events related to these or other risks or uncertainties materialize, or if our underlying assumptions prove to be incorrect, actual results may differ materially from what we anticipate. Accordingly, you should not place undue reliance on any such forward-looking statements. Any forward-looking statement speaks only as of the date on which it is made, and we do not undertake any obligation to update or review any forward-looking statement, whether as a result of new information, future developments or otherwise, except as required by applicable law.

**Company Overview**

FHI is a bank holding company, which owns 100% of the outstanding common stock of FHB, its only direct, wholly owned subsidiary. FHB was founded in 1858 under the name Bishop & Company and was the first successful banking partnership in the Kingdom of Hawaii and the second oldest bank formed west of the Mississippi River. The Bank operates its business through three operating segments: Retail Banking, Commercial Banking and Treasury and Other.

References to “we,” “our,” “us,” or the “Company” refer to the Parent and its subsidiary that are consolidated for financial reporting purposes.

**Transition to an Independent Public Company**

On July 1, 2016, FHI became a direct wholly owned subsidiary of BWC, a Delaware corporation and an indirect wholly owned subsidiary of BNPP. In connection with FHI’s initial public offering in August 2016, BNPP announced its intent to sell its interest in FHI, including FHI’s wholly owned subsidiary FHB, over time, subject to market conditions and other considerations.

Following a series of secondary offerings completed in 2017 and 2018, on February 1, 2019, BWC completed the sale of its remaining 24,859,750 shares of FHI common stock in a public offering. FHI did not receive any of the proceeds from the sales of shares of FHI common stock in that offering, any of the secondary offerings described above or the IPO. As a result of the completion of the February 1, 2019 public offering, BNPP (through BWC, the selling stockholder) fully exited its ownership interest in FHI common stock.

Following the completion of the February 2019 offering, each of the remaining BNPP designees to the FHI board of directors, resigned from the board of directors. As a result, all directors designated by BNPP have resigned from the FHI board of directors.

**Basis of Presentation**

The accompanying unaudited interim consolidated financial statements of the Company reflect the results of operations, financial position and cash flows of FHI and its wholly owned subsidiary, FHB. All significant intercompany accounts and transactions have been eliminated in consolidation.

The accompanying unaudited interim consolidated financial statements of the Company have been prepared in accordance with GAAP for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and accompanying notes required by GAAP for complete financial statements. In the opinion of management, the accompanying unaudited interim consolidated financial statements reflect normal recurring adjustments necessary for a fair presentation of the results for the interim periods.

The accompanying unaudited interim consolidated financial statements of the Company should be read in conjunction with the audited consolidated financial statements and related notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2018 and filed with the U.S. Securities and Exchange Commission (the “SEC”).

**Hawaii Economy**

Hawaii’s economy continued to reflect growth during the three and six months ended June 30, 2019, led in large part by a steady tourism industry, real estate market, and growth in tax revenues. Visitor arrivals for the first five months in 2019 increased by 3.8% compared to the same period in 2018, while total visitor spending for the first five months in 2019 decreased by 3.1% compared to the same period in 2018, according to the Hawaii Tourism Authority. The statewide seasonally-adjusted unemployment rate was 2.8% in June 2019 compared to 2.4% in June 2018, according to the Hawaii State Department of Labor & Industrial Relations. The national seasonally-adjusted unemployment rate was 3.7% in June 2019 compared to 4.0% in June 2018. With regards to housing, the volume of single-family home sales and condominium sales on Oahu decreased by 3.7% and 8.8%, respectively, for the six months ended June 30, 2019 compared to the same period in 2018 according to the Honolulu Board of Realtors. The median price of single-family home sales and condominium sales on Oahu was $775,000 and $419,000, respectively, or a decrease of 0.5% and 1.4%, respectively, for the six months ended June 30, 2019 as compared to the same period in 2018. As of June 30, 2019, months of inventory of single family homes and condominiums on Oahu remained low at approximately 3.6 and 3.9 months, respectively. Lastly, state general excise and use tax revenues increased by 8.3% for the first five months of 2019 as compared to the same period in 2018, according to the Hawaii Department of Taxation.

Although Hawaii's economy continued to reflect growth during the three and six months ended June 30, 2019, we are significantly dependent on U.S. mainland economic conditions as well as key international economies, and in particular, Japan. In addition, we continue to monitor tourism and construction activity in Hawaii and the local economy's ability to absorb further planned expansion, given deteriorating home affordability. Nationally and globally, we are monitoring the potential for a lower federal funds rate in the U.S., the uncertainties related to trade tensions and the strength of the global economy as well as the agenda of the U.S. administration and its impact on existing banking regulations. These factors could impact our profitability in future reporting periods.

## Selected Financial Data

Our financial highlights for the periods indicated are presented in Table 1:

**Financial Highlights** **Table 1**

| (dollars in thousands, except per share data) | For the Three Months Ended June 30, 2019 | 2018 | For the Six Months Ended June 30, 2019 | 2018 |
|---|---|---|---|---|
| **Income Statement Data:** | | | | |
| Interest income | **$ 173,818** | $ 159,019 | **$ 346,379** | $ 313,955 |
| Interest expense | **28,205** | 17,616 | **55,677** | 32,880 |
| Net interest income | **145,613** | 141,403 | **290,702** | 281,075 |
| Provision for loan and lease losses | **3,870** | 6,020 | **9,550** | 11,970 |
| Net interest income after provision for loan and lease losses | **141,743** | 135,383 | **281,152** | 269,105 |
| Noninterest income | **48,773** | 49,797 | **95,845** | 98,497 |
| Noninterest expense | **93,290** | 91,865 | **185,913** | 182,452 |
| Income before provision for income taxes | **97,226** | 93,315 | **191,084** | 185,150 |
| Provision for income taxes | **24,793** | 24,262 | **48,727** | 48,139 |
| Net income | **$ 72,433** | $ 69,053 | **$ 142,357** | $ 137,011 |
| Basic earnings per share | **$ 0.54** | $ 0.50 | **$ 1.06** | $ 0.99 |
| Diluted earnings per share | **$ 0.54** | $ 0.50 | **$ 1.06** | $ 0.99 |
| Basic weighted-average outstanding shares | **134,420,380** | 137,907,063 | **134,655,217** | 138,749,209 |
| Diluted weighted-average outstanding shares | **134,652,008** | 138,065,879 | **134,924,331** | 138,891,955 |
| Dividends declared per share | **$ 0.26** | $ 0.24 | **$ 0.52** | $ 0.48 |
| Dividend payout ratio | **48.15 %** | 48.00 % | **49.06 %** | 48.48 % |
| **Supplemental Income Statement Data (non-GAAP)(1):** | | | | |
| Core net interest income | **$ 145,613** | $ 141,403 | **$ 290,702** | $ 281,075 |
| Core noninterest income | **48,752** | 49,797 | **98,437** | 98,497 |
| Core noninterest expense | **93,029** | 90,951 | **185,391** | 181,131 |
| Core net income | **72,612** | 69,720 | **144,664** | 137,979 |
| Core basic earnings per share | **0.54** | 0.51 | **1.07** | 0.99 |
| Core diluted earnings per share | **0.54** | 0.50 | **1.07** | 0.99 |
| **Other Financial Information / Performance Ratios(2):** | | | | |
| Net interest margin | **3.25 %** | 3.18 % | **3.24 %** | 3.16 % |
| Core net interest margin (non-GAAP)(1),(3) | **3.25 %** | 3.18 % | **3.24 %** | 3.16 % |
| Efficiency ratio | **47.99 %** | 48.04 % | **48.09 %** | 48.06 % |
| Core efficiency ratio (non-GAAP)(1),(4) | **47.86 %** | 47.56 % | **47.64 %** | 47.71 % |
| Return on average total assets | **1.42 %** | 1.38 % | **1.40 %** | 1.36 % |
| Core return on average total assets (non-GAAP)(1),(5) | **1.43 %** | 1.39 % | **1.43 %** | 1.37 % |
| Return on average tangible assets (non-GAAP)(11) | **1.50 %** | 1.45 % | **1.48 %** | 1.43 % |
| Core return on average tangible assets (non-GAAP)(1),(6) | **1.50 %** | 1.46 % | **1.50 %** | 1.44 % |
| Return on average total stockholders' equity | **11.13 %** | 11.23 % | **11.15 %** | 11.13 % |
| Core return on average total stockholders' equity (non-GAAP)(1),(7) | **11.16 %** | 11.34 % | **11.33 %** | 11.20 % |
| Return on average tangible stockholders' equity (non-GAAP)(11) | **17.99 %** | 18.83 % | **18.17 %** | 18.57 % |
| Core return on average tangible stockholders' equity (non-GAAP)(1),(8) | **18.03 %** | 19.01 % | **18.46 %** | 18.70 % |
| Noninterest expense to average assets | **1.84 %** | 1.83 % | **1.83 %** | 1.82 % |
| Core noninterest expense to average assets (non-GAAP)(1),(9) | **1.83 %** | 1.81 % | **1.83 %** | 1.80 % |

| | June 30, 2019 | December 31, 2018 |
|---|---|---|
| **Balance Sheet Data:** | | |
| Cash and cash equivalents | **$ 683,515** | $ 1,003,637 |
| Investment securities | **4,395,476** | 4,498,342 |
| Loans and leases | **13,264,609** | 13,076,191 |
| Allowance for loan and lease losses | **138,535** | 141,718 |
| Goodwill | **995,492** | 995,492 |
| Total assets | **20,526,367** | 20,695,678 |
| Total deposits | **16,792,078** | 17,150,068 |
| Short-term borrowings | **200,000** | — |
| Long-term borrowings | **400,028** | 600,026 |
| Total liabilities | **17,866,926** | 18,170,839 |
| Total stockholders' equity | **2,659,441** | 2,524,839 |
| Book value per share | **$ 19.92** | $ 18.72 |
| Tangible book value per share (non-GAAP)(11) | **$ 12.46** | $ 11.34 |
| | | |
| **Asset Quality Ratios:** | | |
| Non-accrual loans and leases / total loans and leases | **0.03 %** | 0.05 % |
| Allowance for loan and lease losses / total loans and leases | **1.04 %** | 1.08 % |
| Net charge-offs / average total loans and leases(10) | **0.20 %** | 0.14 % |

| **Capital Ratios:** | June 30, 2019 | December 31, 2018 |
|---|---|---|
| Common Equity Tier 1 Capital Ratio | **11.84 %** | 11.97 % |
| Tier 1 Capital Ratio | **11.84 %** | 11.97 % |
| Total Capital Ratio | **12.81 %** | 12.99 % |
| Tier 1 Leverage Ratio | **8.75 %** | 8.72 % |
| Total stockholders' equity to total assets | **12.96 %** | 12.20 % |
| Tangible stockholders' equity to tangible assets (non-GAAP)(11) | **8.52 %** | 7.76 % |

(1) We present net interest income, noninterest income, noninterest expense, net income, basic earnings per share, diluted earnings per share and the related ratios described below, on an adjusted, or "core," basis, each a non-GAAP financial measure. These core measures exclude from the corresponding GAAP measure the impact of certain items that we do not believe are representative of our financial results. We believe that the presentation of these non-GAAP measures helps identify underlying trends in our business from period to period that could otherwise be distorted by the effect of certain expenses, gains and other items included in our operating results. We believe that these core measures provide useful information about our operating results and enhance the overall understanding of our past performance and future performance. Investors should consider our performance and financial condition as reported under GAAP and all other relevant information when assessing our performance or financial condition. Non-GAAP measures have limitations as analytical tools and investors should not consider them in isolation or as a substitute for analysis of our financial results or financial condition as reported under GAAP.

The following table provides a reconciliation of net interest income, noninterest income, noninterest expense and net income to their "core" non-GAAP financial measures:

**GAAP to Non-GAAP Reconciliation** **Table 2**

| (dollars in thousands, except per share data) | For the Three Months Ended June 30, 2019 | For the Three Months Ended June 30, 2018 | For the Six Months Ended June 30, 2019 | For the Six Months Ended June 30, 2018 |
|---|---|---|---|---|
| Net interest income | **$ 145,613** | $ 141,403 | **$ 290,702** | $ 281,075 |
| Core net interest income (non-GAAP) | **$ 145,613** | $ 141,403 | **$ 290,702** | $ 281,075 |
| | | | | |
| Noninterest income | **$ 48,773** | $ 49,797 | **$ 95,845** | $ 98,497 |
| (Gain) loss on sale of securities | **(21)** | — | **2,592** | — |
| Core noninterest income (non-GAAP) | **$ 48,752** | $ 49,797 | **$ 98,437** | $ 98,497 |
| | | | | |
| Noninterest expense | **$ 93,290** | $ 91,865 | **$ 185,913** | $ 182,452 |
| One-time items[(a)] | **(261)** | (914) | **(522)** | (1,321) |
| Core noninterest expense (non-GAAP) | **$ 93,029** | $ 90,951 | **$ 185,391** | $ 181,131 |
| | | | | |
| Net income | **$ 72,433** | $ 69,053 | **$ 142,357** | $ 137,011 |
| (Gain) loss on sale of securities | **(21)** | — | **2,592** | — |
| One-time noninterest expense items[(a)] | **261** | 914 | **522** | 1,321 |
| Tax adjustments[(b)] | **(61)** | (247) | **(807)** | (353) |
| Total core adjustments | **179** | 667 | **2,307** | 968 |
| Core net income (non-GAAP) | **$ 72,612** | $ 69,720 | **$ 144,664** | $ 137,979 |
| | | | | |
| Basic earnings per share | **$ 0.54** | $ 0.50 | **$ 1.06** | $ 0.99 |
| Diluted earnings per share | **$ 0.54** | $ 0.50 | **$ 1.06** | $ 0.99 |
| Efficiency ratio | **47.99 %** | 48.04 % | **48.09 %** | 48.06 % |
| | | | | |
| Core basic earnings per share (non-GAAP) | **$ 0.54** | $ 0.51 | **$ 1.07** | $ 0.99 |
| Core diluted earnings per share (non-GAAP) | **$ 0.54** | $ 0.50 | **$ 1.07** | $ 0.99 |
| Core efficiency ratio (non-GAAP) | **47.86 %** | 47.56 % | **47.64 %** | 47.71 % |

(a) One-time items include nonrecurring offering costs, public company transition related costs and the loss on our funding swap as a result of a decrease in the conversion rate of our Visa Class B restricted shares sold in 2016.

(b) Represents the adjustments to net income, tax effected at the Company's effective tax rate for the respective period.

(2) Except for the efficiency ratio and the core efficiency ratio, amounts are annualized for the three and six months ended June 30, 2019 and 2018.

(3) Core net interest margin is a non-GAAP financial measure. We compute our core net interest margin as the ratio of core net interest income to average earning assets. For a reconciliation to the most directly comparable GAAP financial measure for core net interest income, see Table 2, GAAP to Non-GAAP Reconciliation.

(4) Core efficiency ratio is a non-GAAP financial measure. We compute our core efficiency ratio as the ratio of core noninterest expense to the sum of core net interest income and core noninterest income. For a reconciliation to the most directly comparable GAAP financial measure for core noninterest expense, core net interest income and core noninterest income, see Table 2, GAAP to Non-GAAP Reconciliation.

(5) Core return on average total assets is a non-GAAP financial measure. We compute our core return on average total assets as the ratio of core net income to average total assets. For a reconciliation to the most directly comparable GAAP financial measure for core net income, see Table 2, GAAP to Non-GAAP Reconciliation.

(6) Core return on average tangible assets is a non-GAAP financial measure. We compute our core return on average tangible assets as the ratio of core net income to average tangible assets, which is calculated by subtracting (and thereby effectively excluding) amounts related to the effect of goodwill from our average total assets. For a reconciliation to the most directly comparable GAAP financial measure for core net income, see Table 2, GAAP to Non-GAAP Reconciliation.

(7) Core return on average total stockholders' equity is a non-GAAP financial measure. We compute our core return on average total stockholders' equity as the ratio of core net income to average total stockholders' equity. For a reconciliation to the most directly comparable GAAP financial measure for core net income, see Table 2, GAAP to Non-GAAP Reconciliation.

(8) Core return on average tangible stockholders' equity is a non-GAAP financial measure. We compute our core return on average tangible stockholders' equity as the ratio of core net income to average tangible stockholders' equity, which is calculated by subtracting (and thereby effectively excluding) amounts related to the effect of goodwill from our average total stockholders' equity. For a reconciliation to the most directly comparable GAAP financial measure for core net income, see Table 2, GAAP to Non-GAAP Reconciliation.

(9) Core noninterest expense to average assets is a non-GAAP financial measure. We compute our core noninterest expense to average assets as the ratio of core noninterest expense to average total assets. For a reconciliation to the most directly comparable GAAP financial measure for core noninterest expense, see Table 2, GAAP to Non-GAAP Reconciliation.

(10) Net charge-offs / average total loans and leases are annualized for the six months ended June 30, 2019.

(11) Return on average tangible assets, return on average tangible stockholders' equity, tangible book value per share and tangible stockholders' equity to tangible assets are non-GAAP financial measures. We compute our return on average tangible assets as the ratio of net income to average tangible assets. We compute our return on average tangible stockholders' equity as the ratio of net income to average tangible stockholders' equity. We compute our tangible book value per share as the ratio of tangible stockholders' equity to outstanding shares. We compute our tangible stockholders' equity to tangible assets as the ratio of tangible stockholders' equity to tangible assets. We believe that these financial measures are useful for investors, regulators, management and others to evaluate financial performance and capital adequacy relative to other financial institutions. Although these non-GAAP financial measures are frequently used by shareholders in the evaluation of a company, they have limitations as analytical tools and should not be considered in isolation or as a substitute for analyses of results as reported under GAAP.

