

BANK OF HAWAII CORP
Form 10-Q
July 23, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

☒ Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended June 30, 2018

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: 1-6887

BANK OF HAWAII CORPORATION

(Exact name of registrant as specified in its charter)

Delaware

99-0148992

(State of incorporation)

(I.R.S. Employer Identification No.)

130 Merchant Street, Honolulu, Hawaii 96813

(Address of principal executive offices) (Zip Code)

1-888-643-3888

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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 ☐ (Do not check if a smaller reporting company)

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 ☒

As of July 17, 2018, there were 42,031,229 shares of common stock outstanding.

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Consolidated Statements of Income (Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
(dollars in thousands, except per share amounts)	2018	2017	2018	2017
Interest Income				
Interest and Fees on Loans and Leases	\$ 101,311	\$ 90,909	\$ 198,945	\$ 178,846
Income on Investment Securities				
Available-for-Sale	12,380	11,835	24,521	22,919
Held-to-Maturity	20,711	19,918	42,007	39,624
Deposits	(4) 2	14	7
Funds Sold	846	696	1,603	1,586
Other	341	208	641	438
Total Interest Income	135,585	123,568	267,731	243,420
Interest Expense				
Deposits	9,459	4,998	17,040	8,689
Securities Sold Under Agreements to Repurchase	4,617	5,079	9,181	10,264
Funds Purchased	83	39	136	42
Short-Term Borrowings	13	64	29	64
Other Debt	917	1,109	1,893	2,210
Total Interest Expense	15,089	11,289	28,279	21,269
Net Interest Income	120,496	112,279	239,452	222,151
Provision for Credit Losses	3,500	4,250	7,625	8,650
Net Interest Income After Provision for Credit Losses	116,996	108,029	231,827	213,501
Noninterest Income				
Trust and Asset Management	11,356	11,796	22,537	23,275
Mortgage Banking	2,179	3,819	4,324	7,119
Service Charges on Deposit Accounts	6,865	8,009	13,994	16,334
Fees, Exchange, and Other Service Charges	14,400	13,965	28,733	27,297
Investment Securities Gains (Losses), Net	(1,702) (520) (2,368) 11,613
Annuity and Insurance	1,847	2,161	3,053	4,156
Bank-Owned Life Insurance	1,796	1,550	3,638	3,047
Other	4,557	4,456	11,422	8,311
Total Noninterest Income	41,298	45,236	85,333	101,152
Noninterest Expense				
Salaries and Benefits	52,148	49,676	106,570	100,841
Net Occupancy	8,588	8,131	17,122	16,299
Net Equipment	5,845	5,706	11,372	11,207
Data Processing	4,563	3,881	8,454	7,291
Professional Fees	2,546	2,592	5,319	5,371
FDIC Insurance	2,182	2,097	4,339	4,306
Other	14,919	16,106	31,999	31,442
Total Noninterest Expense	90,791	88,189	185,175	176,757
Income Before Provision for Income Taxes	67,503	65,076	131,985	137,896
Provision for Income Taxes	12,785	20,414	23,227	42,058
Net Income	\$ 54,718	\$ 44,662	\$ 108,758	\$ 95,838
Basic Earnings Per Share	\$ 1.31	\$ 1.05	\$ 2.59	\$ 2.26
Diluted Earnings Per Share	\$ 1.30	\$ 1.05	\$ 2.57	\$ 2.24
Dividends Declared Per Share	\$ 0.60	\$ 0.50	\$ 1.12	\$ 1.00

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Basic Weighted Average Shares	41,884,221	42,353,976	41,960,743	42,379,730
Diluted Weighted Average Shares	42,152,200	42,658,885	42,252,900	42,704,010

The accompanying notes are an integral part of the Consolidated Financial Statements (Unaudited).

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Bank of Hawaii Corporation and Subsidiaries

Consolidated Statements of Comprehensive Income (Unaudited)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
(dollars in thousands)	2018	2017	2018	2017
Net Income	\$ 54,718	\$ 44,662	\$ 108,758	\$ 95,838
Other Comprehensive Income (Loss), Net of Tax:				
Net Unrealized Gains (Losses) on Investment Securities	(2,974)	3,106	(12,095)	8,000
Defined Benefit Plans	216	147	432	293
Total Other Comprehensive Income (Loss)	(2,758)	3,253	(11,663)	8,293
Comprehensive Income	\$ 51,960	\$ 47,915	\$ 97,095	\$ 104,131

The accompanying notes are an integral part of the Consolidated Financial Statements (Unaudited).