The following table provides a reconciliation of these non-GAAP financial measures with their most closely related GAAP measures for the periods indicated:

**GAAP to Non-GAAP Reconciliation** **Table 3**

| | For the three months ended June 30, | | For the six months ended June 30, | |
|---|---|---|---|---|
| (dollars in thousands, except per share data) | **2019** | **2018** | **2019** | **2018** |
| **Income Statement Data:** | | | | |
| Net income | **$ 72,433** | $ 69,053 | **$ 142,357** | $ 137,011 |
| | | | | |
| Average total stockholders' equity | **$ 2,610,565** | $ 2,466,392 | **$ 2,575,775** | $ 2,483,252 |
| Less: average goodwill | **995,492** | 995,492 | **995,492** | 995,492 |
| Average tangible stockholders' equity | **$ 1,615,073** | $ 1,470,900 | **$ 1,580,283** | $ 1,487,760 |
| | | | | |
| Average total assets | **$ 20,390,273** | $ 20,121,504 | **$ 20,442,266** | $ 20,263,820 |
| Less: average goodwill | **995,492** | 995,492 | **995,492** | 995,492 |
| Average tangible assets | **$ 19,394,781** | $ 19,126,012 | **$ 19,446,774** | $ 19,268,328 |
| | | | | |
| Return on average total stockholders' equity[(a)] | **11.13 %** | 11.23 % | **11.15 %** | 11.13 % |
| Return on average tangible stockholders' equity (non-GAAP)[(a)] | **17.99 %** | 18.83 % | **18.17 %** | 18.57 % |
| | | | | |
| Return on average total assets[(a)] | **1.42 %** | 1.38 % | **1.40 %** | 1.36 % |
| Return on average tangible assets (non-GAAP)[(a)] | **1.50 %** | 1.45 % | **1.48 %** | 1.43 % |

| | As of June 30, 2019 | As of December 31, 2018 |
|---|---|---|
| **Balance Sheet Data:** | | |
| Total stockholders' equity | **$ 2,659,441** | $ 2,524,839 |
| Less: goodwill | **995,492** | 995,492 |
| Tangible stockholders' equity | **$ 1,663,949** | $ 1,529,347 |
| | | |
| Total assets | **$ 20,526,367** | $ 20,695,678 |
| Less: goodwill | **995,492** | 995,492 |
| Tangible assets | **$ 19,530,875** | $ 19,700,186 |
| | | |
| Shares outstanding | **133,508,212** | 134,874,302 |
| | | |
| Total stockholders' equity to total assets | **12.96 %** | 12.20 % |
| Tangible stockholders' equity to tangible assets (non-GAAP) | **8.52 %** | 7.76 % |
| | | |
| Book value per share | **$ 19.92** | $ 18.72 |
| Tangible book value per share (non-GAAP) | **$ 12.46** | $ 11.34 |

(a) Annualized for the three and six months ended June 30, 2019 and 2018.

## Financial Highlights

Net income was $72.4 million for the three months ended June 30, 2019, an increase of $3.4 million or 5% as compared to the same period in 2018. Basic and diluted earnings per share were $0.54 per share for the three months ended June 30, 2019, an increase of $0.04 per share or 8% as compared to the same period in 2018. The increase in net income was primarily due to a $4.2 million increase in net interest income and a $2.2 million decrease in the provision for loan and lease losses (the “Provision”), partially offset by a $1.4 million increase in noninterest expense and a $1.0 million decrease in noninterest income for the three months ended June 30, 2019.

Our return on average total assets was 1.42% for the three months ended June 30, 2019 and our return on average total stockholders’ equity was 11.13% for the three months ended June 30, 2019. Our return on average tangible assets was 1.50% for the three months ended June 30, 2019, an increase of five basis points from the same period in 2018, and our return on average tangible stockholders’ equity was 17.99% for the three months ended June 30, 2019, a decrease of 84 basis points from the same period in 2018. We continued to prudently manage our expenses, as our efficiency ratio was 47.99% for the three months ended June 30, 2019, a decrease compared to 48.04% for the same period in 2018.

Our results for the three months ended June 30, 2019 were highlighted by the following:

- Net interest income was $145.6 million for the three months ended June 30, 2019, an increase of $4.2 million or 3% as compared to the same period in 2018. Our net interest margin was 3.25% for the three months ended June 30, 2019, an increase of seven basis points as compared to the same period in 2018. The increase in net interest income, on a fully taxable-equivalent basis, was primarily due to higher average balances and yields in our loan categories, partially offset by higher deposit funding costs, higher average balances in long-term borrowings and lower average balances in our investment securities portfolio during the three months ended June 30, 2019.

- The Provision was $3.9 million for the three months ended June 30, 2019, a decrease of $2.2 million or 36%, as compared to the same period in 2018. The Provision is recorded to maintain the Allowance at levels deemed adequate to absorb probable credit losses that have been incurred in our loan and lease portfolio as of the balance sheet date.

- Noninterest income was $48.8 million for the three months ended June 30, 2019, a decrease of $1.0 million or 2% as compared to the same period in 2018. The decrease was primarily due to a $3.1 million decrease in other noninterest income, partially offset by a $1.2 million increase in trust and investment services income and a $1.0 million increase in bank-owned life insurance (“BOLI”) income.

- Noninterest expense was $93.3 million for the three months ended June 30, 2019, an increase of $1.4 million or 2% as compared to the same period in 2018. The increase in noninterest expense was primarily due to a $1.3 million increase in card rewards program expense, a $1.3 million increase in contracted services and professional fees, a $0.9 million increase in advertising and marketing expenses and a $0.5 million increase in salaries and employee benefits expense. This was partially offset by a $2.1 million decrease in regulatory assessment and fees and a $1.1 million decrease in other noninterest expense.

Net income was $142.4 million for the six months ended June 30, 2019, an increase of $5.3 million or 4% as compared to the same period in 2018. Basic and diluted earnings per share were $1.06 per share for the six months ended June 30, 2019, an increase of $0.07 per share or 7% as compared to the same period in 2018. The increase in net income was primarily due to a $9.6 million increase in net interest income and a $2.4 million decrease in the Provision, partially offset by a $3.5 million increase in noninterest expense and a $2.7 million decrease in noninterest income for the six months ended June 30, 2019.

Our return on average total assets was 1.40% for the six months ended June 30, 2019 and our return on average total stockholders' equity was 11.15% for the six months ended June 30, 2019. Our return on average tangible assets was 1.48% for the six months ended June 30, 2019, an increase of five basis points from the same period in 2018, and our return on average tangible stockholders' equity was 18.17% for the six months ended June 30, 2019, a decrease of 40 basis points from the same period in 2018. We continued to prudently manage our expenses as our efficiency ratio was 48.09% for the six months ended June 30, 2019 compared to 48.06% for the same period in 2018. The efficiency ratio during the six months ended June 30, 2019 included a nonrecurring net loss on available-for-sale debt securities of $2.6 million.

Our results for the six months ended June 30, 2019 were highlighted by the following:

- Net interest income was $290.7 million for the six months ended June 30, 2019, an increase of $9.6 million or 3% as compared to the same period in 2018. Our net interest margin was 3.24% for the six months ended June 30, 2019, an increase of eight basis points as compared to the same period in 2018. The increase in net interest income was primarily due to higher average balances and yields in most loan categories. This was partially offset by lower average balances in our investment securities portfolio, higher average balances in long-term borrowings and higher deposit funding costs.

- The Provision was $9.6 million for the six months ended June 30, 2019, a decrease of $2.4 million or 20% as compared to the same period in 2018. The Provision is recorded to maintain the Allowance at levels deemed adequate to absorb probable credit losses that have been incurred in our loan and lease portfolio as of the balance sheet date.

- Noninterest income was $95.8 million for the six months ended June 30, 2019, a decrease of $2.7 million or 3% as compared to the same period in 2018. The decrease was primarily due to a $5.4 million decrease in other noninterest income and a $2.6 million net loss on available-for-sale debt securities, partially offset by a $2.8 million gain in BOLI income, a $1.6 million increase in trust and investment services income and a $0.9 million increase in credit and debit card fees.

- Noninterest expense was $185.9 million for the six months ended June 30, 2019, an increase of $3.5 million or 2% as compared to the same period in 2018. The increase in noninterest expense was primarily due to a $3.2 million increase in salaries and employee benefits expense, a $2.7 million increase in contracted services and professional fees, a $2.3 million increase in card rewards program expense, a $1.9 million increase in advertising and marketing expenses and a $0.9 million increase in occupancy expense, partially offset by a $4.6 million decrease in regulatory assessment and fees and a $2.8 million decrease in other noninterest expense.

During the six months ended June 30, 2019, we continued to benefit from a steady Hawaii economy as reflected in the continued growth of our loan portfolio. Our investment securities portfolio remained strong as we continued to invest in high-grade investment securities. We also continued to maintain adequate reserves for loan and lease losses and high levels of capital.

- Total loans and leases were $13.3 billion as of June 30, 2019, an increase of $188.4 million or 1% from December 31, 2018. We continued to experience strong growth in our commercial real estate and residential real estate portfolios. This was a reflection of a strong real estate market in Hawaii and the demand by both investors and owner occupants to acquire new real estate assets in a low interest rate environment.

- The Allowance was $138.5 million as of June 30, 2019, a decrease of $3.2 million from December 31, 2018. The ratio of our Allowance to total loans and leases outstanding was 1.04% as of June 30, 2019, a decrease of four basis points compared to December 31, 2018. The overall level of the Allowance was commensurate with our stable credit risk profile and a steady Hawaii economy.

- We continued to invest in high-grade investment securities, primarily collateralized mortgage obligations issued by the Government National Mortgage Association ("Ginnie Mae"), Fannie Mae and Freddie Mac. The total fair value of our investment securities portfolio was $4.4 billion as of June 30, 2019, a decrease of $102.9 million compared to December 31, 2018. This decrease was primarily due to the sale of U.S. Treasury securities.

- Total deposits were $16.8 billion as of June 30, 2019, a decrease of $358.0 million or 2% as compared to December 31, 2018. The decrease in total deposits was primarily due to a $244.8 million decrease in demand deposit balances and a $145.8 million decrease in money market deposit balances.

- Total stockholders' equity was $2.7 billion as of June 30, 2019, an increase of $134.6 million or 5% from December 31, 2018. The increase in stockholders' equity was primarily due to earnings for the period of $142.4 million and a net change in the fair value of our investment securities of $100.8 million. This was partially offset by dividends declared and paid to the Company's stockholders of $70.0 million and common stock repurchased of $40.0 million during the six months ended June 30, 2019.

## Analysis of Results of Operations

### *Net Interest Income*

For the three months ended June 30, 2019 and 2018, average balances, related income and expenses, on a fully taxable-equivalent basis, and resulting yields and rates are presented in Table 4. An analysis of the change in net interest income, on a fully taxable-equivalent basis, is presented in Table 5.

**Average Balances and Interest Rates** **Table 4**

| | Three Months Ended June 30, 2019 | | | Three Months Ended June 30, 2018 | | |
|---|---|---|---|---|---|---|
| (dollars in millions) | Average Balance | Income/ Expense | Average Yield/ Rate | Average Balance | Income/ Expense | Average Yield/ Rate |
| **Earning Assets** | | | | | | |
| Interest-Bearing Deposits in Other Banks | **$ 247.2** | **$ 1.4** | **2.35 %** | $ 281.2 | $ 1.2 | 1.74 % |
| Available-for-Sale Investment Securities | **4,438.1** | **24.8** | **2.23** | 4,961.2 | 27.4 | 2.21 |
| Loans Held for Sale | **0.7** | **—** | **2.76** | 1.9 | — | 3.44 |
| Loans and Leases (1) | | | | | | |
| Commercial and industrial | **3,235.0** | **34.3** | **4.26** | 3,177.4 | 30.5 | 3.84 |
| Commercial real estate | **3,094.4** | **36.0** | **4.67** | 2,883.0 | 28.9 | 4.02 |
| Construction | **583.6** | **6.9** | **4.73** | 620.7 | 6.2 | 4.03 |
| Residential: | | | | | | |
| Residential mortgage | **3,581.2** | **37.2** | **4.16** | 3,228.5 | 34.1 | 4.24 |
| Home equity line | **908.5** | **8.6** | **3.79** | 858.7 | 7.8 | 3.62 |
| Consumer | **1,657.7** | **22.7** | **5.48** | 1,624.6 | 21.7 | 5.35 |
| Lease financing | **149.3** | **1.2** | **3.31** | 159.7 | 1.1 | 2.83 |
| Total Loans and Leases | **13,209.7** | **146.9** | **4.46** | 12,552.6 | 130.3 | 4.16 |
| Other Earning Assets | **76.0** | **0.7** | **3.71** | 21.0 | 0.1 | 2.21 |
| Total Earning Assets (2) | **17,971.7** | **173.8** | **3.88** | 17,817.9 | 159.0 | 3.58 |
| Cash and Due from Banks | **342.6** | | | 317.7 | | |
| Other Assets | **2,076.0** | | | 1,985.9 | | |
| **Total Assets** | **$ 20,390.3** | | | $ 20,121.5 | | |
| | | | | | | |
| **Interest-Bearing Liabilities** | | | | | | |
| Interest-Bearing Deposits | | | | | | |
| Savings | **$ 4,712.2** | **$ 4.0** | **0.34 %** | $ 4,573.0 | $ 2.4 | 0.21 % |
| Money Market | **3,126.7** | **7.4** | **0.95** | 2,725.9 | 2.7 | 0.40 |
| Time | **3,084.6** | **12.3** | **1.60** | 4,003.5 | 12.2 | 1.22 |
| Total Interest-Bearing Deposits | **10,923.5** | **23.7** | **0.87** | 11,302.4 | 17.3 | 0.62 |
| Short-Term Borrowings | **50.4** | **0.3** | **2.25** | 42.7 | 0.2 | 1.85 |
| Long-Term Borrowings | **593.5** | **4.2** | **2.86** | 6.6 | 0.1 | 3.79 |
| **Total Interest-Bearing Liabilities** | **11,567.4** | **28.2** | **0.98** | 11,351.7 | 17.6 | 0.62 |
| **Net Interest Income** | | **$ 145.6** | | | $ 141.4 | |
| Interest Rate Spread | | | **2.90 %** | | | 2.96 % |
| Net Interest Margin | | | **3.25 %** | | | 3.18 % |
| Noninterest-Bearing Demand Deposits | **5,741.3** | | | 5,897.0 | | |
| Other Liabilities | **471.0** | | | 406.4 | | |
| Stockholders' Equity | **2,610.6** | | | 2,466.4 | | |
| **Total Liabilities and Stockholders' Equity** | **$ 20,390.3** | | | $ 20,121.5 | | |

(1) Non-performing loans and leases are included in the respective average loan and lease balances. Income, if any, on such loans and leases is recognized on a cash basis.

(2) For the three months ended June 30, 2019 and 2018, the taxable-equivalent basis adjustments made to the table above were not material.

**Analysis of Change in Net Interest Income** **Table 5**

| (dollars in millions) | Three Months Ended June 30, 2019 Compared to June 30, 2018 | | |
|---|---|---|---|
| | **Volume** | **Rate** | **Total (1)** |
| **Change in Interest Income:** | | | |
| Interest-Bearing Deposits in Other Banks | **$ (0.2)** | **$ 0.4** | **$ 0.2** |
| Available-for-Sale Investment Securities | **(2.9)** | **0.3** | **(2.6)** |
| Loans and Leases | | | |
| Commercial and industrial | **0.6** | **3.3** | **3.9** |
| Commercial real estate | **2.2** | **4.9** | **7.1** |
| Construction | **(0.4)** | **1.0** | **0.6** |
| Residential: | | | |
| Residential mortgage | **3.6** | **(0.5)** | **3.1** |
| Home equity line | **0.5** | **0.4** | **0.9** |
| Consumer | **0.4** | **0.5** | **0.9** |
| Lease financing | **(0.1)** | **0.2** | **0.1** |
| Total Loans and Leases | **6.8** | **9.8** | **16.6** |
| Other Earning Assets | **0.5** | **0.1** | **0.6** |
| **Total Change in Interest Income** | **4.2** | **10.6** | **14.8** |
| | | | |
| **Change in Interest Expense:** | | | |
| Interest-Bearing Deposits | | | |
| Savings | **0.1** | **1.5** | **1.6** |
| Money Market | **0.5** | **4.1** | **4.6** |
| Time | **(3.2)** | **3.3** | **0.1** |
| Total Interest-Bearing Deposits | **(2.6)** | **8.9** | **6.3** |
| Short-term Borrowings | **—** | **0.1** | **0.1** |
| Long-term Borrowings | **4.2** | **—** | **4.2** |
| **Total Change in Interest Expense** | **1.6** | **9.0** | **10.6** |
| **Change in Net Interest Income** | **$ 2.6** | **$ 1.6** | **$ 4.2** |

(1) The change in interest income and expense not solely due to changes in volume or rate has been allocated on a pro-rata basis to the volume and rate columns.