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Consolidated Statements of Condition (Unaudited)

(dollars in thousands)	June 30, 2018	December 31, 2017
Assets		
Interest-Bearing Deposits in Other Banks	\$3,524	\$3,421
Funds Sold	361,933	181,413
Investment Securities		
Available-for-Sale	2,092,870	2,232,979
Held-to-Maturity (Fair Value of \$3,500,497 and \$3,894,121)	3,595,891	3,928,170
Loans Held for Sale	16,025	19,231
Loans and Leases	10,053,323	9,796,947
Allowance for Loan and Lease Losses	(108,188)	(107,346)
Net Loans and Leases	9,945,135	9,689,601
Total Earning Assets	16,015,378	16,054,815
Cash and Due From Banks	312,303	263,017
Premises and Equipment, Net	142,791	130,926
Accrued Interest Receivable	50,594	50,485
Foreclosed Real Estate	2,926	1,040
Mortgage Servicing Rights	24,583	24,622
Goodwill	31,517	31,517
Bank-Owned Life Insurance	281,018	280,034
Other Assets	263,052	252,596
Total Assets	\$17,124,162	\$17,089,052
Liabilities		
Deposits		
Noninterest-Bearing Demand	\$4,729,203	\$4,724,300
Interest-Bearing Demand	3,111,069	3,082,563
Savings	5,389,763	5,389,013
Time	1,713,323	1,688,092
Total Deposits	14,943,358	14,883,968
Short-Term Borrowings	330	—
Securities Sold Under Agreements to Repurchase	504,193	505,293
Other Debt	235,681	260,716
Retirement Benefits Payable	36,730	37,312
Accrued Interest Payable	7,395	6,946
Taxes Payable and Deferred Taxes	15,136	24,009
Other Liabilities	133,622	138,940
Total Liabilities	15,876,445	15,857,184
Shareholders' Equity		
Common Stock (\$.01 par value; authorized 500,000,000 shares; issued / outstanding: June 30, 2018 - 58,070,285 / 42,084,066 and December 31, 2017 - 57,959,074 / 42,401,443)	577	576
Capital Surplus	566,436	561,161
Accumulated Other Comprehensive Loss	(53,855)	(34,715)
Retained Earnings	1,581,168	1,512,218
Treasury Stock, at Cost (Shares: June 30, 2018 - 15,986,219 and December 31, 2017 - 15,557,631)	(846,609)	(807,372)

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Total Shareholders' Equity	1,247,717	1,231,868
Total Liabilities and Shareholders' Equity	\$17,124,162	\$17,089,052

The accompanying notes are an integral part of the Consolidated Financial Statements (Unaudited).

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Consolidated Statements of Shareholders' Equity (Unaudited)

(dollars in thousands)	Common Shares Outstanding	Common Stock	Capital Surplus	Accum. Other Compre- hensive Income (Loss)	Retained Earnings	Treasury Stock	Total
Balance as of December 31, 2017	42,401,443	\$ 576	\$561,161	\$(34,715)	\$1,512,218	\$(807,372)	\$1,231,868
Net Income	—	—	—	—	108,758	—	108,758
Other Comprehensive Loss	—	—	—	(11,663)	—	—	(11,663)
Reclassification of the Income Tax Effects of the Tax Cuts and Jobs Act from AOCI	—	—	—	(7,477)	7,477	—	—
Share-Based Compensation	—	—	4,055	—	—	—	4,055
Common Stock Issued under Purchase and Equity Compensation Plans	179,644	1	1,220	—	166	2,992	4,379
Common Stock Repurchased	(497,021)	—	—	—	—	(42,229)	(42,229)
Cash Dividends Declared (\$1.12 per share)	—	—	—	—	(47,451)	—	(47,451)
Balance as of June 30, 2018	42,084,066	\$ 577	\$566,436	\$(53,855)	\$1,581,168	\$(846,609)	\$1,247,717
Balance as of December 31, 2016	42,635,978	\$ 576	\$551,628	\$(33,906)	\$1,415,440	\$(772,201)	\$1,161,537
Net Income	—	—	—	—	95,838	—	95,838
Other Comprehensive Income	—	—	—	8,293	—	—	8,293
Share-Based Compensation	—	—	3,726	—	—	—	3,726
Common Stock Issued under Purchase and Equity Compensation Plans	275,605	—	1,055	—	(162)	7,545	8,438
Common Stock Repurchased	(255,629)	—	—	—	—	(21,287)	(21,287)
Cash Dividends Declared (\$1.00 per share)	—	—	—	—	(42,788)	—	(42,788)
Balance as of June 30, 2017	42,655,954	\$ 576	\$556,409	\$(25,613)	\$1,468,328	\$(785,943)	\$1,213,757