Net interest income, on a fully taxable-equivalent basis, was $145.6 million for the three months ended June 30, 2019, an increase of $4.2 million or 3% compared to the same period in 2018. Our net interest margin was 3.25% for the three months ended June 30, 2019, an increase of seven basis points from the same period in 2018. The increase in net interest income, on a fully taxable-equivalent basis, was primarily due to higher average balances and yields in most loan categories, partially offset by higher deposit funding costs, higher average balances in long-term borrowings and lower average balances in our investment securities portfolio during the quarter ended June 30, 2019. For the three months ended June 30, 2019, the average balance of our loans and leases was $13.2 billion, an increase of $657.1 million or 5% compared to the same period in 2018. The higher average balance in loans and leases was primarily due to growth in our residential real estate and commercial real estate portfolios. Yields on our loans and leases were 4.46% for the three months ended June 30, 2019, an increase of 30 basis points as compared to the same period in 2018. We experienced an increase in our yields from total loans primarily due to increases in adjustable rate commercial and industrial, commercial real estate and construction loans, which are typically based on the LIBOR. Average balances of our investment securities portfolio were $4.4 billion for the three months ended June 30, 2019, a decrease of $523.1 million or 11% from the same period in 2018. Deposit funding costs were $23.7 million for the three months ended June 30, 2019, an increase of $6.4 million compared to the same period in 2018. Rates paid on our interest-bearing deposits were 87 basis points for the three months ended June 30, 2019, an increase of 25 basis points compared to the same period in 2018. While we experienced higher rates paid on all interest-bearing deposit categories in the three months ended June 30, 2019, particularly high rates were paid on our money market deposits with an increase of 55 basis points compared to the same period in 2018. For the three months ended June 30, 2019, the average balance of our long-term borrowings was $593.5 million, an increase of $586.9 million from the same period in 2018. This was due to increases in FHLB fixed-rate advances held during the three months ended June 30, 2019 compared to the same period in 2018.

For the six months ended June 30, 2019 and 2018, average balances, related income and expenses, on a fully taxable-equivalent basis, and resulting yields and rates are presented in Table 6. An analysis of the change in net interest income, on a fully taxable-equivalent basis, is presented in Table 7.

**Average Balances and Interest Rates** **Table 6**

| (dollars in millions) | Six Months Ended June 30, 2019 Average Balance | Six Months Ended June 30, 2019 Income/ Expense | Six Months Ended June 30, 2019 Yield/ Rate | Six Months Ended June 30, 2018 Average Balance | Six Months Ended June 30, 2018 Income/ Expense | Six Months Ended June 30, 2018 Yield/ Rate |
|---|---|---|---|---|---|---|
| **Earning Assets** | | | | | | |
| Interest-Bearing Deposits in Other Banks | **$ 376.5** | **$ 4.6** | **2.49 %** | $ 448.0 | $ 3.6 | 1.60 % |
| Available-for-Sale Investment Securities | **4,428.0** | **49.3** | **2.23** | 5,060.2 | 56.4 | 2.25 |
| Loans Held for Sale | **0.5** | **—** | **2.76** | 1.1 | — | 3.40 |
| Loans and Leases(1) | | | | | | |
| Commercial and industrial | **3,200.9** | **67.5** | **4.25** | 3,141.0 | 58.2 | 3.74 |
| Commercial real estate | **3,044.9** | **70.7** | **4.68** | 2,841.7 | 55.3 | 3.93 |
| Construction | **610.2** | **14.4** | **4.75** | 620.8 | 12.0 | 3.89 |
| Residential: | | | | | | |
| Residential mortgage | **3,563.2** | **73.9** | **4.14** | 3,188.2 | 67.5 | 4.27 |
| Home equity line | **912.1** | **17.3** | **3.82** | 860.7 | 15.4 | 3.61 |
| Consumer | **1,662.5** | **45.2** | **5.48** | 1,612.3 | 43.0 | 5.38 |
| Lease financing | **148.3** | **2.3** | **3.15** | 160.7 | 2.4 | 2.97 |
| Total Loans and Leases | **13,142.1** | **291.3** | **4.46** | 12,425.4 | 253.8 | 4.12 |
| Other Earning Assets | **84.1** | **1.2** | **2.81** | 17.7 | 0.2 | 2.00 |
| Total Earning Assets(2) | **18,031.2** | **346.4** | **3.86** | 17,952.4 | 314.0 | 3.53 |
| Cash and Due from Banks | **351.4** | | | 318.3 | | |
| Other Assets | **2,059.7** | | | 1,993.1 | | |
| **Total Assets** | **$ 20,442.3** | | | $ 20,263.8 | | |
| | | | | | | |
| **Interest-Bearing Liabilities** | | | | | | |
| Interest-Bearing Deposits | | | | | | |
| Savings | **$ 4,762.6** | **$ 8.2** | **0.35 %** | $ 4,558.2 | $ 4.1 | 0.18 % |
| Money Market | **3,155.0** | **15.0** | **0.96** | 2,718.4 | 4.5 | 0.33 |
| Time | **3,063.3** | **23.7** | **1.56** | 4,127.2 | 24.0 | 1.17 |
| Total Interest-Bearing Deposits | **10,980.9** | **46.9** | **0.86** | 11,403.8 | 32.6 | 0.58 |
| Short-Term Borrowings | **31.7** | **0.4** | **2.29** | 21.5 | 0.2 | 1.85 |
| Long-Term Borrowings | **596.7** | **8.4** | **2.85** | 3.3 | 0.1 | 3.81 |
| **Total Interest-Bearing Liabilities** | **11,609.3** | **55.7** | **0.97** | 11,428.6 | 32.9 | 0.58 |
| **Net Interest Income** | | **$ 290.7** | | | $ 281.1 | |
| Interest Rate Spread | | | **2.89 %** | | | 2.95 % |
| Net Interest Margin | | | **3.24 %** | | | 3.16 % |
| Noninterest-Bearing Demand Deposits | **5,783.8** | | | 5,947.1 | | |
| Other Liabilities | **473.4** | | | 404.8 | | |
| Stockholders' Equity | **2,575.8** | | | 2,483.3 | | |
| **Total Liabilities and Stockholders' Equity** | **$ 20,442.3** | | | $ 20,263.8 | | |

(1) Non-performing loans and leases are included in the respective average loan and lease balances. Income, if any, on such loans and leases is recognized on a cash basis.

(2) For the six months ended June 30, 2019 and 2018, the taxable-equivalent basis adjustments made to the table above were not material.

| Analysis of Change in Net Interest Income | | | Table 7 |
|---|---|---|---|
| | Six Months Ended June 30, 2019 Compared to June 30, 2018 | | |
| (dollars in millions) | Volume | Rate | Total(1) |
| **Change in Interest Income:** | | | |
| Interest-Bearing Deposits in Other Banks | $ (0.6) | $ 1.7 | $ 1.1 |
| Available-for-Sale Investment Securities | (6.7) | (0.4) | (7.1) |
| Loans and Leases | | | |
| Commercial and industrial | 1.1 | 8.2 | 9.3 |
| Commercial real estate | 4.2 | 11.2 | 15.4 |
| Construction | (0.2) | 2.6 | 2.4 |
| Residential: | | | |
| Residential mortgage | 8.3 | (2.0) | 6.3 |
| Home equity line | 1.0 | 0.9 | 1.9 |
| Consumer | 1.3 | 0.8 | 2.1 |
| Lease financing | (0.2) | 0.2 | — |
| Total Loans and Leases | 15.5 | 21.9 | 37.4 |
| Other Earning Assets | 0.9 | 0.1 | 1.0 |
| **Total Change in Interest Income** | 9.1 | 23.3 | 32.4 |
| **Change in Interest Expense:** | | | |
| Interest-Bearing Deposits | | | |
| Savings | 0.2 | 4.0 | 4.2 |
| Money Market | 0.8 | 9.7 | 10.5 |
| Time | (7.1) | 6.7 | (0.4) |
| Total Interest-Bearing Deposits | (6.1) | 20.4 | 14.3 |
| Short-Term Borrowings | 0.1 | — | 0.1 |
| Long-Term Borrowings | 8.4 | — | 8.4 |
| **Total Change in Interest Expense** | 2.4 | 20.4 | 22.8 |
| **Change in Net Interest Income** | $ 6.7 | $ 2.9 | $ 9.6 |

(1) The change in interest income and expense not solely due to changes in volume or rate has been allocated on a pro-rata basis to the volume and rate columns.

Net interest income, on a fully taxable-equivalent basis, was $290.7 million for the six months ended June 30, 2019, an increase of $9.6 million or 3% compared to the same period in 2018. Our net interest margin was 3.24% for the six months ended June 30, 2019, an increase of eight basis points from the same period in 2018. The increase in net interest income, on a fully taxable-equivalent basis, was primarily due to higher average balances and yields in most loan categories. This was partially offset by lower average balances in our investment securities portfolio, higher average balances in long-term borrowings and higher deposit funding costs. For the six months ended June 30, 2019, the average balance of our loans and leases was $13.1 billion, an increase of $716.7 million or 6% compared to the same period in 2018. The higher average balance in loans and leases was primarily due to growth in our residential real estate and commercial real estate portfolios. Yields on our loans and leases were 4.46% for the six months ended June 30, 2019, an increase of 34 basis points as compared to the same period in 2018. We experienced an increase in our yield from total loans primarily due to increases in adjustable rate commercial and industrial, commercial real estate and construction loans, which are typically based on LIBOR. For the six months ended June 30, 2019, the average balance of our investment securities portfolio was $4.4 billion, a decrease of $632.2 million or 12% compared to the same period in 2018. Deposit funding costs were $46.9 million for the six months ended June 30, 2019, an increase of $14.3 million compared to the same period in 2018. Rates paid on our interest-bearing deposits were 86 basis points for the six months ended June 30, 2019, an increase of 28 basis points compared to the same period in 2018. While we experienced higher rates paid on all interest-bearing deposit categories in the six months ended June 30, 2019, particularly high rates were paid on our money market deposits with an increase of 63 basis points compared to the same period in 2018. For the six months ended June 30, 2019, the average balance of our long-term borrowings was $596.7 million, an increase of $593.4 million from the same period in 2018. This was due to increases in FHLB fixed-rate advances held during the six months ended June 30, 2019 compared to the same period in 2018.

***Provision for Loan and Lease Losses***

The Provision was $3.9 million for the three months ended June 30, 2019, which represented a decrease of $2.2 million compared to the same period in 2018. We recorded net charge-offs of loans and leases of $6.9 million and $4.0

million for the three months ended June 30, 2019 and 2018, respectively. This represented net charge-offs of 0.21% and 0.13% of average loans and leases, on an annualized basis, for the three months ended June 30, 2019 and 2018, respectively. The Provision was $9.6 million for the six months ended June 30, 2019, which represented a decrease of $2.4 million compared to the same period in 2018. We recorded net charge-offs of loans and leases of $12.7 million and $8.6 million for the six months ended June 30, 2019 and 2018, respectively. This represented net charge-offs of 0.20% and 0.14% of average loans and leases, on an annualized basis, for the six months ended June 30, 2019 and 2018, respectively. The Allowance was $138.5 million as of June 30, 2019, a decrease of $3.2 million or 2% from December 31, 2018 and represented 1.04% of total outstanding loans and leases as of June 30, 2019 compared to 1.08% of total outstanding loans and leases as of December 31, 2018. The Provision is recorded to maintain the Allowance at levels deemed adequate by management based on the factors noted in the “Risk Governance and Quantitative and Qualitative Disclosures About Market Risk — Credit Risk” section of this Management’s Discussion and Analysis of Financial Condition and Results of Operations (“MD&A”).

***Noninterest Income***

Table 8 presents the major components of noninterest income for the three months ended June 30, 2019 and 2018 and Table 9 presents the major components of noninterest income for the six months ended June 30, 2019 and 2018:

**Noninterest Income** **Table 8**

| (dollars in thousands) | Three Months Ended June 30, 2019 | Three Months Ended June 30, 2018 | Dollar Change | Percent Change |
|---|---|---|---|---|
| Service charges on deposit accounts | **$ 8,123** | $ 7,721 | $ 402 | 5 % |
| Credit and debit card fees | **16,629** | 16,929 | (300) | (2) |
| Other service charges and fees | **9,403** | 9,633 | (230) | (2) |
| Trust and investment services income | **8,931** | 7,711 | 1,220 | 16 |
| Bank-owned life insurance | **3,390** | 2,395 | 995 | 42 |
| Investment securities gains, net | **21** | — | 21 | n.m |
| Other | **2,276** | 5,408 | (3,132) | (58) |
| Total noninterest income | **$ 48,773** | $ 49,797 | $ (1,024) | (2)% |

n.m. – Denotes a variance that is not a meaningful metric to inform the change in noninterest income for the three months ended June 30, 2019 to the same period in 2018.

**Noninterest Income** **Table 9**

| (dollars in thousands) | Six Months Ended June 30, 2019 | Six Months Ended June 30, 2018 | Dollar Change | Percent Change |
|---|---|---|---|---|
| Service charges on deposit accounts | **$ 16,183** | $ 15,676 | $ 507 | 3 % |
| Credit and debit card fees | **33,284** | 32,426 | 858 | 3 |
| Other service charges and fees | **18,532** | 18,975 | (443) | (2) |
| Trust and investment services income | **17,549** | 15,942 | 1,607 | 10 |
| Bank-owned life insurance | **7,203** | 4,439 | 2,764 | 62 |
| Investment securities losses, net | **(2,592)** | — | (2,592) | n.m |
| Other | **5,686** | 11,039 | (5,353) | (48) |
| Total noninterest income | **$ 95,845** | $ 98,497 | $ (2,652) | (3)% |

n.m. – Denotes a variance that is not a meaningful metric to inform the change in noninterest income for the six months ended June 30, 2019 to the same period in 2018.

Total noninterest income was $48.8 million for the three months ended June 30, 2019, a decrease of $1.0 million or 2% as compared to the same period in 2018. Total noninterest income was $95.8 million for the six months ended June 30, 2019, a decrease of $2.7 million or 3% as compared to the same period in 2018.

Service charges on deposit accounts were $8.1 million for the three months ended June 30, 2019, an increase of $0.4 million or 5% as compared to the same period in 2018. Service charges on deposit accounts were $16.2 million for the six months ended June 30, 2019, an increase of $0.5 million or 3% as compared to the same period in 2018. This increase was primarily due to a $0.5 million increase in overdraft and checking account fees.

Credit and debit card fees were $16.6 million for the three months ended June 30, 2019, a decrease of $0.3 million or 2% as compared to the same period in 2018. Credit and debit card fees were $33.3 million for the six months ended June 30, 2019, an increase of $0.9 million or 3% as compared to the same period in 2018. This increase was primarily due to a $1.1 million increase in interchange settlement fees, partially offset by a $0.3 million decrease in merchant service revenues.

Other service charges and fees were $9.4 million for the three months ended June 30, 2019, a decrease of $0.2 million or 2% as compared to the same period in 2018. Other service charges and fees were $18.5 million for the six months ended June 30, 2019, a decrease of $0.4 million or 2% as compared to the same period in 2018.

Trust and investment services income was $8.9 million for the three months ended June 30, 2019, an increase of $1.2 million or 16% as compared to the same period in 2018. This increase was primarily due to a $0.8 million increase in business cash management fees, a $0.1 million increase in investment management fees and a $0.1 million increase in corporate trust and agency fees. Trust and investment services income was $17.5 million for the six months ended June 30, 2019, an increase of $1.6 million or 10% as compared to the same period in 2018. This increase was primarily due to a $1.6 million increase in business cash management fees.

BOLI income was $3.4 million for the three months ended June 30, 2019, an increase of $1.0 million or 42% as compared to the same period in 2018. This increase was due to a $1.0 million increase in BOLI earnings. BOLI income was $7.2 million for the six months ended June 30, 2019, an increase of $2.8 million or 62% as compared to the same period in 2018. This increase was due to a $2.4 million increase in BOLI earnings and a $0.4 million increase in death benefit proceeds from a life insurance policy.

Net gains on the sale of investment securities were nominal for the three months ended June 30, 2019. Net losses on the sale of investment securities were $2.6 million for the six months ended June 30, 2019, a decrease of $2.6 million as compared to the same period in 2018. The net loss was due to the investment portfolio restructuring and sale of the 48 investment securities for which a non-credit related OTTI write-down was recorded in December 2018 as a result of our intent to sell as of December 31, 2018.

Other noninterest income was $2.3 million for the three months ended June 30, 2019, a decrease of $3.1 million or 58% as compared to the same period in 2018. This decrease was primarily due to a $1.1 million gain on the sale of leased equipment in 2018, a $0.9 million decrease in volume-based incentives, a $0.6 million decrease in customer-related interest rate swap fees and a $0.5 million decrease in net gains recognized in income related to derivative contracts. Other noninterest income was $5.7 million for the six months ended June 30, 2019, a decrease of $5.4 million or 48% as compared to the same period in 2018. This decrease was primarily due to a $3.0 million decrease in customer-related interest rate swap fees, a $1.1 million decrease in volume-based incentives, a $1.1 million gain on sale of leased equipment in 2018 and a $0.8 million decrease in net gains recognized in income related to derivative contracts.

***Noninterest Expense***

Table 10 presents the major components of noninterest expense for the three months ended June 30, 2019 and 2018 and Table 11 presents the major components of noninterest expense for the six months ended June 30, 2019 and 2018:

**Noninterest Expense** **Table 10**

| (dollars in thousands) | Three Months Ended June 30, 2019 | Three Months Ended June 30, 2018 | Dollar Change | Percentage Change |
|---|---|---|---|---|
| Salaries and employee benefits | **$ 42,185** | $ 41,636 | $ 549 | 1 % |
| Contracted services and professional fees | **14,303** | 13,005 | 1,298 | 10 |
| Occupancy | **7,286** | 6,908 | 378 | 5 |
| Equipment | **4,544** | 4,335 | 209 | 5 |
| Regulatory assessment and fees | **2,149** | 4,225 | (2,076) | (49) |
| Advertising and marketing | **1,980** | 1,115 | 865 | 78 |
| Card rewards program | **7,664** | 6,359 | 1,305 | 21 |
| Other | **13,179** | 14,282 | (1,103) | (8) |
| Total noninterest expense | **$ 93,290** | $ 91,865 | $ 1,425 | 2 % |

**Noninterest Expense** **Table 11**

| (dollars in thousands) | Six Months Ended June 30, 2019 | Six Months Ended June 30, 2018 | Dollar Change | Percentage Change |
|---|---|---|---|---|
| Salaries and employee benefits | **$ 87,045** | $ 83,796 | $ 3,249 | 4 % |
| Contracted services and professional fees | **27,948** | 25,292 | 2,656 | 11 |
| Occupancy | **14,272** | 13,392 | 880 | 7 |
| Equipment | **8,828** | 8,923 | (95) | (1) |
| Regulatory assessment and fees | **3,596** | 8,198 | (4,602) | (56) |
| Advertising and marketing | **3,946** | 2,066 | 1,880 | 91 |
| Card rewards program | **14,396** | 12,077 | 2,319 | 19 |
| Other | **25,882** | 28,708 | (2,826) | (10) |
| Total noninterest expense | **$ 185,913** | $ 182,452 | $ 3,461 | 2 % |

Total noninterest expense was $93.3 million for the three months ended June 30, 2019, an increase of $1.4 million or 2% as compared to the same period in 2018. Total noninterest expense was $185.9 million for the six months ended June 30, 2019, an increase of $3.5 million or 2% as compared to the same period in 2018.