The accompanying notes are an integral part of the Consolidated Financial Statements (Unaudited).

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Consolidated Statements of Cash Flows (Unaudited)

	Six Months Ended June 30,	
(dollars in thousands)	2018	2017
Operating Activities		
Net Income	\$ 108,758	\$ 95,838
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Provision for Credit Losses	7,625	8,650
Depreciation and Amortization	6,788	6,565
Amortization of Deferred Loan and Lease Fees	(292)	(535)
Amortization and Accretion of Premiums/Discounts on Investment Securities, Net	17,632	20,027
Share-Based Compensation	4,055	3,726
Benefit Plan Contributions	(798)	(741)
Deferred Income Taxes	(2,496)	3,635
Net Gains on Sales of Loans and Leases	(1,070)	(3,971)
Net Losses (Gains) on Sales of Investment Securities	2,368	(11,613)
Proceeds from Sales of Loans Held for Sale	152,004	146,478
Originations of Loans Held for Sale	(148,513)	(150,414)
Net Tax Benefits from Share-Based Compensation	949	2,077
Net Change in Other Assets and Other Liabilities	(18,529)	(21,803)
Net Cash Provided by Operating Activities	128,481	97,919
Investing Activities		
Investment Securities Available-for-Sale:		
Proceeds from Sales, Prepayments and Maturities	209,572	203,177
Purchases	(99,254)	(320,170)
Investment Securities Held-to-Maturity:		
Proceeds from Prepayments and Maturities	425,043	406,904
Purchases	(99,415)	(365,498)
Net Change in Loans and Leases	(264,304)	(508,529)
Proceeds from Sales of Loans	—	112,357
Premises and Equipment, Net	(18,652)	(12,629)
Net Cash Provided by (Used in) Investing Activities	152,990	(484,388)
Financing Activities		
Net Change in Deposits	59,390	464,409
Net Change in Short-Term Borrowings	(770)	(27,702)
Repayments of Long-Term Debt	(25,000)	—
Proceeds from Issuance of Common Stock	4,498	8,457
Repurchase of Common Stock	(42,229)	(21,287)
Cash Dividends Paid	(47,451)	(42,788)
Net Cash Provided by (Used in) Financing Activities	(51,562)	381,089
Net Change in Cash and Cash Equivalents	229,909	(5,380)
Cash and Cash Equivalents at Beginning of Period	447,851	879,607
Cash and Cash Equivalents at End of Period	\$ 677,760	\$ 874,227
Supplemental Information		
Cash Paid for Interest	\$ 27,830	\$ 21,498

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Cash Paid for Income Taxes	24,487	32,058
Non-Cash Investing Activities:		
Transfer from Loans to Foreclosed Real Estate	2,307	2,207
Transfers from Loans to Loans Held for Sale	—	62,727

The accompanying notes are an integral part of the Consolidated Financial Statements (Unaudited).

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Bank of Hawaii Corporation and Subsidiaries
Notes to Consolidated Financial Statements
(Unaudited)

Note 1. Summary of Significant Accounting Policies

Basis of Presentation

Bank of Hawaii Corporation (the “Parent”) is a Delaware corporation and a bank holding company headquartered in Honolulu, Hawaii. Bank of Hawaii Corporation and its subsidiaries (collectively, the “Company”) provide a broad range of financial products and services to customers in Hawaii, Guam, and other Pacific Islands. The accompanying consolidated financial statements include the accounts of the Parent and its subsidiaries. The Parent’s principal operating subsidiary is Bank of Hawaii (the “Bank”).