Salaries and employee benefits expense was $42.2 million for the three months ended June 30, 2019, an increase of $0.5 million or 1% as compared to the same period in 2018. This increase was primarily due to a $1.4 million increase in incentive compensation and a $0.4 million increase in other compensation, primarily related to stock-based compensation bonuses, partially offset by a $0.7 million increase in deferred loan origination costs and a $0.6 million decrease in base salaries and related payroll taxes. Salaries and employee benefits expense was $87.0 million for the six months ended June 30, 2019, an increase of $3.2 million or 4% as compared to the same period in 2018. This increase was primarily due to a $2.1 million increase in incentive compensation, a $0.8 million increase in base salaries and related payroll taxes, a $0.6 million increase in other compensation, primarily related to stock-based compensation bonuses and a $0.2 million increase in group health plan costs. This was partially offset by a $0.9 million decrease in retirement plan expenses.

Contracted services and professional fees were $14.3 million for the three months ended June 30, 2019, an increase of $1.3 million or 10% as compared to the same period in 2018. This increase was primarily due to a $1.1 million increase in contracted data processing expenses, primarily related to system upgrades and product enhancements. Contracted services and professional fees were $27.9 million for the six months ended June 30, 2019, an increase of $2.7 million or 11% as compared to the same period in 2018. This increase was primarily due to a $2.4 million increase in contracted data processing expenses, primarily related to system upgrades and product enhancements and a $0.6 million increase in outside services, primarily attributable to marketing and new customer services. This was partially offset by a $0.4 million decrease in audit, legal and consultant fees.

Occupancy expense was $7.3 million for the three months ended June 30, 2019, an increase of $0.4 million or 5% as compared to the same period in 2018. Occupancy expense was $14.3 million for the six months ended June 30, 2019, an increase of $0.9 million or 7% as compared to the same period in 2018. This increase was primarily due to a $0.6 million increase in rent expense and a $0.3 million increase in real property tax expense.

Equipment expense was $4.5 million for the three months ended June 30, 2019, an increase of $0.2 million or 5% as compared to the same period in 2018. Equipment expense was $8.8 million for the six months ended June 30, 2019, a decrease of $0.1 million or 1% as compared to the same period in 2018.

Regulatory assessment and fees were $2.1 million for the three months ended June 30, 2019, a decrease of $2.1 million or 49% as compared to the same period in 2018. Starting in the third quarter of 2016, there was a change in the calculation of the FDIC insurance assessment and the adoption of an additional surcharge, which resulted in a higher insurance rate. This additional surcharge required by the FDIC ended during the third quarter of 2018. The decrease of the regulatory assessment and fees for the three months ended June 30, 2019 as compared to the same period in 2018 is due to the exclusion of the additional surcharge for the three months ended June 30, 2019. Regulatory assessment and fees were $3.6 million for the six months ended June 30, 2019, a decrease of $4.6 million or 56% as compared to the same period in 2018. This decrease is primarily due to the termination of the additional surcharge and a $0.8 million decrease in the FDIC insurance assessment rate.

Advertising and marketing expense was $2.0 million for the three months ended June 30, 2019, an increase of $0.9 million or 78% as compared to the same period in 2018. This increase was primarily due to a $0.7 million decrease in vendor reimbursements and a $0.2 million increase in advertising costs. Advertising and marketing expense was $3.9 million for the six months ended June 30, 2019, an increase of $1.9 million or 91% as compared to the same period in 2018. This increase was primarily due to a $1.5 million decrease in vendor reimbursements and a $0.3 million increase in advertising costs.

Card rewards program expense was $7.7 million for the three months ended June 30, 2019, an increase of $1.3 million or 21% as compared to the same period in 2018. This increase was primarily due to a $0.8 million increase in interchange fees paid to our credit card partners and a $0.6 million increase in priority rewards card redemptions. Card rewards program expense was $14.4 million for the six months ended June 30, 2019, an increase of $2.3 million or 19% as compared to the same period in 2018. This increase was primarily due to a $1.2 million increase in priority rewards card redemptions, a $0.8 million increase in interchange fees paid to our credit card partners and a $0.3 million increase in credit card cash reward redemptions.

Other noninterest expense was $13.2 million for the three months ended June 30, 2019, a decrease of $1.1 million or 8% as compared to the same period in 2018. This decrease was primarily due to a $0.7 million loss recorded during the second quarter of 2018 on our funding swap related to a decrease in the conversion rate of our Visa Class B restricted shares sold in 2016 and a $0.5 million decrease in operational losses (which includes losses as a result of bank error, fraud, items processing, or theft). Other noninterest expense was $25.9 million for the six months ended June 30, 2019, a decrease of $2.8 million or 10% as compared to the same period in 2018. This decrease was primarily due to a $1.1 million decrease in operational losses (which includes losses as a result of bank error, fraud, items processing, or theft), a $0.7 million loss recorded in 2018 on our funding swap related to a decrease in the conversion rate of our Visa Class B restricted shares sold in 2016, a $0.4 million decrease in software amortization expense, a $0.3 million decrease in expenses related to the safekeeping and handling of securities-related transactions and a $0.2 million decrease in charitable contributions.

***Provision for Income Taxes***

The provision for income taxes was $24.8 million (an effective tax rate of 25.50%) for the three months ended June 30, 2019, compared with the provision for income taxes of $24.3 million (an effective tax rate of 26.00%) for the same period in 2018. The provision for income taxes was $48.7 million (an effective tax rate of 25.50%) for the six months ended June 30, 2019, compared with the provision for income taxes of $48.1 million (an effective tax rate of 26.00%) for the same period in 2018.

**Analysis of Business Segments**

Our business segments are Retail Banking, Commercial Banking and Treasury and Other. Table 12 summarizes net income from our business segments for the three and six months ended June 30, 2019 and 2018. Additional information about operating segment performance is presented in “Note 19. Reportable Operating Segments” contained in our unaudited interim consolidated financial statements.

**Business Segment Net Income** **Table 12**

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| (dollars in thousands) | 2019 | 2018 | 2019 | 2018 |
| Retail Banking | **$ 57,095** | $ 55,837 | **$ 115,509** | $ 110,207 |
| Commercial Banking | **18,684** | 18,859 | **36,111** | 37,160 |
| Treasury and Other | **(3,346)** | (5,643) | **(9,263)** | (10,356) |
| **Total** | **$ 72,433** | $ 69,053 | **$ 142,357** | $ 137,011 |

*Retail Banking.* Our Retail Banking segment includes the financial products and services we provide to consumers, small businesses and certain commercial customers. Loan and lease products offered include residential and commercial mortgage loans, home equity lines of credit, automobile loans and leases, personal lines of credit, installment loans and small business loans and leases. Deposit products offered include checking, savings and time deposit accounts. Our Retail Banking segment also includes our wealth management services.

Net income for the Retail Banking segment was $57.1 million for the three months ended June 30, 2019, an increase of $1.3 million or 2% as compared to the same period in 2018. The increase in net income for the Retail Banking segment was primarily due to a $2.9 million increase in net interest income, a $1.5 million increase in noninterest income and a $1.0 million decrease in noninterest expense. This was partially offset by an increase in expenses allocated to the Retail Banking segment. The increase in net interest income was primarily due to higher spreads on our deposit portfolio, partially offset by lower spreads on our loan portfolio. The increase in noninterest income was primarily due to an increase in trust and investment services income. The decrease in noninterest expense was primarily due to lower compensation expense and lower deposit insurance partially offset by an increase in occupancy expense. Net income for the Retail Banking segment was $115.5 million for the six months ended June 30, 2019, an increase of $5.3 million or 5% as compared to the same period in 2018. The increase in net income for the Retail Banking segment was primarily due to a $7.1 million increase in net interest income and a $3.0 million increase in noninterest income. This was partially offset by an increase in expenses allocated to the Retail Banking segment. The increase in net interest income was primarily due to higher spreads on our deposit portfolio, partially offset by lower spreads on our loan portfolio. The increase in noninterest income was primarily due to an increase in trust and investment services income and gains on foreign exchange transactions.

*Commercial Banking.* Our Commercial Banking segment includes our corporate banking, residential and commercial real estate loans, commercial lease financing, automobile loans and auto dealer financing, business deposit products and credit cards that we provide primarily to middle market and large companies in Hawaii, Guam, Saipan and California.

Net income for the Commercial Banking segment was $18.7 million for the three months ended June 30, 2019, a decrease of $0.2 million or 1% as compared to the same period in 2018. The decrease in net income for the Commercial Banking segment was primarily due to a $3.0 million decrease in noninterest income, partially offset by a $2.2 million decrease in noninterest expense. The decrease in noninterest income was primarily due to lower recoveries, swap fees and other miscellaneous income. The decrease in noninterest expense was primarily due to credits on amended use taxes, lower losses and charge offs, deposit insurance and contracted data processing. This was partially offset by higher card reward expenses. Net income for the Commercial Banking segment was $36.1 million for the six months ended June 30, 2019, a decrease of $1.0 million or 3% as compared to the same period in 2018. The decrease in net income for the Commercial Banking segment was primarily due to a $5.0 million decrease in noninterest income, partially offset by a $2.4 million decrease in noninterest expense and a decrease in the provision for loan and lease losses of $2.0 million. The decrease in noninterest income was primarily due lower recoveries, swap fees and other miscellaneous income, partially offset by an increase in credit and debit card fees. The decrease in noninterest expense was primarily due to credits on amended use taxes, lower losses and charge offs, deposit insurance and contracted data processing. This was partially offset by higher card reward expenses.

*Treasury and Other.* Our Treasury and Other segment includes our treasury business, which consists of corporate asset and liability management activities, including interest rate risk management. The assets and liabilities (and related interest income and expense) of our treasury business consist of interest bearing deposits, investment securities, federal funds sold and purchased, government deposits, short- and long-term borrowings and bank owned properties. Our primary sources of noninterest income are from bank owned life insurance, net gains from the sale of investment securities, foreign exchange income related to customer driven currency requests from merchants and island visitors and management of bank owned properties in Hawaii and Guam. The net residual effect of the transfer pricing of assets and liabilities is included in Treasury and Other, along with the elimination of intercompany transactions.

Other organizational units (Technology, Operations, Credit and Risk Management, Human Resources, Finance, Administration, Marketing and Corporate and Regulatory Administration) provide a wide range of support to our other income earning segments. Expenses incurred by these support units are charged to the applicable business segments through an internal cost allocation process.

Net loss for the Treasury and Other segment was $3.3 million for the three months ended June 30, 2019, a decrease in loss of $2.3 million or 41% as compared to the same period in 2018. The decrease in the net loss was primarily due to a $1.6 million increase in net interest income and a decrease in allocated expenses, partially offset by a $4.3 million increase in noninterest expense. The increase in noninterest expense was primarily due to higher contracted data processing, amended use tax, and advertising and marketing expenses, partially offset by a decrease in deposit insurance fees. The increase in net interest income was primarily due to higher earnings credits as a result of higher average balances in our loan portfolio, partially offset by lower average balances in our investment securities portfolio. Net loss for the Treasury and Other segment was $9.3 million for the six months ended June 30, 2019, a decrease in loss of $1.1 million or 11% as compared to the same period in 2018. The decrease in the net loss was primarily due to a $2.6 million increase in net interest income and a decrease in allocated expenses, partially offset by a $5.5 million increase in noninterest expense. The increase in noninterest expense was primarily due to higher contracted data processing, other employee benefits, amended use tax, and advertising and marketing expenses, partially offset by a decrease in deposit insurance fees. The increase in net interest income was primarily due to higher earnings credits as a result of higher average balances in our loan portfolio, partially offset by lower average balances in our investment securities portfolio.

**Analysis of Financial Condition**

***Liquidity***

Liquidity refers to our ability to maintain cash flow that is adequate to fund operations and meet present and future financial obligations through either the sale or maturity of existing assets or by obtaining additional funding through liability management. We consider the effective and prudent management of liquidity to be fundamental to our health and strength. Our objective is to manage our cash flow and liquidity reserves so that they are adequate to fund our obligations and other commitments on a timely basis and at a reasonable cost.

Liquidity is managed to ensure stable, reliable and cost effective sources of funds to satisfy demand for credit, deposit withdrawals and investment opportunities. Funding requirements are impacted by loan originations and refinancings, deposit balance changes, liability issuances and settlements and off-balance sheet funding commitments. We consider and comply with various regulatory and internal guidelines regarding required liquidity levels and periodically monitor our liquidity position in light of the changing economic environment and customer activity. Based on periodic liquidity assessments, we may alter our asset, liability and off-balance sheet positions. The Company's Asset Liability Management Committee ("ALCO") monitors sources and uses of funds and modifies asset and liability positions as liquidity requirements change. This process, combined with our ability to raise funds in money and capital markets and through private placements, provides flexibility in managing the exposure to liquidity risk.

Immediate liquid resources are available in cash, which is primarily on deposit with the FRB. As of June 30, 2019 and December 31, 2018, cash and cash equivalents were $0.7 billion and $1.0 billion, respectively. Potential sources of liquidity also include investment securities in our available-for-sale portfolio. The carrying value of our available-for-sale investment securities was $4.4 billion and $4.5 billion as of June 30, 2019 and December 31, 2018, respectively. As of June 30, 2019 and December 31, 2018, we maintained our excess liquidity primarily in collateralized mortgage obligations issued by Ginnie Mae, Fannie Mae and Freddie Mac. As of June 30, 2019, our available-for-sale investment securities portfolio was comprised of securities with an average base duration of approximately 3.8 years. These funds offer substantial resources to meet either new loan demand or to help offset reductions in our deposit funding base. Liquidity is further enhanced by our ability to pledge loans to access secured borrowings from the FHLB and the FRB. As of June 30, 2019, we have borrowing capacity of $1.6 billion from the FHLB and $665.7 million from the FRB based on the amount of collateral pledged.

Our core deposits have historically provided us with a long term source of stable and relatively lower cost of funding. Our core deposits, defined as all deposits exclusive of time deposits exceeding $250,000, totaled $14.9 billion and $15.3 billion as of June 30, 2019 and December 31, 2018, respectively, which represented 89% of our total deposits as of both June 30, 2019 and December 31, 2018. These core deposits are normally less volatile, often with customer relationships tied to other products offered by the Company. While we consider core deposits to be less volatile, deposit levels could decrease if interest rates increase significantly or if corporate customers increase investing activities and reduce deposit balances.

The Company's routine funding requirements are expected to consist primarily of general corporate needs and dividends to be paid to our stockholders. We expect to meet these obligations primarily from dividends paid by the Bank to the Parent. Additional sources of liquidity available to us include selling residential real estate loans in the secondary market, short- and long-term borrowings and the issuance of long-term debt and equity securities.

### *Investment Securities*

Table 13 presents the book value, which is also the estimated fair value, of our available-for-sale investment securities portfolio as of June 30, 2019 and December 31, 2018:

**Investment Securities** **Table 13**

| (dollars in thousands) | June 30, 2019 | December 31, 2018 |
|---|---|---|
| U.S. Treasury securities | **$ 29,556** | $ 389,470 |
| Government agency debt securities | **24,713** | — |
| Government-sponsored enterprises debt securities | **164,316** | 241,594 |
| Government agency mortgage-backed securities | **362,221** | 411,536 |
| Government-sponsored enterprises mortgage-backed securities | **151,683** | 150,847 |
| Collateralized mortgage obligations: | | |
| Government agency | **2,613,465** | 2,682,449 |
| Government-sponsored enterprises | **1,049,522** | 602,592 |
| Debt securities issued by state and political subdivisions | **—** | 19,854 |
| **Total available-for-sale securities** | **$ 4,395,476** | $ 4,498,342 |

Table 14 presents the maturity distribution at amortized cost and weighted-average yield to maturity of our available-for-sale investment securities portfolio as of June 30, 2019:

**Maturities and Weighted-Average Yield on Securities(1)** **Table 14**

| | 1 Year or Less | | After 1 Year - 5 Years | | After 5 Years - 10 Years | | Over 10 Years | | Total | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| (dollars in millions) | Amount | Weighted Average Yield | Amount | Weighted Average Yield | Amount | Weighted Average Yield | Amount | Weighted Average Yield | Amount | Weighted Average Yield | Fair Value |
| **As of June 30, 2019** | | | | | | | | | | | |
| **Available-for-Sale Securities** | | | | | | | | | | | |
| U.S. Treasury securities | **$ 29.5** | **2.40 %** | **$ —** | **— %** | **$ —** | **— %** | **$ —** | **— %** | **$ 29.5** | **2.40 %** | **$ 29.6** |
| Government agency debt securities(2) | **—** | **—** | **9.2** | **2.91** | **15.4** | **2.91** | **—** | **—** | **24.6** | **2.91** | **24.7** |
| Government-sponsored enterprises debt securities(3) | **88.0** | **2.21** | **50.0** | **1.84** | **26.7** | **1.86** | **—** | **—** | **164.7** | **2.04** | **164.3** |
| Mortgage-Backed Securities(2): | | | | | | | | | | | |
| Government agency | **—** | **—** | **161.5** | **2.84** | **201.8** | **2.46** | **—** | **—** | **363.3** | **2.63** | **362.2** |
| Government-sponsored enterprises | **—** | **—** | **152.5** | **2.28** | **—** | **—** | **—** | **—** | **152.5** | **2.28** | **151.7** |
| Collateralized mortgage obligations(2): | | | | | | | | | | | |
| Government agency | **—** | **—** | **2,485.4** | **2.17** | **134.1** | **2.32** | **—** | **—** | **2,619.5** | **2.18** | **2,613.5** |
| Government-sponsored enterprises | **—** | **—** | **912.3** | **2.46** | **90.6** | **2.97** | **42.6** | **2.25** | **1,045.5** | **2.49** | **1,049.5** |
| **Total available-for-sale securities as of June 30, 2019** | **$ 117.5** | **2.26 %** | **$ 3,770.9** | **2.27 %** | **$ 468.6** | **2.50 %** | **$ 42.6** | **2.25 %** | **$ 4,399.6** | **2.30 %** | **$ 4,395.5** |

(1) Weighted-average yields were computed on a fully taxable-equivalent basis.
(2) Maturities for government agency debt securities, mortgage-backed securities and collateralized mortgage obligations anticipate future prepayments.
(3) Maturities for government-sponsored enterprises debt securities purchased at a premium are categorized by their first call date.