The consolidated financial statements in this report have not been audited by an independent registered public accounting firm, but in the opinion of management, reflect all adjustments necessary for a fair presentation of the results for the interim periods. All such adjustments are of a normal recurring nature. Intercompany accounts and transactions have been eliminated in consolidation. Certain prior period information has been reclassified to conform to the current period presentation. Operating results for the interim periods disclosed herein are not necessarily indicative of the results that may be expected for the full fiscal year or for any future period.

The accompanying consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and accompanying notes required by GAAP for complete financial statements and 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, 2017.

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts in the financial statements and accompanying notes. Actual results may differ from those estimates and such differences could be material to the financial statements.

Variable Interest Entities

Variable interests are defined as contractual ownership or other interests in an entity that change with fluctuations in an entity’s net asset value. The primary beneficiary consolidates the variable interest entity (“VIE”). The primary beneficiary is defined as the enterprise that has both the power to direct the activities of the VIE that most significantly impact the entity’s economic performance and the obligation to absorb losses or the right to receive benefits that could be significant to the VIE.

The Company has limited partnership interests in several low-income housing partnerships. These partnerships provide funds for the construction and operation of apartment complexes that provide affordable housing to lower-income households. If these developments successfully attract a specified percentage of residents falling in that lower-income range, state and/or federal income tax credits are made available to the partners. The tax credits are generally recognized over 10 years. In order to continue receiving the tax credits each year over the life of the partnership, the low-income residency targets must be maintained.

Prior to January 1, 2015, the Company utilized the effective yield method whereby the Company recognized tax credits generally over 10 years and amortized the initial cost of the investment to provide a constant effective yield over the period that tax credits are allocated to the Company. On January 1, 2015, the Company adopted ASU No. 2014-01, "Accounting for Investments in Qualified Affordable Housing Projects" prospectively for new investments. ASU No. 2014-01 permits reporting entities to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. As permitted by ASU No. 2014-01, the Company elected to continue to utilize the effective yield method for investments made prior to January 1, 2015.

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Unfunded commitments to fund these low-income housing partnerships were \$13.8 million and \$17.5 million as of June 30, 2018 and December 31, 2017, respectively. These unfunded commitments are unconditional and legally binding and are recorded in other liabilities in the consolidated statements of condition. See Note 6 Affordable Housing Projects Tax Credit Partnerships for more information.

The Company also has limited partnership interests in solar energy tax credit partnership investments. These partnerships develop, build, own and operate solar renewable energy projects. Over the course of these investments, the Company expects to receive federal and state tax credits, tax-related benefits, and excess cash available for distribution, if any. The Company may be called to sell its interest in the limited partnerships through a call option once all investment tax credits have been recognized. Tax benefits associated with these investments are generally recognized over six years.

These entities meet the definition of a VIE; however, the Company is not the primary beneficiary of the entities as the general partner has both the power to direct the activities that most significantly impact the economic performance of the entities and the obligation to absorb losses or the right to receive benefits that could be significant to the entities. While the partnership agreements allow the limited partners, through a majority vote, to remove the general partner, this right is not deemed to be substantive as the general partner can only be removed for cause.

The investments in these entities are initially recorded at cost, which approximates the maximum exposure to loss as a result of the Company's involvement with these unconsolidated entities. The balance of the Company's investments in these entities was \$82.9 million and \$87.6 million as of June 30, 2018 and December 31, 2017, respectively, and is included in other assets in the consolidated statements of condition.

Tax Cuts and Jobs Act

Public law No. 115-97, known as the Tax Cuts and Jobs Act (the "Tax Act"), enacted on December 22, 2017, reduced the U.S. federal corporate tax rate from 35% to 21% effective January 1, 2018. Also on December 22, 2017, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 118 ("SAB 118"), which provides guidance on accounting for tax effects of the Tax Act. SAB 118 provides a measurement period of up to one year from the enactment date to complete the accounting. Any adjustments during this measurement period will be included in net earnings from continuing operations as an adjustment to income tax expense in the reporting period when such adjustments are determined. Based on the information available and current interpretation of the rules, the Company estimated the impact of the reduction in the corporate tax rate and remeasurement of certain deferred tax assets and liabilities. The provisional amount recorded in the fourth quarter of 2017 related to the remeasurement of the Company's deferred tax balance resulted in additional income tax expense of \$3.6 million. An additional \$0.1 million was expensed in the first quarter of 2018 due to the remeasurement of the Company's deferred tax balance. In addition, during the first quarter of 2018, the Company recorded a \$2.0 million basis adjustment on its low income housing partnership investments, which consequently reduced income tax expense by the same amount. The final impact of the Tax Act may differ from these estimates as a result of changes in management's interpretations and assumptions, as well as new guidance that may be issued by the Internal Revenue Service.

Accounting Standards Adopted in 2018

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers." The standard's core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. In doing so, companies generally will be required to use more judgment and make more estimates than under current guidance. These may include identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. Subsequent to the issuance of ASU 2014-09, the FASB issued targeted updates to clarify

specific implementation issues including ASU No. 2016-08, “Principal versus Agent Considerations (Reporting Revenue Gross versus Net),” ASU No. 2016-10, “Identifying Performance Obligations and Licensing,” ASU No. 2016-12, “Narrow-Scope Improvements and Practical Expedients,” and ASU No. 2016-20 “Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers.” For financial reporting purposes, the standard allows for either full retrospective adoption, meaning the standard is applied to all of the periods presented, or modified retrospective adoption, meaning the standard is applied only to the most current period presented in the financial statements with the cumulative effect of initially applying the standard recognized at the date of initial application. Since the guidance does not apply to revenue associated with financial instruments, including loans and securities that are accounted for under other GAAP, the new guidance did not have a material impact on revenue most closely associated with financial instruments, including interest income and expense. The Company completed its overall assessment of revenue streams and review of related contracts potentially affected by the ASU, including trust and asset management fees, deposit related fees, interchange fees, merchant income, and annuity and insurance commissions. Based on this assessment, the

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Company concluded that ASU 2014-09 did not materially change the method in which the Company currently recognizes revenue for these revenue streams. The Company also completed its evaluation of certain costs related to these revenue streams to determine whether such costs should be presented as expenses or contra-revenue (i.e., gross vs. net). Based on its evaluation, the Company determined that the classification of certain debit and credit card related costs should change (i.e., costs previously recorded as expense is now recorded as contra-revenue, and vice versa). These classification changes resulted in immaterial changes to both revenue and expense. The Company also determined that certain costs related to ATMs should be recorded as an expense rather than a reduction of revenue. This change did not have a material effect to noninterest income or expense. The Company adopted ASU 2014-09 and its related amendments on its required effective date of January 1, 2018 utilizing the modified retrospective approach. Since there was no net income impact upon adoption of the new guidance, a cumulative effect adjustment to opening retained earnings was not deemed necessary. Consistent with the modified retrospective approach, the Company did not adjust prior period amounts for the debit and credit card costs and the ATM costs reclassifications noted above. See Note 15 Revenue Recognition for more information.

In January 2016, the FASB issued ASU No. 2016-01, “Recognition and Measurement of Financial Assets and Financial Liabilities.” This ASU addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments by making targeted improvements to GAAP as follows: (1) require equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. However, an entity may choose to measure equity investments that do not have readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer; (2) simplify the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment. When a qualitative assessment indicates that impairment exists, an entity is required to measure the investment at fair value; (3) eliminate the requirement to disclose the fair value of financial instruments measured at amortized cost for entities that are not public business entities; (4) eliminate the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; (5) require public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; (6) require an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments; (7) require separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements; and (8) clarify that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity’s other deferred tax assets. The Company’s adoption of ASU No. 2016-01 on January 1, 2018 did not have a material impact on the Company’s Consolidated Financial Statements. In accordance with (5) above, the Company measured the fair value of its loan portfolio as of June 30, 2018 using an exit price notion (see Note 14 Fair Value of Assets and Liabilities).