The fair value of our available-for-sale investment securities portfolio was $4.4 billion as of June 30, 2019, a decrease of $102.9 million or 2% compared to December 31, 2018. Our available-for-sale investment securities are carried at fair value with changes in fair value reflected in other comprehensive income (loss), unless a security is deemed to be OTTI.

As of June 30, 2019, we maintained all of our investment securities in the available-for-sale category recorded at fair value in the unaudited interim consolidated balance sheets, with $3.7 billion invested in collateralized mortgage obligations issued by Ginnie Mae, Fannie Mae and Freddie Mac. Our available-for-sale portfolio also included $513.9 million in mortgage backed securities issued by Ginnie Mae, Freddie Mac and Fannie Mae, $164.3 million in debt securities issued by government-sponsored enterprises (FHLB and Federal Farm Credit Banks Funding Corporation callable bonds), $29.6 million in U.S. Treasury securities and $24.7 million in debt securities issued by government agencies (Small Business Administration).

We continually evaluate our investment securities portfolio in response to established asset/liability management objectives, changing market conditions that could affect profitability and the level of interest rate risk to which we are exposed. These evaluations may cause us to change the level of funds we deploy into investment securities and change the composition of our investment securities portfolio.

Gross unrealized gains in our investment securities portfolio were $20.8 million and $0.1 million as of June 30, 2019 and December 31, 2018, respectively. Gross unrealized losses in our investment securities portfolio were $24.9 million and $142.2 million as of June 30, 2019 and December 31, 2018, respectively. Lower unrealized losses in our investment securities portfolio were primarily due to lower market interest rates as of June 30, 2019, relative to December 31, 2018, resulting in a higher valuation. The lower gross unrealized loss positions were primarily related to our collateralized mortgage obligations, the fair value of which is sensitive to changes in market interest rates.

We conduct a regular assessment of our investment securities portfolio to determine whether any securities are OTTI. When assessing unrealized losses for OTTI, we consider the nature of the investment, the financial condition of the issuer, the extent and duration of unrealized losses, expected cash flows of underlying assets and market conditions. As of June 30, 2019, we had no plans to sell investment securities with unrealized losses, and believe it is more likely than not that we would not be required to sell such securities before recovery of their amortized cost, which may be at maturity. As of December 31, 2018, we intended to sell 48 investment securities with an aggregate book value of $898.2 million, primarily comprised of U.S. Treasury securities and longer duration collateralized mortgage obligations. As a result, we recorded a non-credit related OTTI write-down of $24.1 million for the year ended December 31, 2018. In January 2019, the sale of these securities were executed and the proceeds were used to invest in securities to improve portfolio return, reposition interest rate risk, maintain liquidity and to diversify asset allocation.

We are required to hold non-marketable equity securities, comprised of FHLB stock, as a condition of our membership in the FHLB system. Our FHLB stock is accounted for at cost, which equals par or redemption value. As of both June 30, 2019 and December 31, 2018, we held $34.1 million in FHLB stock, which is recorded as a component of other assets in our unaudited interim consolidated balance sheets.

See “Note 2. Investment Securities” contained in our unaudited interim consolidated financial statements for more information on our investment securities portfolio.

***Loans and Leases***

Table 15 presents the composition of our loan and lease portfolio by major categories as of June 30, 2019 and December 31, 2018:

**Loans and Leases** **Table 15**

| (dollars in thousands) | **June 30, 2019** | **December 31, 2018** |
|---|---|---|
| Commercial and industrial | **$ 3,177,844** | $ 3,208,760 |
| Commercial real estate | **3,194,219** | 2,990,783 |
| Construction | **549,578** | 626,757 |
| Residential: | | |
| Residential mortgage | **3,618,433** | 3,527,101 |
| Home equity line | **908,452** | 912,517 |
| Total residential | **4,526,885** | 4,439,618 |
| Consumer | **1,650,713** | 1,662,504 |
| Lease financing | **165,370** | 147,769 |
| **Total loans and leases** | **$ 13,264,609** | $ 13,076,191 |

Total loans and leases were $13.3 billion as of June 30, 2019, an increase of $188.4 million or 1% from December 31, 2018 with increases in commercial real estate loans, residential real estate loans and lease financing.

Commercial and industrial loans are made primarily to corporations, middle market and small businesses for the purpose of financing equipment acquisition, expansion, working capital and other general business purposes. We also offer a variety of automobile dealer flooring lines to our customers in Hawaii and California to assist with the financing of their inventory. Commercial and industrial loans were $3.2 billion as of June 30, 2019, a decrease of $30.9 million or 1% from December 31, 2018. This decrease was primarily due to greater than expected prepayments.

Commercial real estate loans are secured by first mortgages on commercial real estate at loan to value (“LTV”) ratios generally not exceeding 75% and a minimum debt service coverage ratio of 1.20 to 1. The commercial properties are predominantly apartments, neighborhood and grocery anchored retail, industrial, office, and to a lesser extent, specialized properties such as hotels. The primary source of repayment for investor property is cash flow from the property and for owner occupied property is the operating cash flow from the business. Commercial real estate loans were $3.2 billion as of June 30, 2019, an increase of $203.4 million or 7% from December 31, 2018. Strong demand for commercial real estate lending activities was reflective of a strong real estate market in Hawaii and the demand by both investors and owner occupants to refinance and/or to acquire new real estate assets.

Construction loans are for the purchase or construction of a property for which repayment will be generated by the property. Loans in this portfolio are primarily for the purchase of land, as well as for the development of commercial properties, single family homes and condominiums. We classify loans as construction until the completion of the construction phase. Following construction, if a loan is retained by the Bank, the loan is reclassified to the commercial real estate or residential real estate classes of loans. Construction loans were $549.6 million as of June 30, 2019, a decrease of $77.2 million or 12% from December 31, 2018.

Residential real estate loans are generally secured by 1-4 unit residential properties and are underwritten using traditional underwriting systems to assess the credit risks and financial capacity and repayment ability of the consumer. Decisions are primarily based on LTV ratios, debt-to-income (“DTI”) ratios, liquidity and credit scores. LTV ratios generally do not exceed 80%, although higher levels are permitted with mortgage insurance. We offer fixed rate mortgage products and variable rate mortgage products with interest rates that are subject to change every year after the first, third, fifth or tenth year, depending on the product and are based on LIBOR. Variable rate residential mortgage loans are underwritten at fully-indexed interest rates. We generally do not offer interest-only, payment-option facilities, Alt-A loans or any product with negative amortization. Residential real estate loans were $4.5 billion as of June 30, 2019, an increase of $87.3 million or 2% from December 31, 2018. Our portfolio of residential real estate loans continues to benefit from Hawaii’s strong real estate market and continued demand for new housing developments in the relatively low interest rate environment.

Consumer loans consist primarily of open- and closed-end direct and indirect credit facilities for personal, automobile and household purchases as well as credit card loans. We seek to maintain reasonable levels of risk in consumer lending by following prudent underwriting guidelines, which include an evaluation of personal credit history, cash flow and collateral values based on existing market conditions. Consumer loans were $1.7 billion as of June 30, 2019, a decrease of $11.8 million or 1% from December 31, 2018. The decrease in consumer loans was primarily due to lower credit card balances.

Lease financing consists of commercial single investor leases and leveraged leases. Underwriting of new lease transactions is based on our lending policy, including but not limited to an analysis of customer cash flows and secondary sources of repayment, including the value of leased equipment, the guarantors’ cash flows and/or other credit enhancements. No new leveraged leases are being added to the portfolio and all remaining leveraged leases are running off. Lease financing was $165.4 million as of June 30, 2019, an increase of $17.6 million or 12% from December 31, 2018.

See “Note 3. Loans and Leases” and “Note 4. Allowance for Loan and Lease Losses” contained in our unaudited interim consolidated financial statements and the discussion in “Analysis of Financial Condition — Allowance for Loan and Lease Losses” of this MD&A for more information on our loan and lease portfolio.

The Company's loan and lease portfolio includes adjustable-rate loans, primarily tied to Prime and LIBOR, hybrid-rate loans, for which the initial rate is fixed for a period from one year to as much as ten years, and fixed rate loans, for which the interest rate does not change through the life of the loan. Table 16 presents the recorded investment in our loan and lease portfolio as of June 30, 2019 by rate type:

**Loans and Leases by Rate Type** **Table 16**

| | June 30, 2019 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Adjustable Rate | | | | | Hybrid | Fixed | |
| (dollars in thousands) | Prime | LIBOR | Treasury | Other | Total | Rate | Rate | Total |
| Commercial and industrial | $ 237,592 | $ 2,522,771 | $ — | $ 3,026 | $ 2,763,389 | $ 11,984 | $ 402,471 | $ 3,177,844 |
| Commercial real estate | 49,667 | 1,759,142 | 353 | 1,021,259 | 2,830,421 | 69,551 | 294,247 | 3,194,219 |
| Construction | 38,917 | 349,451 | 39 | 56,838 | 445,245 | 929 | 103,404 | 549,578 |
| Residential: | | | | | | | | |
| Residential mortgage | 28,162 | 194,075 | 122,031 | 49,341 | 393,609 | 372,349 | 2,852,475 | 3,618,433 |
| Home equity line | 327,580 | — | 51,696 | — | 379,276 | 529,094 | 82 | 908,452 |
| Total residential | 355,742 | 194,075 | 173,727 | 49,341 | 772,885 | 901,443 | 2,852,557 | 4,526,885 |
| Consumer | 332,497 | 20,265 | 1,714 | 114 | 354,590 | 12,763 | 1,283,360 | 1,650,713 |
| Lease financing | — | — | — | — | — | — | 165,370 | 165,370 |
| **Total loans and leases** | $ 1,014,415 | $ 4,845,704 | $ 175,833 | $ 1,130,578 | $ 7,166,530 | $ 996,670 | $ 5,101,409 | $ 13,264,609 |
| % by rate type at June 30, 2019 | 8 % | 36 % | 1 % | 9 % | 54 % | 8 % | 38 % | 100 % |

Tables 17 and 18 present the geographic distribution of our loan and lease portfolio as of June 30, 2019 and December 31, 2018:

**Geographic Distribution of Loan and Lease Portfolio** **Table 17**

| | June 30, 2019 | | | | |
|---|---|---|---|---|---|
| (dollars in thousands) | Hawaii | U.S. Mainland(1) | Guam & Saipan | Foreign & Other | Total |
| Commercial and industrial | $ 1,307,439 | $ 1,687,405 | $ 120,374 | $ 62,626 | $ 3,177,844 |
| Commercial real estate | 2,129,884 | 661,388 | 402,600 | 347 | 3,194,219 |
| Construction | 281,332 | 238,622 | 29,624 | — | 549,578 |
| Residential: | | | | | |
| Residential mortgage | 3,492,002 | 2,806 | 123,625 | — | 3,618,433 |
| Home equity line | 879,107 | 65 | 29,280 | — | 908,452 |
| Total residential | 4,371,109 | 2,871 | 152,905 | — | 4,526,885 |
| Consumer | 1,233,631 | 22,387 | 392,495 | 2,200 | 1,650,713 |
| Lease financing | 47,631 | 111,048 | 6,691 | — | 165,370 |
| **Total Loans and Leases** | $ 9,371,026 | $ 2,723,721 | $ 1,104,689 | $ 65,173 | $ 13,264,609 |
| **Percentage of Total Loans and Leases** | 71% | 21% | 8% | 0% | 100% |

(1) For secured loans and leases, classification as U.S. Mainland is made based on where the collateral is located. For unsecured loans and leases, classification as U.S. Mainland is made based on the location where the majority of the borrower's business operations are conducted.

**Geographic Distribution of Loan and Lease Portfolio** — **Table 18**

| (dollars in thousands) | December 31, 2018 Hawaii | U.S. Mainland[1] | Guam & Saipan | Foreign & Other | Total |
|---|---|---|---|---|---|
| Commercial and industrial | $ 1,289,171 | $ 1,707,713 | $ 130,477 | $ 81,399 | $ 3,208,760 |
| Commercial real estate | 2,003,997 | 615,364 | 370,546 | 876 | 2,990,783 |
| Construction | 326,006 | 272,709 | 28,042 | — | 626,757 |
| Residential: | | | | | |
| Residential mortgage | 3,405,867 | 2,890 | 118,344 | — | 3,527,101 |
| Home equity line | 882,805 | — | 29,712 | — | 912,517 |
| Total residential | 4,288,672 | 2,890 | 148,056 | — | 4,439,618 |
| Consumer | 1,239,563 | 23,038 | 397,783 | 2,120 | 1,662,504 |
| Lease financing | 46,409 | 93,954 | 7,406 | — | 147,769 |
| **Total Loans and Leases** | $ 9,193,818 | $ 2,715,668 | $ 1,082,310 | $ 84,395 | $ 13,076,191 |
| **Percentage of Total Loans and Leases** | 70% | 21% | 8% | 1% | 100% |

(1) For secured loans and leases, classification as U.S. Mainland is made based on where the collateral is located. For unsecured loans and leases, classification as U.S. Mainland is made based on the location where the majority of the borrower's business operations are conducted.

Our lending activities are concentrated primarily in Hawaii. However, we also have lending activities on the U.S. mainland, Guam and Saipan. Our commercial lending activities on the U.S. mainland include automobile dealer flooring activities in California, limited participation in the Shared National Credits Program and selective commercial real estate projects based on existing customer relationships. Our lease financing portfolio includes leveraged lease financing activities on the U.S. mainland, but this portfolio continues to run off and no new leveraged leases are being added to the portfolio. Our consumer lending activities are concentrated primarily in Hawaii and, to a smaller extent, in Guam and Saipan.

Table 19 presents certain contractual loan maturity categories and sensitivities of those loans to changes in interest rates as of June 30, 2019:

**Maturities for Selected Loan Categories[1]** — **Table 19**

| (dollars in thousands) | June 30, 2019 Due in One Year or Less | Due After One to Five Years | Due After Five Years | Total |
|---|---|---|---|---|
| Commercial and industrial | **$ 1,227,382** | **$ 1,573,989** | **$ 376,473** | **$ 3,177,844** |
| Construction | **163,835** | **234,252** | **151,491** | **549,578** |
| **Total Loans and Leases** | **$ 1,391,217** | **$ 1,808,241** | **$ 527,964** | **$ 3,727,422** |
| | | | | |
| Total of loans with: | | | | |
| Adjustable interest rates | **$ 1,297,629** | **$ 1,517,811** | **$ 393,194** | **$ 3,208,634** |
| Hybrid interest rates | **1,529** | **3,028** | **8,356** | **12,913** |
| Fixed interest rates | **92,059** | **287,402** | **126,414** | **505,875** |
| Total Loans and Leases | **$ 1,391,217** | **$ 1,808,241** | **$ 527,964** | **$ 3,727,422** |

(1) Based on contractual maturities.

***Credit Quality***

We evaluate certain loans and leases, including commercial and industrial loans, commercial real estate loans and construction loans, individually for impairment and non-accrual status. A loan is considered to be impaired when it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan. We generally place a loan on non-accrual status when management believes that collection of principal or interest has become doubtful or when a loan or lease becomes 90 days past due as to principal or interest, unless it is well secured and in the process of collection. Loans on non-accrual status are generally classified as impaired, but not all impaired loans are necessarily placed on non-accrual status. See "Note 4. Allowance for Loan and Lease Losses" contained in our unaudited interim consolidated financial statements for more information about our credit quality indicators.

For purposes of managing credit risk and estimating the Allowance, management has identified three categories of loans (commercial, residential real estate and consumer) that we use to develop our systematic methodology to determine the Allowance. The categorization of loans for the evaluation of credit risk is specific to our credit risk evaluation process and these loan categories are not necessarily the same as the loan categories used for other evaluations of our loan portfolio. See “Note 4. Allowance for Loan and Lease Losses” contained in our unaudited interim consolidated financial statements for more information about our approach to estimating the Allowance.

The following tables and discussion address non-performing assets, loans and leases that are 90 days past due but are still accruing interest, impaired loans and loans modified in a TDR.

*Non-Performing Assets and Loans and Leases Past Due 90 Days or More and Still Accruing Interest*

Table 20 presents information on our non-performing assets and accruing loans and leases past due 90 days or more as of June 30, 2019 and December 31, 2018:

**Non-Performing Assets and Accruing Loans and Leases Past Due 90 Days or More** — **Table 20**

| (dollars in thousands) | **June 30, 2019** | **December 31, 2018** |
|---|---|---|
| **Non-Performing Assets** | | |
| Non-Accrual Loans and Leases | | |
| Commercial Loans: | | |
| Commercial and industrial | **$ 119** | $ 274 |
| Commercial real estate | **—** | 1,658 |
| Total Commercial Loans | **119** | 1,932 |
| Residential Loans: | | |
| Residential mortgage | **3,771** | 4,611 |
| Total Residential Loans | **3,771** | 4,611 |
| Total Non-Accrual Loans and Leases | **3,890** | 6,543 |
| Other Real Estate Owned | **—** | 751 |
| **Total Non-Performing Assets** | **$ 3,890** | $ 7,294 |
| | | |
| **Accruing Loans and Leases Past Due 90 Days or More** | | |
| Commercial Loans: | | |
| Commercial and industrial | **$ 807** | $ 141 |
| Total Commercial Loans | **807** | 141 |
| Residential Loans: | | |
| Residential mortgage | **—** | 32 |
| Home equity line | **1,635** | 2,842 |
| Total Residential Loans | **1,635** | 2,874 |
| Consumer | **3,295** | 3,373 |
| **Total Accruing Loans and Leases Past Due 90 Days or More** | **$ 5,737** | $ 6,388 |
| | | |
| **Restructured Loans on Accrual Status and Not Past Due 90 Days or More** | **23,466** | 24,033 |
| **Total Loans and Leases** | **$ 13,264,609** | $ 13,076,191 |
| | | |
| Ratio of Non-Accrual Loans and Leases to Total Loans and Leases | **0.03 %** | 0.05 % |
| Ratio of Non-Performing Assets to Total Loans and Leases and Other Real Estate Owned | **0.03 %** | 0.06 % |
| Ratio of Non-Performing Assets and Accruing Loans and Leases Past Due 90 Days or More to Total Loans and Leases and Other Real Estate Owned | **0.07 %** | 0.10 % |

Table 21 presents the activity in Non-Performing Assets (“NPAs”) for the six months ended June 30, 2019:

**Non-Performing Assets** — **Table 21**

| (dollars in thousands) | **Six Months Ended June 30, 2019** |
|---|---|
| Balance at beginning of period | **$ 7,294** |
| Additions | **1,419** |
| Reductions | |
| Payments | **(2,351)** |
| Return to accrual status | **(1,721)** |
| Sales of other real estate owned | **(751)** |
| Total Reductions | **(4,823)** |
| **Balance at End of Period** | **$ 3,890** |

The level of NPAs represents an indicator of the potential for future credit losses. NPAs consist of non-accrual loans and leases and other real estate owned. Changes in the level of non-accrual loans and leases typically represent increases for loans and leases that reach a specified past due status, offset by reductions for loans and leases that are charged-off, paid down, sold, transferred to other real estate owned or are no longer classified as non-accrual because they have returned to accrual status as a result of continued performance and an improvement in the borrower's financial condition and loan repayment capabilities.

Total NPAs were $3.9 million as of June 30, 2019, a decrease of $3.4 million or 47% from December 31, 2018. The ratio of our NPAs to total loans and leases and other real estate owned was 0.03% as of June 30, 2019, a decrease of three basis points from December 31, 2018. The decrease in total NPAs was primarily due to a $1.7 million decrease in commercial real estate non-accrual loans, a $0.8 million decrease in residential mortgage non-accrual loans and a $0.8 million decrease in other real estate owned.

The largest component of our NPAs continues to be residential mortgage loans. The level of these NPAs can remain elevated due to a lengthy judicial foreclosure process in Hawaii. As of June 30, 2019, residential mortgage non-accrual loans were $3.8 million, a decrease of $0.8 million or 18% from December 31, 2018. As of June 30, 2019, our residential mortgage non-accrual loans were comprised of 25 loans with a weighted average current LTV ratio of 64%.

There were no commercial real estate non-accrual loans as of June 30, 2019, a decrease of 1.7 million or 100% from December 31, 2018. This decrease was attributable to payoffs of four commercial real estate non-accrual loans during the six months ended June 30, 2019.

Other real estate owned represents property acquired as the result of borrower defaults on loans. Other real estate owned is recorded at fair value, less estimated selling costs, at the time of foreclosure. On an ongoing basis, properties are appraised as required by market conditions and applicable regulations. There was no other real estate owned as of June 30, 2019. As of December 31, 2018, other real estate owned was $0.8 million which was comprised of two residential real estate properties.

NPAs continue to remain at relatively low levels due to steady general economic conditions in Hawaii, led by steady tourism and construction industries, low unemployment and a continued strong real estate market. We have also continued to remain diligent in our collection and recovery efforts and have continued to seek new lending opportunities while maintaining sound judgment and underwriting practices.

*Loans and Leases Past Due 90 Days or More and Still Accruing Interest.* Loans and leases in this category are 90 days or more past due, as to principal or interest, and are still accruing interest because they are well secured and in the process of collection.

Loans and leases past due 90 days or more and still accruing interest were $5.7 million as of June 30, 2019, a decrease of $0.7 million or 10% as compared to December 31, 2018. Home equity lines that were past due 90 days or more and still accruing interest decreased by $1.2 million during the six months ended June 30, 2019. This was partially offset by an increase of $0.7 million in commercial and industrial loans that were past due 90 days or more and still accruing interest during the six months ended June 30, 2019.

*Impaired Loans.* A loan is impaired when, based on current information and events, it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement. For a loan that has been modified in a TDR, the contractual terms of the loan agreement refers to the contractual terms specified by the original loan agreement, not the contractual terms specified by the modified loan agreement.

Impaired loans were $27.4 million and $30.6 million as of June 30, 2019 and December 31, 2018, respectively. These impaired loans had a related Allowance of $0.5 million as of both June 30, 2019 and December 31, 2018. The decrease in impaired loans during the six months ended June 30, 2019 was primarily due to a net decrease of four commercial real estate loans totaling $1.7 million and a net decrease of two residential mortgage loans totaling $1.1 million, partially offset by a net increase of three commercial and industrial loans totaling $0.8 million. The impaired loan balance is further decreased by charge-offs and paydowns. As of June 30, 2019 and December 31, 2018, we recorded charge-offs of $0.6 million and $0.7 million, respectively, related to our total impaired loans. Our impaired loans are considered in management's assessment of the overall adequacy of the Allowance.

If interest due on the balances of all non-accrual loans as of June 30, 2019 had been accrued under the original terms, approximately nil and $0.1 million in additional interest income would have been recorded during the three and six months ended June 30, 2019, respectively, compared to $0.2 million and $0.3 million in additional interest income that would have been recorded for the same period in 2018, respectively. Actual interest income recorded on these loans was $0.4 million and $0.9 million, for the three and six months ended June 30, 2019, respectively, compared to $0.5 million and $1.0 million, respectively, for the same periods in 2018.

*Loans Modified in a Troubled Debt Restructuring*

Table 22 presents information on loans whose terms have been modified in a TDR as of June 30, 2019 and December 31, 2018:

**Loans Modified in a Troubled Debt Restructuring** **Table 22**

| (dollars in thousands) | June 30, 2019 | December 31, 2018 |
|---|---|---|
| Commercial and industrial | **$ 8,763** | $ 8,445 |
| Commercial real estate | **3,726** | 4,086 |
| Total commercial | **12,489** | 12,531 |
| Residential mortgage | **11,709** | 12,128 |
| Total residential | **11,709** | 12,128 |
| **Total** | **$ 24,198** | $ 24,659 |

Loans modified in a TDR were $24.2 million as of June 30, 2019, a decrease of $0.5 million or 2% from December 31, 2018. This decrease was primarily due to paydowns of commercial and industrial loans and commercial real estate loans totaling $0.9 million and pay-offs of two residential mortgage loans of $0.6 million, partially offset by four new commercial and industrial loans modified in a TDR totaling $0.9 million. As of June 30, 2019, $23.5 million or 97% of our loans modified in a TDR were performing in accordance with their modified contractual terms and were on accrual status.

Generally, loans modified in a TDR are returned to accrual status after the borrower has demonstrated performance under the modified terms by making six consecutive timely payments. See ‘‘Note 4. Allowance for Loan and Lease Losses’’ contained in our unaudited interim consolidated financial statements for more information and a description of the modification programs that we currently offer to our customers.

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

We maintain the Allowance at a level which, in our judgment, is adequate to absorb probable losses that have been incurred in our loan and lease portfolio as of the balance sheet date. The Allowance consists of two components, allocated and unallocated. The allocated portion of the Allowance includes reserves that are allocated based on impairment analyses of specific loans or pools of loans. The unallocated component of the Allowance incorporates our judgment of the determination of the risks inherent in the loan and lease portfolio, economic uncertainties and imprecision in the estimation process. Although we determine the amount of each component of the Allowance separately, the Allowance as a whole was considered appropriate by management as of June 30, 2019 and December 31, 2018 based on our ongoing analysis of estimated probable loan and lease losses, credit risk profiles, economic conditions, coverage ratios and other relevant factors.

Table 23 presents an analysis of our Allowance for the periods indicated:

**Allowance for Loan and Lease Losses** — **Table 23**

| (dollars in thousands) | Three Months Ended June 30, 2019 | Three Months Ended June 30, 2018 | Six Months Ended June 30, 2019 | Six Months Ended June 30, 2018 |
|---|---|---|---|---|
| **Balance at Beginning of Period** | **$ 141,546** | $ 138,574 | **$ 141,718** | $ 137,253 |
| Loans and Leases Charged-Off | | | | |
| Commercial Loans: | | | | |
| Commercial and industrial | **(2,000)** | — | **(2,000)** | (475) |
| Lease financing | **—** | — | **(24)** | — |
| Total Commercial Loans | **(2,000)** | — | **(2,024)** | (475) |
| Residential | **—** | (34) | **—** | (34) |
| Consumer | **(7,505)** | (6,290) | **(16,103)** | (12,915) |
| **Total Loans and Leases Charged-Off** | **(9,505)** | (6,324) | **(18,127)** | (13,424) |
| Recoveries on Loans and Leases Previously Charged-Off | | | | |
| Commercial Loans: | | | | |
| Commercial and industrial | **25** | 39 | **62** | 103 |
| Commercial real estate | **32** | 32 | **63** | 154 |
| Total Commercial Loans | **57** | 71 | **125** | 257 |
| Residential | **185** | 60 | **435** | 242 |
| Consumer | **2,382** | 2,200 | **4,834** | 4,303 |
| **Total Recoveries on Loans and Leases Previously Charged-Off** | **2,624** | 2,331 | **5,394** | 4,802 |
| Net Loans and Leases Charged-Off | **(6,881)** | (3,993) | **(12,733)** | (8,622) |
| Provision for Loan and Lease Losses | **3,870** | 6,020 | **9,550** | 11,970 |
| **Balance at End of Period** | **$ 138,535** | $ 140,601 | **$ 138,535** | $ 140,601 |
| Average Loans and Leases Outstanding | **$ 13,209,655** | $ 12,552,610 | **$ 13,142,057** | $ 12,425,351 |
| Ratio of Net Loans and Leases Charged-Off to Average Loans and Leases Outstanding[1] | **0.21 %** | 0.13 % | **0.20 %** | 0.14 % |
| Ratio of Allowance for Loan and Lease Losses to Loans and Leases Outstanding | **1.04 %** | 1.11 % | **1.04 %** | 1.11 % |

(1) Annualized for the three and six months ended June 30, 2019 and 2018.

Tables 24 and 25 present the allocation of the Allowance by loan and lease category, in both dollars and as a percentage of total loans and leases outstanding as of June 30, 2019 and December 31, 2018:

**Allocation of the Allowance by Loan and Lease Category** — **Table 24**

| (dollars in thousands) | June 30, 2019 | December 31, 2018 |
|---|---|---|
| Commercial and industrial | **$ 31,688** | $ 34,501 |
| Commercial real estate | **22,204** | 19,725 |
| Construction | **5,014** | 5,813 |
| Lease financing | **446** | 432 |
| Total commercial | **59,352** | 60,471 |
| Residential | **43,420** | 44,906 |
| Consumer | **33,638** | 35,813 |
| Unallocated | **2,125** | 528 |
| **Total Allowance for Loan and Lease Losses** | **$ 138,535** | $ 141,718 |

**Allocation of the Allowance by Loan and Lease Category (as a percentage of total loans and leases outstanding)** — **Table 25**

| | June 30, 2019 | | December 31, 2018 | |
|---|---|---|---|---|
| | Allocated Allowance as % of loan or lease category | Loan category as % of total loans and leases | Allocated Allowance as % of loan or lease category | Loan category as % of total loans and leases |
| Commercial and industrial | **1.00 %** | **23.96** % | 1.08 % | 24.54 % |
| Commercial real estate | **0.70** | **24.08** | 0.66 | 22.87 |
| Construction | **0.91** | **4.14** | 0.93 | 4.79 |
| Lease financing | **0.27** | **1.25** | 0.29 | 1.13 |
| Total commercial | **0.84** | **53.43** | 0.87 | 53.33 |
| Residential | **0.96** | **34.13** | 1.01 | 33.96 |
| Consumer | **2.04** | **12.44** | 2.15 | 12.71 |
| **Total** | **1.04** % | **100.00** % | 1.08 % | 100.00 % |

As of June 30, 2019, the Allowance was $138.5 million or 1.04% of total loans and leases outstanding, compared with an Allowance of $141.7 million or 1.08% of total loans and leases outstanding as of December 31, 2018. The level of the Allowance was commensurate with our stable credit risk profile, loan portfolio growth and composition and a steady Hawaii economy.

Net charge-offs of loans and leases were $6.9 million or 0.21% of total average loans and leases, on an annualized basis, for the three months ended June 30, 2019 compared to $4.0 million or 0.13% of total average loans and leases, on an annualized basis, for the three months ended June 30, 2018. Net charge-offs in our commercial lending portfolio were $1.9 million for the three months ended June 30, 2019, compared to net recoveries of $0.1 million for the three months ended June 30, 2018. The increase in net charge-offs in our commercial lending portfolio was primarily due to the full charge-off of one commercial and industrial loan of $2.0 million. Net recoveries in our residential lending portfolio were $0.2 million and nominal for the three months ended June 30, 2019 and 2018, respectively. Net charge-offs in our consumer lending portfolio were $5.1 million and $4.1 million for the three months ended June 30, 2019 and 2018, respectively. Net charge-offs in our consumer portfolio segment include those related to credit cards, automobile loans, installment loans and small business lines of credit and reflect the inherent risk associated with these loans.

Net charge-offs of loans and leases were $12.7 million or 0.20% of total average loans and leases, on an annualized basis, for the six months ended June 30, 2019 compared to $8.6 million or 0.14% of total average loans and leases, on an annualized basis, for the six months ended June 30, 2018. Net charge-offs in our commercial lending portfolio were $1.9 million and $0.2 million for the six months ended June 30, 2019 and 2018, respectively. The increase in net charge-offs in our commercial lending portfolio was primarily due to the full charge-off of one commercial and industrial loan of $2.0 million. Net recoveries in our residential lending portfolio were $0.4 million and $0.2 million for the six months ended June 30, 2019 and 2018, respectively. Our net recovery position in this portfolio segment is largely attributable to rising real estate prices in Hawaii. Net charge-offs in our consumer lending portfolio were $11.3 million and $8.6 million for the six months ended June 30, 2019 and 2018, respectively. Net charge-offs in our consumer portfolio segment include those related to credit card, automobile loans, installment loans and small business lines of credit and reflect the inherent risk associated with these loans.

As of June 30, 2019, the allocation of the Allowance to our commercial, residential and consumer loans was comparable to the respective allocations as of December 31, 2018. See “Note 4. Allowance for Loan and Lease Losses” contained in our unaudited interim consolidated financial statements for more information on the Allowance.

***Goodwill***

Goodwill was $995.5 million as of both June 30, 2019 and December 31, 2018. Our goodwill originated from the acquisition of BWC by BNPP in December 2001. Goodwill generated in that acquisition was recorded on the balance sheet of the Bank as a result of push down accounting treatment, and remains on our consolidated balance sheets. Goodwill is not amortized but is subject, at a minimum, to annual tests for impairment at a reporting unit level. Determining the amount of goodwill impairment, if any, includes assessing the current implied fair value of the reporting unit as if it were being acquired in a business combination and comparing it to the carrying amount of the reporting unit’s goodwill. There was no impairment in our goodwill for the three and six months ended June 30, 2019. Future events that could cause a significant decline in our expected future cash flows or a significant adverse change in our business or the business climate may necessitate taking charges in future reporting periods related to the impairment of our goodwill and other intangible assets.

***Other Assets***

Other assets were $497.9 million as of June 30, 2019, an increase of $51.5 million or 12% from December 31, 2018. This increase was primarily due to Accounting Standard Update No. 2016-02, *Leases (Topic 842),* which required the Company to record a right-of-use asset of $50.6 million as part of other assets and a $46.1 million increase in interest rate swap agreements. This was partially offset by a $38.3 million decrease in current tax receivables and deferred tax assets and a $6.5 million decrease in prepaid expenses.

***Deposits***

Deposits are the primary funding source for the Bank and are acquired from a broad base of local markets, including both individual and corporate customers. We obtain funds from depositors by offering a range of deposit types, including demand, savings, money market and time.