In August 2016, the FASB issued ASU No. 2016-15, “Classification of Certain Cash Receipts and Cash Payments.” At the time, GAAP was unclear or did not include specific guidance on how to classify certain transactions in the statement of cash flows. This ASU is intended to reduce diversity in practice in how eight particular transactions are classified in the statement of cash flows. ASU No. 2016-15 was effective for interim and annual reporting periods beginning after December 15, 2017. Entities were required to apply the guidance retrospectively. If it is impracticable to apply the guidance retrospectively for an issue, the amendments related to that issue would be applied prospectively. The Company adopted ASU No. 2016-15 on January 1, 2018. ASU No. 2016-15 did not have a material impact on the Company’s Consolidated Financial Statements.

In March 2017, the FASB issued ASU No. 2017-07, “Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost.” Under the new guidance, employers are required to present the service cost component of the net periodic benefit cost in the same income statement line item (e.g., Salaries and Benefits) as other employee compensation costs arising from services rendered during the period. In addition, only the service cost component will be eligible for capitalization in assets. Employers will present the other components of net periodic benefit cost separately (e.g., Other Noninterest Expense) from the line item that includes the service cost. ASU No. 2017-07 became effective for interim and annual reporting periods beginning after December 15, 2017. Employers will apply the guidance on the presentation of the components of net periodic benefit cost in the income statement retrospectively. The guidance limiting the capitalization of net periodic benefit cost in assets to the service cost component will be applied prospectively. The Company adopted ASU No. 2017-07 on January 1, 2018 and utilized the ASU’s practical expedient allowing entities to estimate amounts for comparative periods using the information previously disclosed in their pension and other postretirement benefit plan footnote. ASU No. 2017-07 did not have a material impact on the Company’s Consolidated Financial Statements.

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In February 2018, the FASB issued ASU No. 2018-02, “Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income.” This ASU allows a reclassification from accumulated other comprehensive income (“AOCI”) to retained earnings for certain income tax effects stranded in AOCI as a result of the Tax Act. Consequently, the reclassification eliminates the stranded tax effects resulting from the Tax Act and is intended to improve the usefulness of information reported to financial statement users. However, because the ASU only relates to the reclassification of the income tax effects of the Tax Act, the underlying guidance that requires the effect of a change in tax laws or rates to be included in income from continuing operations is not affected. ASU No. 2018-02 is effective for the Company’s reporting period beginning on January 1, 2019; early adoption is permitted. The Company elected to early adopt ASU No. 2018-02 during the first quarter of 2018, and elected to reclassify the income tax effects of the Tax Act from AOCI to retained earnings. The reclassification decreased AOCI and increased retained earnings by \$7.5 million, with zero net effect on total shareholders’ equity. The Company utilizes the individual securities approach when releasing income tax effects from AOCI for its investment securities.

Accounting Standards Pending Adoption

In February 2016, the FASB issued ASU No. 2016-02, “Leases.” Under the new guidance, lessees will be required to recognize the following for all 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. Leveraged leases have been eliminated, although lessors can continue to account for existing leveraged leases using the current accounting guidance. Other limited changes were made to align lessor accounting with the lessee accounting model and the new revenue recognition standard. All entities will classify leases to determine how to recognize lease-related revenue and expense. Quantitative and qualitative disclosures will be required by lessees and lessors to meet the objective of enabling users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases. The intention is to require enough information to supplement the amounts recorded in the financial statements so that users can understand more about the nature of an entity’s leasing activities. ASU No. 2016-02 is effective for interim and annual reporting periods beginning after December 15, 2018; early adoption is permitted. All entities are required to use a modified retrospective approach for leases that exist or are entered into after the beginning of the earliest comparative period in the financial statements. They have the option to use certain relief; full retrospective application is prohibited. The Company has several lease agreements, such as branch locations, which are currently considered operating leases, and therefore, not recognized on the Company’s consolidated statements of condition. The Company expects the new guidance will require these lease agreements to be recognized on the consolidated statements of condition as a right-of-use asset and a corresponding lease liability. Therefore, the Company’s preliminary evaluation indicates the provisions of ASU No. 2016-02 are expected to impact the Company’s consolidated statements of condition, along with the Company’s regulatory capital ratios. However, the Company continues to evaluate the extent of potential impact the new guidance will have on the Company’s Consolidated Financial Statements. The Company is nearing completion of identifying a complete inventory of arrangements containing a lease and accumulating the lease data necessary to apply the amended guidance. In addition, the Company purchased new software to aid in the transition to the new leasing guidance, and the majority of the Company’s leases have been entered into this new leasing software program.