Table 26 presents the composition of our deposits as of June 30, 2019 and December 31, 2018:

**Deposits** **Table 26**

| (dollars in thousands) | June 30, 2019 | December 31, 2018 |
|---|---|---|
| Demand | **$ 5,763,157** | $ 6,007,941 |
| Savings | **4,908,000** | 4,853,285 |
| Money Market | **3,050,843** | 3,196,678 |
| Time | **3,070,078** | 3,092,164 |
| **Total Deposits[1]** | **$ 16,792,078** | $ 17,150,068 |

(1) Public deposits were $1.6 billion as of both June 30, 2019 and December 31, 2018.

Total deposits were $16.8 billion as of June 30, 2019, a decrease of $358.0 million or 2% from December 31, 2018. The decrease in deposit balances stemmed from a $244.8 million or 4% decrease in demand deposit balances and a $145.8 million or 5% decrease in money market deposit balances.

***Short-term and Long-term Borrowings***

Short-term borrowings were $200.0 million as of June 30, 2019, an increase of $200.0 million from December 31, 2018. This increase was due to the reclassification of a $200.0 million FHLB fixed-rate advance from long-term borrowings to short-term borrowings as the maturity date for this advance is less than one year. This short-term FHLB fixed-rate advance has an annual interest rate of 2.79% and matures in June 2020.

Table 27 below provides selected information for short-term borrowings for the six months ended June 30, 2019 and 2018:

**Short-term borrowings** **Table 27**

| | Six Months Ended June 30, | |
|---|---|---|
| (dollars in thousands) | 2019 | 2018 |
| Federal funds purchased: | | |
| Weighted-average interest rate at June 30, | **— %** | — % |
| Highest month-end balance | **$ 110,000** | $ — |
| Average outstanding balance | **$ 28,392** | $ 7,492 |
| Weighted-average interest rate paid | **1.21 %** | 0.88 % |
| Short-term FHLB fixed-rate advance: | | |
| Weighted-average interest rate at June 30, | **2.79 %** | — % |
| Highest month-end balance | **$ 200,000** | $ 81,800 |
| Average outstanding balance | **$ 3,315** | $ 13,974 |
| Weighted-average interest rate paid | **0.47 %** | 0.94 % |

Long-term borrowings were $400.0 million as of June 30, 2019, a decrease of $200.0 million from December 31, 2018. The Company's long-term borrowings included $400.0 million in FHLB fixed-rate advances with a weighted average interest rate of 2.80% and maturity dates ranging from 2020 to 2024. Long-term borrowings have an original maturity in excess of one year.

As of June 30, 2019, the available remaining borrowing capacity with the FHLB was $1.6 billion. The FHLB fixed rate advances and remaining borrowing capacity were secured by residential real estate loan collateral as of June 30, 2019 and December 31, 2018.

***Pension and Postretirement Plan Obligations***

We have a noncontributory qualified defined benefit pension plan, an unfunded supplemental executive retirement plan, a directors' retirement plan (a non-qualified pension plan for eligible directors) and a postretirement benefit plan providing life insurance and healthcare benefits that we offer to our directors and employees, as applicable. The noncontributory qualified defined benefit pension plan, the unfunded supplemental executive retirement plan and the directors' retirement plan are all frozen to new participants. On March 11, 2019, the Company's board of directors approved an amendment to the SERP to freeze the SERP. As a result of such amendment, effective July 1, 2019, there are no new accruals of benefits, including service accruals. To calculate annual pension costs, we use the following key variables: (1) size of the employee population, length of service and estimated compensation increases; (2) actuarial assumptions and estimates; (3) expected long-term rate of return on plan assets; and (4) discount rate.

Pension and postretirement benefit plan obligations, net of pension plan assets, were $121.2 million as of June 30, 2019, an increase of $2.0 million from December 31, 2018. This increase was primarily due to net periodic benefit costs for the six months ended June 30, 2019 of $5.2 million, partially offset by payments of $4.1 million.

See ''Note 17. Benefit Plans'' contained in our unaudited interim consolidated financial statements for more information on our pension and postretirement benefit plans.

***Foreign Activities***

Cross-border outstandings are defined as loans (including accrued interest), acceptances, interest-bearing deposits with other banks, other interest-bearing investments and any other monetary assets which are denominated in dollars or other non-local currency. As of June 30, 2019, aggregate cross-border outstandings in countries which amounted to 0.75% to 1% of our total consolidated assets were approximately $185.9 million to Japan and $158.3 million to Canada. As of December 31, 2018, aggregate cross-border outstandings in countries which amounted to 0.75% to 1% of our total consolidated assets were approximately $186.3 million to Japan. There were no cross-border outstandings in excess of 1% of our total consolidated assets as of both June 30, 2019 and December 31, 2018.

**Capital**

In July 2013, the federal bank regulators approved final rules implementing the Basel Committee on Banking Supervision's December 2010 final capital framework for strengthening international capital standards, known as Basel III and various provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Capital Rules"). Subject to a phase-in period for various provisions, the Capital Rules became effective for us and for the Bank on January 1, 2015. The Capital Rules require bank holding companies and their bank subsidiaries to maintain substantially more capital than previously required, with a greater emphasis on common equity. The Capital Rules, among other things, (i) introduced a capital measure called CET1 capital, (ii) specified that Tier 1 capital consists of CET1 capital and ''Additional Tier 1 capital'' instruments meeting specified requirements, (iii) defined CET1 capital narrowly by requiring that most deductions/adjustments to regulatory capital measures be made to CET1 capital and not to the other components of capital and (iv) expanded the scope of the deductions/adjustments to capital as compared to prior regulations.

Under the Capital Rules, the minimum capital ratios that became effective on January 1, 2015 were as follows:

- 4.5% CET1 capital to risk-weighted assets,
- 6.0% Tier 1 capital (that is, CET1 capital plus Additional Tier 1 capital) to risk-weighted assets,
- 8.0% Total capital (that is, Tier 1 capital plus Tier 2 capital) to risk-weighted assets, and
- 4.0% Tier 1 capital to average quarterly assets.

On that date, the deductions from CET1 capital were limited to 40% of the final phased-in deductions. Implementation of the deductions and other adjustments to CET1 capital began on January 1, 2015 and were phased-in with full implementation beginning on January 1, 2019. Implementation of the capital conservation buffer began on January 1, 2016 at 0.625% and was phased-in in increments of 0.625% per year until it reached 2.5% on January 1, 2019.

As of June 30, 2019, the Company's capital levels remained characterized as "well capitalized" under the Capital Rules. Our regulatory capital ratios, calculated in accordance with the Capital Rules, are presented in Table 28 below.

There have been no conditions or events since June 30, 2019 that management believes have changed either the Company's or the Bank's capital classifications.

**Regulatory Capital** **Table 28**

| (dollars in thousands) | June 30, 2019 | December 31, 2018 |
|---|---|---|
| Stockholders' Equity | **$ 2,659,441** | $ 2,524,839 |
| Less: | | |
| Goodwill | **995,492** | 995,492 |
| Accumulated other comprehensive loss, net | **(31,984)** | (132,195) |
| Common Equity Tier 1 Capital and Tier 1 Capital | **$ 1,695,933** | $ 1,661,542 |
| Add: | | |
| Allowable Reserve for Loan and Lease Losses and Unfunded Commitments | **139,135** | 142,318 |
| Total Capital | **$ 1,835,068** | $ 1,803,860 |
| Risk-Weighted Assets | **$ 14,325,398** | $ 13,884,976 |
| | | |
| **Key Regulatory Capital Ratios** | | |
| Common Equity Tier 1 Capital Ratio | **11.84 %** | 11.97 % |
| Tier 1 Capital Ratio | **11.84 %** | 11.97 % |
| Total Capital Ratio | **12.81 %** | 12.99 % |
| Tier 1 Leverage Ratio | **8.75 %** | 8.72 % |

Total stockholders' equity was $2.7 billion as of June 30, 2019, an increase of $134.6 million or 5% from December 31, 2018. The increase in stockholders' equity was primarily due to earnings for the period of $142.4 million and a net change in the fair value of our investment securities of $100.8 million. This was partially offset by dividends declared and paid to the Company's stockholders of $70.0 million for the six months ended June 30, 2019.

In July 2019, the Company's Board of Directors declared a quarterly cash dividend of $0.26 per share on our outstanding shares. The dividend will be paid on September 6, 2019 to shareholders of record at the close of business on August 26, 2019.

**Off-Balance Sheet Arrangements and Guarantees**

***Off-Balance Sheet Arrangements***

We hold interests in several unconsolidated variable interest entities ("VIEs"). These unconsolidated VIEs are primarily low income housing tax credit investments in partnerships and limited liability companies. Variable interests are defined as contractual ownership or other interest in an entity that change with fluctuations in an entity's net asset value. The primary beneficiary consolidates the VIE. Based on our analysis, we have determined that the Company is not the primary beneficiary of these entities. As a result, we do not consolidate these VIEs.

***Guarantees***

We sell residential mortgage loans in the secondary market primarily to Fannie Mae or Freddie Mac. The agreements under which we sell residential mortgage loans to Fannie Mae or Freddie Mac contain provisions that include various representations and warranties regarding the origination and characteristics of the residential mortgage loans. Although the specific representations and warranties vary among investors, insurance or guarantee agreements, they typically cover ownership of the loan, validity of the lien securing the loan, the absence of delinquent taxes or liens against the property securing the loan, compliance with loan criteria set forth in the applicable agreement, compliance with applicable federal, state and local laws and other matters. As of June 30, 2019 and December 31, 2018, the unpaid principal balance of our portfolio of residential mortgage loans sold was $2.5 billion and $2.7 billion, respectively. The agreements under which we sell residential mortgage loans require delivery of various documents to the investor or its document custodian. Although these loans are primarily sold on a non-recourse basis, we may be obligated to repurchase residential mortgage loans or reimburse investors for losses incurred if a loan review reveals that underwriting and documentation standards were potentially not met in the origination of those loans. Upon receipt of a repurchase request, we work with investors to arrive at a mutually agreeable resolution. Repurchase demands are typically reviewed on an individual loan by loan basis to validate the claims made by the investor to determine if a contractually required repurchase event has occurred. We manage the risk associated with potential repurchases or other forms of settlement through our underwriting and quality assurance practices and by servicing mortgage loans to meet investor and secondary market standards. For the six months ended June 30, 2019, there was one repurchase of a residential mortgage loan of $0.4 million and there were no pending repurchase requests.

In addition to servicing loans in our portfolio, substantially all of the loans we sell to investors are sold with servicing rights retained. We also service loans originated by other mortgage loan originators. As servicer, our primary duties are to: (1) collect payments due from borrowers; (2) advance certain delinquent payments of principal and interest; (3) maintain and administer any hazard, title or primary mortgage insurance policies relating to the mortgage loans; (4) maintain any required escrow accounts for payment of taxes and insurance and administer escrow payments; and (5) foreclose on defaulted mortgage loans, or loan modifications or short sales. Each agreement under which we act as servicer generally specifies a standard of responsibility for actions taken by the Company in such capacity and provides protection against expenses and liabilities incurred by the Company when acting in compliance with the respective servicing agreements. However, if we commit a material breach of obligations as servicer, we may be subject to termination if the breach is not cured within a specified period following notice. The standards governing servicing and the possible remedies for violations of such standards vary by investor. These standards and remedies are determined by servicing guides issued by the investors as well as the contract provisions established between the investors and the Company. Remedies could include repurchase of an affected loan. For the six months ended June 30, 2019, we had no repurchase requests related to loan servicing activities, nor were there any pending repurchase requests as of June 30, 2019.

Although to date repurchase requests related to representation and warranty provisions and servicing activities have been limited, it is possible that requests to repurchase mortgage loans may increase in frequency as investors more aggressively pursue all means of recovering losses on their purchased loans. However, as of June 30, 2019, management believes that this exposure is not material due to the historical level of repurchase requests and loss trends and thus has not established a liability for losses related to mortgage loan repurchases. As of June 30, 2019, 99% of our residential mortgage loans serviced for investors were current. We maintain ongoing communications with investors and continue to evaluate this exposure by monitoring the level and number of repurchase requests as well as the delinquency rates in loans sold to investors.

**Contractual Obligations**

Our contractual obligations have not changed materially since previously reported as of December 31, 2018.

**Future Application of Accounting Pronouncements**

For a discussion of the expected impact of accounting pronouncements recently issued but not adopted by us as of June 30, 2019, see “Note 1. Organization and Basis of Presentation — Recent Accounting Pronouncements” to the unaudited interim consolidated financial statements for more information.

**Risk Governance and Quantitative and Qualitative Disclosures About Market Risk**

Managing risk is an essential part of successfully operating our business. Management believes that the most prominent risk exposures for the Company are credit risk, market risk, liquidity risk management, capital management and operational risk. See “Analysis of Financial Condition — Liquidity” and “—Capital” sections of this MD&A for further discussions of liquidity risk management and capital management, respectively.

***Credit Risk***

Credit risk is the risk that borrowers or counterparties will be unable or unwilling to repay their obligations in accordance with the underlying contractual terms. We manage and control credit risk in the loan and lease portfolio by adhering to well-defined underwriting criteria and account administration standards established by management. Written credit policies document underwriting standards, approval levels, exposure limits and other limits or standards deemed necessary and prudent. Portfolio diversification at the obligor, industry, product, and/or geographic location levels is actively managed to mitigate concentration risk. In addition, credit risk management includes an independent credit review process that assesses compliance with commercial, real estate and consumer credit policies, risk ratings and other critical credit information. In addition to implementing risk management practices that are based upon established and sound lending practices, we adhere to sound credit principles. We understand and evaluate our customers' borrowing needs and capacity to repay, in conjunction with their character and history.

Management has identified three categories of loans that we use to develop our systematic methodology to determine the Allowance: commercial, residential real estate and consumer.

Commercial lending is further categorized into four distinct classes based on characteristics relating to the borrower, transaction and collateral. These classes are: commercial and industrial, commercial real estate, construction and lease financing. Commercial and industrial loans are primarily for the purpose of financing equipment acquisition, expansion, working capital and other general business purposes by medium to larger Hawaii based corporations, as well as U.S. mainland and international companies. Commercial and industrial loans are typically secured by non-real estate assets whereby the collateral is trading assets, enterprise value or inventory. As with many of our customers, our commercial and industrial loan customers are heavily dependent on tourism, government expenditures and real estate values. Commercial real estate loans are secured by real estate, including but not limited to structures and facilities to support activities designated as retail, health care, general office space, warehouse and industrial space. Our Bank's underwriting policy generally requires that net cash flows from the property be sufficient to service the debt while still maintaining an appropriate amount of reserves. Commercial real estate loans in Hawaii are characterized by having a limited supply of real estate at commercially attractive locations, long delivery time frames for development and high interest rate sensitivity. Our construction lending portfolio consists primarily of land loans, single family and condominium development loans. Financing of construction loans is subject to a high degree of credit risk given the long delivery time frames for such projects. Construction lending activities are underwritten on a project financing basis whereby the cash flows or lease rents from the underlying real estate collateral or the sale of the finished inventory is the primary source of repayment. Market feasibility analysis is typically performed by assessing market comparables, market conditions and demand in the specific lending area and general community. We require presales of finished inventory prior to loan funding. However, because this analysis is typically performed on a forward looking basis, real estate construction projects typically present a higher risk profile in our lending activities. Lease financing activities include commercial single investor leases and leveraged leases used to purchase items ranging from computer equipment to transportation equipment. Underwriting of new leasing arrangements typically includes analyzing customer cash flows, evaluating secondary sources of repayment, such as the value of the leased asset, the guarantors' net cash flows as well as other credit enhancements provided by the lessee.

Residential real estate is further categorized into the following classes: residential mortgages (loans secured by 1-4 family residential properties and home equity loans) and home equity lines of credit. Our Bank's underwriting standards typically require LTV ratios of not more than 80%, although higher levels are permitted with accompanying mortgage insurance. First mortgage loans secured by residential properties generally carry a moderate level of credit risk, with an average loan size of approximately $339,000. Residential mortgage loan production is added to our loan portfolio or is sold in the secondary market, based on management's evaluation of our liquidity, capital and loan portfolio mix as well as market conditions. Changes in interest rates, the economic environment and other market factors have impacted, and will likely continue to impact, the marketability and value of collateral and the financial condition of our borrowers which impacts the level of credit risk inherent in this portfolio, although we remain a supply constrained housing environment in Hawaii. Geographic concentrations exist for this portfolio as nearly all residential mortgage loans and home equity lines of credit are for residences located in Hawaii, Guam or Saipan. These island locales are susceptible to a wide array of potential natural disasters including, but not limited to, hurricanes, floods, tsunamis and earthquakes. We offer home equity lines of credit with variable rates; fixed rate options may be available post-closing. All lines are underwritten at 2% over the fully indexed rate. Our procedures for underwriting home equity lines of credit include an assessment of an applicant's overall financial capacity and repayment ability. Decisions are primarily based on repayment ability via debt-to-income ratios, LTV ratios and an evaluation of credit history.