In June 2016, the FASB issued ASU No. 2016-13, “Measurement of Credit Losses on Financial Instruments.” This ASU significantly changes how entities will measure credit losses for most financial assets and certain other instruments that aren’t measured at fair value through net income. In issuing the standard, the FASB is responding to criticism that today’s guidance delays recognition of credit losses. The standard will replace today’s “incurred loss” approach with an “expected loss” model. The new model, referred to as the current expected credit loss (“CECL”) model, will apply to: (1) financial assets subject to credit losses and measured at amortized cost, and (2) certain off-balance sheet credit exposures. This includes, but is not limited to, loans, leases, held-to-maturity securities, loan

commitments, and financial guarantees. The CECL model does not apply to available-for-sale (“AFS”) debt securities. For AFS debt securities with unrealized losses, entities will measure credit losses in a manner similar to what they do today, except that the credit losses will be recognized as allowances rather than reductions in the amortized cost of the securities. As a result, entities will recognize improvements to estimated credit losses immediately in earnings rather than as interest income over time, as they do today. The ASU also simplifies the accounting model for purchased credit-impaired debt securities and loans. ASU 2016-13 also expands the disclosure requirements regarding an entity’s assumptions, models, and methods for estimating the allowance for loan and lease losses. In addition, entities will need to disclose the amortized cost balance for each class of financial asset by credit quality indicator, disaggregated by the year of origination. ASU No. 2016-13 is effective for interim and annual reporting periods beginning after December 15, 2019; early adoption is permitted for interim and annual reporting periods beginning after December 15, 2018. Entities will apply the standard’s provisions as a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective (i.e., modified retrospective approach). The Company is continuing its implementation efforts through its Company-wide implementation team. This team has assigned roles and responsibilities,

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key tasks to complete, and a general timeline to be followed. The team meets periodically to discuss the latest developments and ensure progress is being made. The team also keeps current on evolving interpretations and industry practices related to ASU 2016-13 via webcasts, publications, conferences, and peer bank meetings. The team is currently working with an advisory consultant in reviewing and validating the possible methodologies the Company can consider for CECL before determining the specific methodologies that will be utilized. The Company's preliminary evaluation indicates the provisions of ASU No. 2016-13 are expected to impact the Company's Consolidated Financial Statements, in particular the level of the reserve for credit losses. The Company is continuing to evaluate the extent of the potential impact.

In August 2017, the FASB issued ASU No. 2017-12, "Targeted Improvements to Accounting for Hedging Activities." This ASU's objectives are 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. ASU No. 2017-12 is effective for interim and annual reporting periods beginning after December 15, 2018; early adoption is permitted. The Company currently does not designate any derivative financial instruments as formal hedging relationships, and therefore, does not utilize hedge accounting. However, the Company is currently evaluating this ASU to determine whether its provisions will enhance the Company's ability to employ risk management strategies, while improving the transparency and understanding of those strategies for financial statement users.

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Note 2. Cash and Cash Equivalents

The following table provides a reconciliation of cash and cash equivalents reported within the consolidated statements of condition that sum to the total of the same such amounts shown in the consolidated statements of cash flows:

(dollars in thousands)	June 30, 2018	December 31, 2017
Interest-Bearing Deposits in Other Banks	\$3,524	\$ 3,421
Funds Sold	361,933	181,413
Cash and Due From Banks	312,303	263,017
Total Cash and Cash Equivalents	\$677,760	\$ 447,851

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Note 3. Investment Securities

The amortized cost, gross unrealized gains and losses, and fair value of the Company's investment securities as of June 30, 2018 and December 31, 2017 were as follows:

(dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
June 30, 2018				
Available-for-Sale:				
Debt Securities Issued by the U.S. Treasury and Government Agencies	\$446,766	\$ 578	\$(2,632)	\$444,712
Debt Securities Issued by States and Political Subdivisions	587,160	6,655	(1,214)	592,601
Debt Securities Issued by Corporations	224,997	79	(1,299)	223,777
Mortgage-Backed Securities:				
Residential - Government Agencies	209,624	2,180	(1,108)	210,696
Residential - U.S. Government-Sponsored Enterprises	579,602	383	(20,117)	559,868
Commercial - Government Agencies	65,565	—	(4,349)	61,216
Total Mortgage-Backed Securities	854,791	2,563	(25,574)	831,780
Total	\$2,113,714	\$ 9,875	\$(30,719)	\$2,092,870
Held-to-Maturity:				
Debt Securities Issued by the U.S. Treasury and Government Agencies	\$364,604	\$ 1	\$(1,824)	\$362,781
Debt Securities Issued by States and Political Subdivisions	236,567	7,400	—	243,967
Debt Securities Issued by Corporations	104,955	—	(2,977)	101,978
Mortgage-Backed Securities:				
Residential - Government Agencies	2,003,782	4,976	(70,085)	1,938,673
Residential - U.S. Government-Sponsored Enterprises	701,326	273	(26,872)	674,727
Commercial - Government Agencies	184,657	45	(6,331)	178,371
Total Mortgage-Backed Securities	2,889,765	5,294	(103,288)	2,791,771
Total	\$3,595,891	\$ 12,695	\$(108,089)	\$3,500,497
December 31, 2017				
Available-for-Sale:				
Debt Securities Issued by the U.S. Treasury and Government Agencies	\$424,912	\$ 2,053	\$(1,035)	\$425,930
Debt Securities Issued by States and Political Subdivisions	618,167	9,894	(1,042)	627,019
Debt Securities Issued by Corporations	268,003	199	(2,091)	266,111
Mortgage-Backed Securities:				
Residential - Government Agencies	233,268	3,129	(1,037)	235,360
Residential - U.S. Government-Sponsored Enterprises	619,795	420	(10,403)	609,812
Commercial - Government Agencies	71,999	—	(3,252)	68,747
Total Mortgage-Backed Securities	925,062	3,549	(14,692)	913,919
Total	\$2,236,144	\$ 15,695	\$(18,860)	\$2,232,979
Held-to-Maturity:				
Debt Securities Issued by the U.S. Treasury and Government Agencies	\$375,074	\$ 18	\$(1,451)	\$373,641
Debt Securities Issued by States and Political Subdivisions	238,504	9,125	—	247,629
Debt Securities Issued by Corporations	119,635	123	(1,591)	118,167

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Mortgage-Backed Securities:

Residential - Government Agencies	2,229,985	9,975	(37,047) 2,202,913
Residential - U.S. Government-Sponsored Enterprises	763,312	911	(11,255) 752,968
Commercial - Government Agencies	201,660	797	(3,654) 198,803
Total Mortgage-Backed Securities	3,194,957	11,683	(51,956) 3,154,684
Total	\$3,928,170	\$ 20,949	\$(54,998) \$3,894,121

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The table below presents an analysis of the contractual maturities of the Company's investment securities as of June 30, 2018. Debt securities issued by government agencies (Small Business Administration securities) and mortgage-backed securities are disclosed separately in the table below as these investment securities may prepay prior to their scheduled contractual maturity dates.

(dollars in thousands)	Amortized Cost	Fair Value
Available-for-Sale:		
Due in One Year or Less	\$46,250	\$46,201
Due After One Year Through Five Years	628,271	628,659
Due After Five Years Through Ten Years	115,193	118,197
Due After Ten Years	22,994	23,856
	812,708	816,913
Debt Securities Issued by Government Agencies	446,215	444,177
Mortgage-Backed Securities:		
Residential - Government Agencies	209,624	210,696
Residential - U.S. Government-Sponsored Enterprises	579,602	559,868
Commercial - Government Agencies	65,565	61,216
Total Mortgage-Backed Securities	854,791	831,780
Total	\$2,113,714	\$2,092,870
Held-to-Maturity:		
Due in One Year or Less	\$244,843	\$244,173
Due After One Year Through Five Years	209,721	210,339
Due After Five Years Through Ten Years	234,444	236,128
Due After Ten Years	17,118	18,086
	706,126	708,726
Mortgage-Backed Securities:		
Residential - Government Agencies	2,003,782	1,938,673
Residential - U.S. Government-Sponsored Enterprises	701,326	674,727
Commercial - Government Agencies	184,657	178,371
Total Mortgage-Backed Securities	2,889,765	2,791,771