Consumer lending is further categorized into the following classes of loans: credit cards, automobile loans and other consumer-related installment loans. Consumer loans are either unsecured or secured by the borrower's personal assets. The average loan size is generally small and risk is diversified among many borrowers. We offer a wide array of credit cards for business and personal use. In general, our customers are attracted to our credit card offerings on the basis of price, credit limit, reward programs and other product features. Credit card underwriting decisions are generally based on repayment ability of our borrower via DTI ratios, credit bureau information, including payment history, debt burden and credit scores, such as FICO, and analysis of financial capacity. Automobile lending activities include loans and leases secured by new or used automobiles. We originate the majority of our automobile loans and leases on an indirect basis through selected dealerships. Our procedures for underwriting automobile loans include an assessment of an applicant's overall financial capacity and repayment ability, credit history and the ability to meet existing obligations and payments on the proposed loan or lease. Although an applicant's creditworthiness is the primary consideration, the underwriting process also includes a comparison of the value of the collateral security to the proposed loan amount. We require borrowers to maintain full coverage automobile insurance on automobile loans and leases, with the Bank listed as either the loss payee or additional insured. Installment loans consist of open and closed end facilities for personal and household purchases. We seek to maintain reasonable levels of risk in installment lending by following prudent underwriting guidelines which include an evaluation of personal credit history and cash flow.

In addition to geographic concentration risk, we also monitor our exposure to industry risk. While the Bank, our customers and our results of operations could be adversely impacted by events affecting the tourism industry, we also monitor our other industry exposures, including, but not limited to, our exposures in the oil, gas and energy industries. As of June 30, 2019 and December 31, 2018, we did not have material exposures to customers in the oil, gas and energy industries.

***Market Risk***

Market risk is the potential of loss arising from changes in interest rates, foreign exchange rates, equity prices and commodity prices, including the correlation among these factors and their volatility. When the value of an instrument is tied to such external factors, the holder faces market risk. We are exposed to market risk primarily from interest rate risk, which is defined as the risk of loss of net interest income or net interest margin because of changes in interest rates.

The potential cash flows, sales or replacement value of many of our assets and liabilities, especially those that earn or pay interest, are sensitive to changes in the general level of interest rates. In the banking industry, changes in interest rates can significantly impact earnings and the safety and soundness of an entity.

Interest rate risk arises primarily from our core business activities of extending loans and accepting deposits. This occurs when our interest earning loans and interest bearing deposits mature or reprice at different times, on a different basis or in unequal amounts. Interest rates may also affect loan demand, credit losses, mortgage origination volume, pre- payment speeds and other items affecting earnings.

Many factors affect our exposure to changes in interest rates, such as general economic and financial conditions, customer preferences, historical pricing relationships and repricing characteristics of financial instruments. Our earnings are affected not only by general economic conditions, but also by the monetary and fiscal policies of the United States and its agencies, particularly the Federal Reserve. The monetary policies of the Federal Reserve can influence the overall growth of loans, investment securities and deposits and the level of interest rates earned on assets and paid for liabilities.

***Market Risk Measurement***

We primarily use net interest income simulation analysis to measure and analyze interest rate risk. We run various hypothetical interest rate scenarios on a quarterly basis and compare these results against a measured base case scenario. Our net interest income simulation analysis incorporates various assumptions, which we believe are reasonable but which may have a significant impact on results. These assumptions include: (1) the timing of changes in interest rates, (2) shifts or rotations in the yield curve, (3) re-pricing characteristics for market rate sensitive instruments on and off balance sheet, (4) differing sensitivities of financial instruments due to differing underlying rate indices and (5) varying loan prepayment speeds for different interest rate scenarios. Because of limitations inherent in any approach used to measure interest rate risk, simulation results are not intended as a forecast of the actual effect of a change in market interest rates on our results but rather as a means to better plan and execute appropriate asset liability management strategies to manage our interest rate risk.

Table 29 presents, for the twelve months subsequent to June 30, 2019 and December 31, 2018, an estimate of the changes in net interest income that would result from ramps (gradual changes) and shocks (immediate changes) in market interest rates, moving in a parallel fashion over the entire yield curve, relative to the measured base case scenario. Ramp scenarios assume interest rates move gradually in parallel across the yield curve relative to the base case scenario. The base case scenario assumes that the balance sheet and interest rates are generally unchanged. We evaluate the sensitivity by using a static forecast, where the balance sheets as of June 30, 2019 and December 31, 2018 are held constant.

| Net Interest Income Sensitivity Profile - Estimated Percentage Change Over 12 Months | Static Forecast As of June 30, 2019 | Static Forecast As of December 31, 2018 |
|---|---|---|
| **Ramp Change in Interest Rates (basis points)** | | |
| +100 | **2.8 %** | 2.4 % |
| +50 | **1.5** | 1.2 |
| (50) | **(1.5)** | (1.2) |
| (100) | **(3.3)** | (2.5) |
| | | |
| **Immediate Change in Interest Rates (basis points)** | | |
| +100 | **5.8 %** | 5.5 % |
| +50 | **3.0** | 2.7 |
| (50) | **(3.6)** | (2.8) |
| (100) | **(8.3)** | (6.2) |

Table 29

The table above shows the effects of a simulation which estimates the effect of a gradual and immediate sustained parallel shift in the yield curve of −100, −50, +50 and +100 basis points in market interest rates over a twelve month period on our net interest income.

Currently, our interest rate profile is such that we project net interest income will benefit modestly from higher interest rates as our assets would reprice faster and to a greater degree than our liabilities, while in the case of lower interest rates, our assets would reprice downward and to a greater degree than our liabilities.

Under the static balance sheet forecast as of June 30, 2019, our net interest income sensitivity profile is slightly more sensitive as compared to similar forecasts as of December 31, 2018. The higher sensitivity is primarily due to lower market interest rates, which has the effect of higher prepayments of loans and investment securities and reinvestments which occur at lower interest rates. Also contributing to the higher net interest income sensitivity as of June 30, 2019, is lower balances in our interest rate sensitive deposit products.

Projecting deposit activity in a period of historically low interest rates is difficult, and the Company cannot predict how deposits will actually react to shifting rates. The comparisons above provide insight into the potential effects of changes in interest rates on net interest income. The Company believes that its approach to interest rate risk has appropriately considered its susceptibility to both rising and falling rates and has adopted strategies which minimize the impact of such risks.

We also have longer term interest rate risk exposures which may not be appropriately measured by net interest income simulation analysis. We use market value of equity ("MVE") sensitivity analysis to study the impact of long term cash flows on earnings and capital. MVE involves discounting present values of all cash flows of on-balance sheet and off-balance sheet items under different interest rate scenarios. The discounted present value of all cash flows represents our MVE. MVE analysis requires modifying the expected cash flows in each interest rate scenario, which will impact the discounted present value. The amount of base case measurement and its sensitivity to shifts in the yield curve allow management to measure longer term repricing option risk in the balance sheet.

We also analyze the historical sensitivity of our interest bearing transaction accounts to determine the portion that it classifies as interest rate sensitive versus the portion classified over one year. This analysis divides interest bearing assets and liabilities into maturity categories and measures the "gap" between maturing assets and liabilities in each category.

***Limitations of Market Risk Measures***

The results of our simulation analyses are hypothetical, and a variety of factors might cause actual results to differ substantially from what is depicted. For example, if the timing and magnitude of interest rate changes differ from those projected, our net interest income might vary significantly. Non parallel yield curve shifts such as a flattening or steepening of the yield curve or changes in interest rate spreads would also cause our net interest income to be different from that depicted. An increasing interest rate environment could reduce projected net interest income if deposits and other short-term liabilities re-price faster than expected or faster than our assets re-price. Actual results could differ from those projected if we grow assets and liabilities faster or slower than estimated, if we experience a net outflow of deposits or if our mix of assets and liabilities otherwise changes. For example, while we maintain relatively high levels of liquidity, a faster than expected withdrawal of deposits out of the bank may cause us to seek higher cost sources of funding. Actual results could also differ from those projected if we experience substantially different prepayment speeds in our loan portfolio than those assumed in the simulation analyses. Finally, these simulation results do not consider all the actions that we may undertake in response to potential or actual changes in interest rates, such as changes to our loan, investment, deposit, funding or hedging strategies.

***Market Risk Governance***

We seek to achieve consistent growth in net interest income and capital while managing volatility arising from changes in market interest rates. The objective of our interest rate risk management process is to increase net interest income while operating within acceptable limits established for interest rate risk and maintaining adequate levels of funding and liquidity.

To manage the impact on net interest income, we manage our exposure to changes in interest rates through our asset and liability management activities within guidelines established by our ALCO and approved by our board of directors. The ALCO has the responsibility for approving and ensuring compliance with the ALCO management policies, including interest rate risk exposures. The objective of our interest rate risk management process is to maximize net interest income while operating within acceptable limits established for interest rate risk and maintaining adequate levels of funding and liquidity.

Through review and oversight by the ALCO, we attempt to engage in strategies that neutralize interest rate risk as much as possible. Our use of derivative financial instruments, as detailed in “Note 12. Derivative Financial Instruments” to the unaudited interim consolidated financial statements, has generally been limited. This is due to natural on balance sheet hedges arising out of offsetting interest rate exposures from loans and investment securities with deposits and other interest-bearing liabilities. In particular, the investment securities portfolio is utilized to manage the interest rate exposure and sensitivity to within the guidelines and limits established by the ALCO. We utilize natural and offsetting economic hedges in an effort to reduce the need to employ off-balance sheet derivative financial instruments to hedge interest rate risk exposures. Expected movements in interest rates are also considered in managing interest rate risk. Thus, as interest rates change, we may use different techniques to manage interest rate risk.

Management uses the results of its various simulation analyses to formulate strategies to achieve a desired risk profile within the parameters of our capital and liquidity guidelines.

***Operational Risk***

Operational risk is the risk of loss arising from inadequate or failed processes, people or systems, external events (such as natural disasters), or compliance, reputational or legal matters, including the risk of loss resulting from fraud, litigation and breaches in data security. Operational risk is inherent in all of our business ventures and the management of that risk is important to the achievement of our objectives. We have a framework in place that includes the reporting and assessment of any operational risk events, and the assessment of our mitigating strategies within our key business lines. This framework is implemented through our policies, processes and reporting requirements. We measure and report operational risk using the seven operational risk event types projected by the Basel Committee on Banking Supervision in Basel II: (1) external fraud; (2) internal fraud; (3) employment practices and workplace safety; (4) clients, products and business practices; (5) damage to physical assets; (6) business disruption and system failures; and (7) execution, delivery and process management. Our operational risk review process is also a core part of our assessment of material new products or activities.

## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

See “Part I, Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations — Risk Governance and Quantitative and Qualitative Disclosures About Market Risk.”

## ITEM 4. CONTROLS AND PROCEDURES

*Disclosure Controls and Procedures*

The Company’s management, including the Chief Executive Officer and Chief Financial Officer, conducted an evaluation of the effectiveness of the Company’s disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”)) as of June 30, 2019. The Company’s disclosure controls and procedures are designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC’s rules and forms, and that such information is accumulated and communicated to the Company’s management, including the Company’s Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure. Based on this evaluation, the Company’s Chief Executive Officer and Chief Financial Officer concluded that the Company’s disclosure controls and procedures were effective as of June 30, 2019.

*Changes in Internal Control over Financial Reporting*

There were no changes in the Company’s internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the quarter ended June 30, 2019 that have materially affected or are reasonably likely to materially affect the Company’s internal control over financial reporting.

## PART II – OTHER INFORMATION

## ITEM 1. LEGAL PROCEEDINGS

The Company operates in a highly regulated environment. From time to time, the Company is party to various litigation matters incidental to the conduct of our business. We are not presently party to any legal proceedings the resolution of which we believe would have a material adverse effect on our business, prospects, financial condition, liquidity, results of operation, cash flows or capital levels. For additional information, see the discussion related to contingencies in “Note 13. Commitments and Contingent Liabilities” in our unaudited interim consolidated financial statements under “Part I, Item 1. Financial Statements.”

## ITEM 1A. RISK FACTORS

There are no material changes from the risk factors as disclosed in the Company’s Annual Report on Form 10-K for the year ended December 31, 2018, except as described below.

*Uncertainty About the Transition from LIBOR as a Reference Rate May Adversely Impact Our Business*

On July 27, 2017, the United Kingdom’s Financial Conduct Authority (“FCA”), which regulates the London Interbank Offered Rate (“LIBOR”), announced that after December 31, 2021 it would no longer compel banks to submit the rates required to calculate LIBOR. After 2021, there also is uncertainty about the continued availability of LIBOR. If LIBOR ceases to exist or the methodology for the LIBOR calculation changes, financial products with interest rates tied to LIBOR may be adversely affected.

After 2021, if LIBOR remains available it may no longer be considered to be an acceptable market benchmark. There is also uncertainty regarding acceptable alternatives to LIBOR and the effect of any such changes may have on the pricing for LIBOR-indexed financial instruments. We have loans, derivative contracts, and other financial instruments with rates that are either directly or indirectly tied to LIBOR and the interest rates on these instruments, as well as the associated revenue and expenses, may be adversely affected. Failing to adequately manage this transition process with our customers could also adversely impact our reputation.

## ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

The following table provides certain information with respect to our purchases of shares of the Company's common stock during the three months ended June 30, 2019:

**Issuer Purchases of Equity Securities**

| Period | Total Number of Shares Purchased[1] | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs[2] |
|---|---|---|---|---|
| April 1, 2019 through April 30, 2019 | - | $ - | - | $ 100,000,000 |
| May 1, 2019 through May 31, 2019 | 855,122 | 27.14 | 855,000 | 76,795,036 |
| June 1, 2019 through June 30, 2019 | 654,846 | 25.65 | 654,846 | 60,000,017 |
| Total | 1,509,968 | $ 26.49 | 1,509,846 | |

(1) During the three months ended June 30, 2019, 122 shares were acquired from employees to satisfy income tax withholding requirements in connection with vested restricted stock units.

(2) The share repurchase program was announced in March 2019 for purchases of up to $100 million during 2019. The timing and amount of future purchases will be subject to various internal and external factors.

## ITEM 5. OTHER INFORMATION

On July 23, 2019, Mr. Eric Yeaman, President and Chief Operating Officer of the Company and the Bank, informed the Company that he is resigning from his positions with the Company and the Bank and will cease serving as a director on the board of directors of the Bank, in each case effective August 12, 2019. Effective August 12, 2019, Mr. Robert S. Harrison, currently the Chairman and Chief Executive Officer of the Company and the Bank, will become Chairman, President and Chief Executive Officer of the Company and the Bank. Information with respect to Mr. Harrison's age, positions and offices held with the Company and the Bank and business experience is incorporated herein by reference to the section captioned "Directors and Executive Officers" in the Company's definitive Proxy Statement on Schedule 14A for the 2019 Annual Meeting of Stockholders filed with the Securities and Exchange Commission on March 25, 2019.

Mr. Yeaman will be entitled to payments and benefits pursuant to the terms of the Bank's Executive Change-in-Control Retention Plan (the "Plan") in an amount reflecting Mr. Yeaman's election to be bound by the one-year non-competition and employee and customer non-solicitation provisions thereunder, consistent with the description of the Plan in the Company's Proxy Statement filed with the SEC on March 25, 2019 under the caption "Potential Payments upon Termination or Change in Control."

The information set forth above is included herein for the purpose of providing the disclosure required under "Item 5.02 - Departure of Directors or Principal Officers; Election of Directors; Appointment of Principal Officers" of Form 8-K.

**ITEM 6. EXHIBITS**

A list of exhibits to this Form 10-Q is set forth on the Exhibit Index and is incorporated herein by reference.

**Exhibit Index**

| **Exhibit Number** | |
|---|---|
| 31.1 | Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as Amended, Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 31.2 | Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as Amended, Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 32.1 | Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 32.2 | Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 101.INS | XBRL Instance Document – the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document. |
| 101.SCH | XBRL Taxonomy Extension Schema Document |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document |

**Signatures**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

| | | |
|---|---|---|
| Date: July 29, 2019 | | First Hawaiian, Inc. |
| | By: | /s/ Robert S. Harrison |
| | | Robert S. Harrison<br>Chairman of the Board and Chief Executive Officer<br>(Principal Executive Officer) |
| | By: | /s/ Ravi Mallela |
| | | Ravi Mallela<br>Chief Financial Officer<br>(Principal Financial Officer and Principal Accounting Officer) |

**Exhibit 31.1**

**Certification of Chief Executive Officer Pursuant to
Rule 13a-14(a) of the Securities Exchange Act of 1934, as Amended,
Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002**

I, Robert S. Harrison, certify that:

1. I have reviewed this quarterly report on Form 10-Q of First Hawaiian, Inc.;

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 that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.

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:

   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: July 29, 2019

/s/ Robert S. Harrison
Robert S. Harrison
Chairman of the Board and Chief Executive Officer
(Principal Executive Officer)

**Exhibit 31.2**

**Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as Amended, Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002**

I, Ravi Mallela, certify that:

1. I have reviewed this quarterly report on Form 10-Q of First Hawaiian, Inc.;

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 that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.

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:

    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: July 29, 2019

/s/ Ravi Mallela
Ravi Mallela
Chief Financial Officer
(Principal Financial Officer and Principal Accounting Officer)

**Exhibit 32.1**

**Certification of Chief Executive Officer**
**Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to**
**Section 906 of the Sarbanes-Oxley Act of 2002**

I hereby certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- The Quarterly Report on Form 10-Q of First Hawaiian, Inc. (the "Company") for the quarter ended June 30, 2019 (the "Report") fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and

- the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: July 29, 2019

/s/ Robert S. Harrison
Robert S. Harrison
Chairman of the Board and Chief Executive Officer
(Principal 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 U.S. Securities and Exchange Commission or its staff upon request.

**Exhibit 32.2**

**Certification of Chief Financial Officer**
**Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to**
**Section 906 of the Sarbanes-Oxley Act of 2002**

I hereby certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- The Quarterly Report on Form 10-Q of First Hawaiian, Inc. (the "Company") for the quarter ended June 30, 2019 (the "Report") fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and

- the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: July 29, 2019

/s/ Ravi Mallela
Ravi Mallela
Chief Financial Officer
(Principal Financial Officer and Principal Accounting 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 U.S. Securities and Exchange Commission or its staff upon request.